REPORT TO THE SUBCOMMITTEE ON LEGAL AND MONETARY AFFAIRS COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

SUMMARY INFORMATION ON HUD-HELD MULTIFAMILY MORTGAGES

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

APRIL 10, 1974
The Honorable William J. Randall  
Chairman, Legal and Monetary Affairs  
Subcommittee  
Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

The report on our review of the Department of Housing and Urban Development's management of its portfolio of assigned multifamily mortgages was forwarded to you on March 14, 1974. As agreed with your office on January 28, 1974, this report contains detailed summaries of information we developed on five of the six projects, which were included in our review with the advice and concurrence of your office.

Our examination of selected cash receipt and disbursement transactions of these projects included a determination of whether (1) rental and other income was properly accounted for and deposited into appropriate bank accounts in the name of the project, and (2) cash disbursements were made pursuant to the provisions of the plan established by HUD to reinstate the delinquent mortgage.

Our review was made at HUD area and insuring offices in St. Louis, Phoenix, Los Angeles, Dallas and Fort Worth. The five projects for which we are providing summary information are Regency Inn Nursing Home, St. Louis, Missouri; the Tucson House, Tucson, Arizona; the Pacific Holiday Towers, Long Beach, California; the Allen McDonald Foundation, Waco, Texas; and the St. Francis Village, Lake Benbrook, Texas. The mortgages on these multifamily projects had been assigned to HUD and were in its portfolio as of March 31, 1973.

As you requested we did not obtain written comments from HUD or responsible project officials on the matters discussed in the detailed summaries. However, during our review we discussed these matters with agency and project officials and incorporated their views in the summaries where appropriate.
We plan to make no further distribution of this report unless you agree or publicly announce its contents.

Sincerely yours,

[Signature]

Comptroller General
of the United States

Enclosure
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>BACKGROUND INFORMATION</td>
<td>1</td>
</tr>
<tr>
<td>TUCSON HOUSE</td>
<td>4</td>
</tr>
<tr>
<td>REGENCY INN NURSING HOME</td>
<td>10</td>
</tr>
<tr>
<td>ST. FRANCIS VILLAGE, INC.</td>
<td>23</td>
</tr>
<tr>
<td>PACIFIC HOLIDAY TOWERS</td>
<td>28</td>
</tr>
<tr>
<td>ALLEN McDONALD FOUNDATION</td>
<td>30</td>
</tr>
</tbody>
</table>
BACKGROUND INFORMATION

The National Housing Act, as amended (12 U.S.C. 1701), allows the Department of Housing and Urban Development (HUD) to insure mortgage loans made by private lending institutions on various types of housing, including multifamily rental housing projects. Parties to a multifamily mortgage insurance transaction are the mortgagee (the lender), the mortgagor (the project owner), and HUD.

The mortgagor's functions and responsibilities, and provisions for HUD's control of project operations, are set forth in either the regulatory agreement, the corporate charter, or the trust agreement.

The regulatory agreement is the document most commonly used by HUD. It is an agreement between HUD and the project owner (an individual, partnership, corporation, or trust) in which the project owner, in consideration of an insured mortgage, consents to HUD's regulation of rents, rate of return, and methods of operation.

If an insured mortgage default continues for 30 days, HUD requires the mortgagee to notify HUD in writing within a 30-day period. Mortgagees have 45 days thereafter (30 days for insurance written before August 13, 1954) to notify HUD of their intent to acquire title to the property to assign the mortgage note to HUD.

Under the mortgage insurance contract, the mortgagee may acquire the deed through foreclosure and convey the title directly to HUD for full insurance benefits or may assign the mortgage directly to HUD and forfeit 1 percent of the unpaid principal. The lengthy and expensive foreclosure process in most States influences a mortgagee in most cases to assign the mortgage to HUD.

There are two courses of action available to HUD as assignee of a defaulted mortgage. It can

--hold the mortgage and give the mortgagor an opportunity to work out his financial difficulties and subsequently reinstate the mortgage or

--proceed with acquisition of the property title through foreclosure or through voluntary conveyance by deed in lieu of foreclosure.
Under the first course of action, HUD uses various plans to reinstate the defaulted mortgages. These plans include informal forbearance, modification of the mortgage, and a workout arrangement.

Informal forbearance is used when no more than two installments are due and the reasons for default are beyond the mortgagor's control. The contributing conditions of the default should be temporary.

When a mortgagor is prepared to resume mortgage payments—and service charges, interest, and escrows are current—the mortgage can be modified to spread the delinquent principal over the remaining term of the mortgage. Under HUD's policy, a modification to a mortgage is approved only when an orderly liquidation of the mortgage obligation is foreseeable.

A workout arrangement offers delinquent mortgagors maximum financial relief. The monthly workout payment is equal to the sum of monthly service charges (HUD's servicing fee), interest, and taxes plus an agreed upon fixed dollar amount to be applied against delinquent interest. If the net cash balance in the project checking account at the end of the previous month is greater than the workout payment, this amount is to be paid to HUD.

Under the second course of action available to HUD as assignee of a defaulted mortgage, HUD can acquire title to the property through foreclosure or through voluntary conveyance by deed in lieu of foreclosure.

After acquiring title to properties, HUD generally absorbs any operating losses and attempts to resell the properties. Losses from the sale of 46 properties during the first 9 months in fiscal year 1973 amounted to about $12.5 million. The average loss amounted to about 19 percent, or $2,539 per rental unit.

HUD Programs

The six projects with HUD-held mortgages included in our detailed review of receipts and disbursements of funds were assisted under sections 207, 220, 231, and 232 of the National Housing Act, as amended (12 U.S.C. 1713, 1715k, 1715v, and 1715w).
Rental housing

Under section 207, HUD insures privately financed loans for rental housing that serves the needs of a broad section of the rental housing market. The insured projects should provide rental accommodation suitable for family living and should be available at reasonable rents.

Urban renewal housing

Under section 220, HUD insures mortgage loans for new or rehabilitated single-family or multifamily structures located in areas receiving assistance under HUD's conventional urban renewal, concentrated code enforcement, and disaster rehabilitation programs.

Elderly housing

Under section 231, HUD insures mortgage loans to finance new or rehabilitated rental housing projects of eight or more dwelling units specifically designed for occupancy by the elderly or the handicapped.

Nursing homes

Under section 232, HUD insures mortgage loans for constructing or rehabilitating facilities accommodating patients requiring skilled nursing care and related medical services or needing minimum but continuous care by trained or licensed personnel. Before HUD can insure a mortgage on a nursing home or intermediate care facility, the appropriate State agency must certify that the facility is needed and that reasonable minimum licensing and operating standards are being applied.
TUCSON HOUSE

BACKGROUND

HUD approved an application for section 231 mortgage-loan insurance for the Tucson House located in Tucson, Arizona, in July 1962 for about $5.8 million. The Tucson House is a 16-story, 409-unit rental apartment building which was constructed in 1964 for elderly or handicapped people.

The mortgagor, Tucson Title Insurance Company, holding title to the property for the beneficiary of a trust--Mr. Raymond S. Schiff--defaulted in the very early operational stages of the project. The mortgagee assigned the mortgage to HUD in December 1965 at which time the outstanding principal balance was still $5.8 million. After HUD initiated foreclosure proceedings in May 1966, Tucson House was placed under receivership by the United States District Court in July 1966.

HUD withdrew its foreclosure action in August 1969 and the receivership was terminated in January 1970. At the time the foreclosure action was withdrawn, HUD and the mortgagor negotiated a workout agreement that permitted Mr. Schiff to manage the property for a fee amounting to 5 percent of gross project income. The other provisions of the agreement required the mortgagor to

--make monthly payments to HUD covering service charges, taxes, interest, and supplemental amounts in accordance with a fixed schedule of payments;

--submit $15,000 in cash together with a $50,000 "key man" life insurance policy on Mr. Schiff naming HUD as the beneficiary; and

--submit to HUD monthly statements of project cash receipts and disbursements.

In December 1969, Mr. Schiff formed the Miracle Property Corporation with Mr. Schiff and his wife (about 77 percent) and the project accountant (about 23 percent) as stockholders. Mr. Schiff sold and assigned to the Miracle Property Corporation the 100 percent of his beneficial interest in the trust being held for him by the Tucson Title Insurance Company in return for a long-term note of about $587,000. After the receivership was terminated, Mr. Schiff began managing the project through the Miracle Property Corporation.
On March 7, 1973, the Miracle Property Corporation entered into a contract with a prospective purchaser for the sale of the Tucson House. At this time, the outstanding principal balance was still $5.8 million. The payment provision of the contract required the prospective purchaser to satisfy HUD's first lien and chattel mortgages with a payment of $4.6 million. During March 1973, HUD accepted the offer agreed to in this contract. As of February 28, 1974, the sale had not been completed.

CONTROL OVER RECEIPTS AND DISBURSEMENTS.

When HUD accepted an offer of $4.6 million for the sale of the mortgage note on this project in March 1973, the prospective purchaser agreed to establish a "new" project checking account and deposit therein rentals collected after March 31, 1973. At this time, the "old" account maintained by Mr. Schiff had a balance of $89,924. Since that time rentals have been deposited in the "new" account. We found no evidence of an agreement or understanding between Mr. Schiff, the prospective purchaser, or HUD to insure that funds remaining in the "old" account would be turned over to HUD and applied against the delinquent mortgage.

Security deposits

Security deposit trust funds were used in violation of that trust and HUD regulations. Security deposits are amounts paid in advance by the project tenants for their last month's rent. These funds are to be held in trust, in a separate account, until the tenant terminates his occupancy. The deposits are then returned to the tenant or applied to the last month's rent, as appropriate.

The Tucson House accounting system provides for depositing these funds into the operating account and on a monthly basis transferring the deposits to the trust account. As tenants vacate apartments, the deposits were to be either returned to the tenant or transferred to the operating account as earned income. However, in actual practice, this procedure was not consistently followed. For 17 of the 39 months between January 1970 and March 1973, deposit funds were not transferred to the trust account but remained in the operating account to meet operating expenses. In addition, a direct transfer of $25,000 in April 1972 was made from the trust account to meet an operating account deficiency. The project owner restored funds to the trust account in December 1972 and January 1973 by transferring $62,968 from the operating account.
At the time of our review, HUD officials were not aware of these transactions. HUD headquarters officials acknowledged the serious nature of the deficiency and stated that these acts violate the project's Regulatory Agreement. These officials stated also that any legal action against the project owner would have to be instituted by the project tenants since the security deposit funds are payable to them and not to HUD.

**Workout agreement required**
**monthly statements on receipts and disbursements**

Contrary to the provisions of the workout agreement, the mortgagor stopped filing monthly statements of cash receipts and disbursements in August 1972. HUD did not take action to have these reports prepared until July 1973.

**Withdrawal of funds**

Mr. Schiff wrote three checks in December 1972 and February 1973 totaling $100,953.53 for his own personal use. Local HUD officials were not aware of these withdrawals until we brought them to their attention in September 1973.

The first check, dated December 28, 1972, was written for $38,300.25 in favor of an Arizona bank. The project records contained no information to indicate that the funds were used for the purpose of the project. Mr. Schiff informed us that he used these funds to pay several personal notes to the bank which was demanding payment. Endorsements on the canceled check state that the proceeds of the check were used to "pay off loans." Mr. Schiff informed us that the notes were not project debts and that he would refund the money if HUD takes exception to the use of the funds.

The second and third checks dated February 8, 1973, were written for $60,000 and $2,653.28, respectively. These checks were deposited in Mr. Schiff's personal account and later converted into cashier's checks. The cashier's checks were deposited 4 days later in the project operation account.

A project owner is considered to have violated section 239 of the National Housing Act if he willfully uses, while a mortgage is in default and under a reinstatement agreement, rents or other funds derived from the property for any purposes other than to meet actual and necessary expenses.
Workout payments not made

After October 1972, HUD did not receive any of the mortgage payments required by the workout agreement. These mortgage payments through March 31, 1973, totaled about $272,338. The project account at March 31, 1973, however, had an accumulated fund balance totaling $89,924 which could have been used to reduce the mortgage delinquency. The Phoenix insuring office notified Mr. Schiff in April 1973 that the delinquent amounts should be paid.

In June 1973, HUD informed the purchaser of the project that he was required to make mortgage payments of $39,402 per month (covering current interest, tax, and servicing fee accruals), from April 1, 1973, to the eventual closing date of the sale. The monthly payment and a supplemental payment of $15,347 per month (to be applied against delinquent interest) represented the mortgage payment which Mr. Schiff was obligated to make under the previous workout agreement. Although the prospective purchaser should have been required to make the supplemental payment, HUD failed to include this requirement in the new agreement.

The prospective purchaser paid HUD $157,553 for the period April through July 1973. During this same period, $61,388 in supplemental payments would have accrued under the previous workout agreement. A HUD headquarters official advised us that, although the prospective purchaser should have been required to make these supplemental payments in the June 1973 agreement, HUD cannot now demand payment.

The project records showed that since March 1973 the project expenses had been paid either from the "old" account which was reimbursed by the prospective purchaser from the "new" account or directly by the prospective purchaser from the "new" account. These records showed, however, that as of July 30, 1973, project expenses totaling about $33,230 which had been paid from the "old" account had not been reimbursed by the prospective purchaser from the "new" account.

HUD did not aggressively enforce compliance with the terms of the workout agreement or its regulations, particularly the provisions relating to submittal of monthly statements of cash receipts and disbursements and payment of monthly charges. Without these reports, HUD could not properly monitor the cash position of the project account to determine whether project proceeds had been improperly used.

HUD headquarters officials advised us that they would require the remittance of all funds due HUD prior to the sale of the project. This action should assure that project funds in excess of expenses are paid toward the outstanding mortgage debt.
Management fees

With HUD's approval, starting in 1970, Mr. Schiff performed all the management services for the project for an annual fee of about $50,000. We questioned the payment of a fee of this magnitude since in January 1970 the mortgage loan was delinquent by $2.5 million and was being reinstated under a workout arrangement. By July 1973 the delinquency had increased to about $2.7 million. HUD guidelines governing workout agreements state that it is desirable for project owners performing management services to forego the collection of a fee as evidence of good faith while the mortgage is being reinstated under a workout agreement. Moreover, HUD requires its field offices to encourage this practice.

We found no evidence in the HUD records which would indicate that Mr. Schiff was asked to forego the collection of a management fee during the workout period. HUD records did not indicate the rationale used in allowing a fee of this amount; however, HUD headquarters and local office officials agreed that under the circumstances the fee was very large.

Because Mr. Schiff was also the manager, HUD did not require a written management agreement. Instead, HUD allowed him, under the provisions of the workout agreement, to collect a management fee of 5 percent of gross project income. His fee amounted to about $164,888 for the period January 1970 through March 1973. The workout agreement did not specify the types of services or expenses that were to be covered by the fee.

The following project expenses totaling $72,198 had been incurred during the 3-year period ending December 31, 1972. These expenses were paid from project funds: office salaries, $38,306; office expenses, $9,248; telephone and telegraph costs, $17,006; and miscellaneous expenses, $7,638. HUD guidelines governing projects managed by outside firms specifically exclude the payment of these expenses from project funds. The guidelines provide that these expenses are to be covered by the management fee received by the firm. It is not clear, however, whether these guidelines apply to a situation where the owner also serves as project manager.

During the period January 1970 through March 1973, part of the management fee amounting to about $4,670 was collected by Mr. Schiff on income from receipts of tenant security deposits held in trust totaling about $93,407. A fee was again collected on the security deposits, however, when the tenants moved and the deposits were applied against the rent for the last month.
Insurance proceeds of about $49,269 were paid to the project in July 1972 for losses to the air conditioning system. These funds did not qualify as income but were included in the gross income for this period and a corresponding management fee of about $2,463 was collected by Mr. Schiff.

Items such as other insurance proceeds, workman compensation rebate, medical insurance refund, payroll tax refund, and return of several small advances totaling about $9,538 were also improperly included in gross income. The management fee collected on these amounts was $477.

Key man life insurance

A condition of the workout agreement required that Mr. Schiff obtain a life insurance policy in the amount of $50,000 payable to HUD and pay $15,000 towards the mortgage delinquency. He paid the $15,000 and about $8,772 in premiums on the policy through calendar year 1974. The $15,000 payment towards the mortgage delinquency was made with funds from outside the project, but the insurance premiums were paid with project funds.

Although not specified in the workout agreement, it would appear that the premium payments would also be his obligation rather than the project's.

---

Officials of the Phoenix insuring office stated that the major problem in servicing multifamily mortgages is due to the lack of staff. After calendar year 1972, the one-man servicing staff—handling about 150 multifamily mortgages—was increased to three. As additional staff is added the insuring office intends to obtain an ideal workable level of 30 projects per servicer. In the opinion of these officials, staffing at this level would make it impossible for a project such as the Tucson House to go underserviced as it did in the past.

HUD AUDIT ACTIVITIES

HUD performed no audits of Tucson House during the period the project mortgage was under a workout agreement.
REGENCY INN NURSING HOME

BACKGROUND

HUD approved an application for section 232 mortgage-loan insurance for the Regency Inn Nursing Home (Regency) in June 1964 in the amount of about $5.2 million. The Regency—the second largest nursing home in the United States with a 500 bed capacity—is a 15-story structure located in St. Louis, Missouri.

Several persons and corporations have been involved in the ownership and operation of the Regency and as holders of the mortgage note.

The Educational Development and Research Corporation (EDR), the owner of Regency since 1972, manages four other nursing homes having a total capacity of 478 beds. EDR has managed nursing homes since 1969.

The mortgage note was assigned to HUD on March 10, 1971. The project was first billed by HUD in February 1972 at which time the total delinquent amount under the mortgage loan was $656,323. HUD agreed to place the mortgage loan under a workout arrangement in June 1971. As of July 1973, the total delinquency had increased to about $1,111,460.

In June 1973, after five workout payments were missed and the checks for two others were returned by the bank for insufficient funds, HUD's Office of Loan Management in Washington requested HUD's General Counsel to foreclose the mortgage. On October 30, 1973, the General Counsel instructed the Director of the St. Louis Area Office to exercise his power of sale under the project's Deed of Trust. A court appointed receiver was placed in charge of the project on February 15, 1974.

BILLING PROCEDURES

Regency prepares monthly billings and separates residents into five categories according to the source of the payment as follows:

<table>
<thead>
<tr>
<th>Billing category of resident</th>
<th>Source of funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>Private funds</td>
</tr>
<tr>
<td>Medicare</td>
<td>Blue Cross/Blue Shield</td>
</tr>
<tr>
<td>Medicaid</td>
<td>State of Missouri</td>
</tr>
<tr>
<td>Department of Mental Health</td>
<td>State of Missouri</td>
</tr>
<tr>
<td>State (welfare)</td>
<td>State of Missouri</td>
</tr>
</tbody>
</table>
Financial circumstances or the degree of care needed for each resident may change and result in his transfer from one billing class to another. For instance, a private resident may exhaust his funds and become a State (welfare) resident, or a State (welfare) or private resident may become ill and qualify for Medicare or Medicaid payment.

Billing personnel are assigned particular classes of residents. Each month, individual bills are prepared from documents in each resident's file. A monthly summary is also prepared of total billings for each particular class of patients. However, neither a file of unpaid bills nor an accounts receivable ledger is maintained, and there is no reconciliation of cash receipts with amounts billed.

The employees responsible for billing also handle cash collections and deposits. In addition, they are responsible for:

--preparing and verifying the weekly payroll,
--distributing the payroll checks,
--collecting trust fund/security deposits, and
--computing monthly billing summaries.

CASH RECEIPT AND DISBURSEMENT PROCEDURES

We were advised by officials of EDR and Regency that since January 1973, only petty cash disbursements are made in St. Louis. All cash receipts are deposited in a general fund under direct control of EDR's corporate comptroller in Atlanta. We were further advised by the corporate comptroller that he had established a special bank account for payroll and that he periodically replenishes this account, and the petty cash account, by fund transfers from Regency's general fund.

According to EDR and Regency officials, a schedule of accounts payable with supporting documentation is periodically prepared and mailed to the Atlanta office. After reviewing the schedule, the Atlanta office issues checks for disbursement by Regency personnel in St. Louis. Our examination disclosed that these procedures were not in effect until July 1973 although the corporate comptroller proposed their use in February 1973.

The Regency has used two banks as depositories for funds since June 1972. At the time of our review, Regency maintained four accounts at one bank.
CONTROL OVER RECEIPTS AND DISBURSEMENTS

Condition of books and records

The certificate executed by the mortgagor for mortgage insurance, as well as the project regulatory agreement, contains a requirement that the books and accounts of the mortgaged property should be kept in accordance with the requirements of HUD and in such form as to permit a speedy and effective audit. HUD requires that the project's books and accounts must be kept current, complete, and accurate and frequent postings must be made to the ledger accounts. Monthly posting to the accounts is recommended, and year-end adjusting entries are required to be promptly recorded in the ledger accounts.

During our review at Regency and at EDR's headquarters in Atlanta, we found that current, complete, and accurate accounting records were not maintained. The EDR corporate comptroller could not provide us a trial balance of the Regency accounts as of June 30, 1973. He advised us that project records were not being maintained to provide such information and that EDR had employed a certified public accountant from June 1, 1972, to December 31, 1972, to maintain accounting records, but the only record used was a check book.

The comptroller advised us that he was hired in January 1973 to correct this deficiency and that he requested the shipment of all records to Atlanta, so that he could determine what information was available prior to establishing a set of books for Regency.

Our review of cash disbursements in Atlanta and St. Louis disclosed a lack of documentation to support most cash disbursements. Also, we found that accounts payable were not under accounting controls and no file of unpaid bills was maintained.

Vendor bills that we reviewed were filed in large envelopes, and in some cases, the vendor's name was penciled on the envelope. The bills, however, did not show whether payment had been made. For example, bills in one envelope consisted of vendor's statements for towel and linen service which covered a period of about 2 years. The file contained no evidence of payments or information to support or verify the correctness of the vendor's statements.

The comptroller advised us that the files were not better organized because he was unable to hire and retain qualified personnel.
In most cases, the only evidence to support an expenditure was a notation on the check stub. In several instances, the check stub contained only the payee's name.

We found similar deficiencies relating to disbursements by Regency from the petty cash bank account in St. Louis.

Accordingly, we were unable to determine (1) whether disbursements were for only reasonable and necessary items and (2) the correct amount of Regency's accounts payable liability.

In the Atlanta office the cash receipt and disbursement journals showed that for the 13 month period ending June 30, 1973, gross receipts exceeded gross expenditures by about $480,000.

This amount cannot be accurate because:

-- cash in the bank at June 30, 1973, was only about $3,000, well below the $480,000 excess cash position shown by the journals.

-- the cash disbursement journal showed no payments of accounts payable for the last 6 months of the period.

-- the cash disbursement journal showed no payroll costs for February 1973 and only $10,000 and $15,000 for January and March 1973, respectively, when the normal payroll according to the comptroller averages about $100,000 per month.

-- a $144,000 payment made to HUD in July 1972 was drawn on an EDR custodial account and did not appear in the projects cash disbursements journal.

In attempting to verify cash receipts, we found that the amounts recorded for patient receipts did not agree with records at Regency. For example, in one instance Regency records showed that a bank deposit had been made in the amount of about $12,816, whereas the bank statement showed a deposit of about $12,943, a difference of $127. Regency records showed collections of patient revenues of about $183,550 in June 1973, the cash receipt journal in the Atlanta office showed about $186,484 had been collected; and the bank statement showed deposits of about $185,654 excluding credit memos of $20,000 representing transfers-in from other subsidiaries.

The HUD St. Louis area office has repeatedly asked Regency for the required monthly accounting reports. Regency, however, has submitted only one report since June 1972. The Assistant Administrator of Regency advised us that the reason for not
filing the reports was due to the condition of the records. When we began our review at Regency, the comptroller promised to start furnishing the required reports. None had been provided HUD at the completion of our review.

Controls over cash receipts

We traced selected transactions recorded in the cash receipts journal to deposit slips for April and May 1973 and found that erroneous entries had been recorded in the cash receipts journal, and checks and cash were manipulated to force agreement in the total between the bank deposit slip and the cash receipts journal. In addition, daily cash receipts from the cafeteria were not deposited intact, and unreasonable delays occurred in depositing cash receipts.

An example of erroneous entries in the cash receipts journal occurred on April 19, 1973. The bank deposit slip showed receipts which totaled about $16,812, but the cash receipts journal listed receipts of about $16,767 or $45 less.

Our comparison of checks recorded in the cash receipts journal on that day to checks listed on the daily bank deposit slip disclosed the following.

<table>
<thead>
<tr>
<th>Payor</th>
<th>Cash receipts journal</th>
<th>Bank deposit slip</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$ 20.69</td>
<td>$ 20.69</td>
<td>-</td>
</tr>
<tr>
<td>B</td>
<td>204.00</td>
<td>204.00</td>
<td>-</td>
</tr>
<tr>
<td>C</td>
<td>75.00</td>
<td>75.00</td>
<td>-</td>
</tr>
<tr>
<td>D</td>
<td>62.72</td>
<td>62.72</td>
<td>-</td>
</tr>
<tr>
<td>E</td>
<td>185.00</td>
<td>200.00</td>
<td>$15.00</td>
</tr>
<tr>
<td>F</td>
<td>190.00</td>
<td>200.00</td>
<td>10.00</td>
</tr>
<tr>
<td>G</td>
<td>190.00</td>
<td>200.00</td>
<td>10.00</td>
</tr>
<tr>
<td>H</td>
<td>190.00</td>
<td>200.00</td>
<td>10.00</td>
</tr>
<tr>
<td>I</td>
<td>15,649.34</td>
<td>15,649.34</td>
<td>-</td>
</tr>
</tbody>
</table>

|       | $16,766.75     | $16,811.75      | $45.00     |
A project official told us that the $45 was for the patients trust fund, yet there was no record of the deposit of this $45 in the fund.

An example showing manipulation of checks to force agreement between the cash receipts journal and the bank deposit slip occurred on April 4, 1973, as follows:

<table>
<thead>
<tr>
<th>Payor</th>
<th>Cash receipts journal</th>
<th>Bank deposit slip</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$ 83.38</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>107.98</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>30.00</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>$ 3.86</td>
</tr>
<tr>
<td>D</td>
<td></td>
<td>110.30</td>
</tr>
<tr>
<td>E</td>
<td></td>
<td>15.00</td>
</tr>
<tr>
<td>F</td>
<td></td>
<td>10.00</td>
</tr>
<tr>
<td>G</td>
<td></td>
<td>30.00</td>
</tr>
<tr>
<td>H</td>
<td></td>
<td>52.20</td>
</tr>
</tbody>
</table>

$221.36 $221.36

Regency personnel advised us that sometimes cash received is used to pay a bill or supplement cash in the patients trust fund and when this occurs they have to manipulate checks and cash shown on the bank deposit slip to force agreement with the amounts shown in the cash receipts journal.

In another case, the deposit slip prepared by the project for May 4, 1973, showed a total deposit of about $8,057. This figure agreed with the entry in the cash receipts journal. Our review, however, disclosed that the actual deposit was about $7,617. In comparing checks in the cash receipts journal to the bank's copy of the deposit slip, we found that although three checks totaling $419.98 and cash receipts of $20.02 were shown on the deposit slip in Regency's files, those funds were not included in the actual bank deposit.
The Assistant Administrator told us that he knew about two of the checks totaling $400 and that he had fired the employee responsible for losing them. He promised to provide us information concerning this case but before the information was provided he was placed on extended leave pending dismissal. Other employees had no knowledge of the transaction.

We also noted four cases during this 2-month period where cafeteria receipts entered on the cash receipts journal were not deposited intact as shown below.

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash receipts journal</th>
<th>Bank deposit slip</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>5/ 4/73</td>
<td>$109.94</td>
<td>$72.92</td>
<td>$37.02</td>
</tr>
<tr>
<td>5/ 7/73</td>
<td>16.45</td>
<td>-</td>
<td>16.45</td>
</tr>
<tr>
<td>5/ 8/73</td>
<td>32.57</td>
<td>20.00</td>
<td>12.57</td>
</tr>
<tr>
<td>5/11/73</td>
<td>38.50</td>
<td>38.50</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$197.46</strong></td>
<td><strong>$131.42</strong></td>
<td><strong>$66.04</strong></td>
</tr>
</tbody>
</table>

Controls over patients trust funds and security deposits

We found that Regency did not maintain acceptable accounting records to disclose its liability for patients' trust funds and security deposits.

The regulatory agreement requires that trust funds be deposited in a separate bank account. The balance of the account at all times should equal the liability for these funds.

Security deposits ranging from $255 to $310 are collected from patients to guarantee payments of routine charges for 1 month's stay. Patient trust funds represent patients' money which has been deposited for safekeeping with Regency.

When funds of this nature are received, Regency issues two types of receipts. The type issued depends on whether or not the receipt is recorded in the cash receipts journal. When it is recorded, the payor receives the same type receipt as issued for patient's payment of routine charges. A copy of the receipt is placed in the patient's file and in those cases where the receipt represents a security deposit, it often becomes Regency's only record of its obligation for the money. When the payment is not recorded, Regency personnel issue a receipt from an ordinary book of receipts that contains an
original and carbon copy. The original is given to the payor and the carbon copy remains in the book. The clerks could use the carbon copy to post ledgers which they maintain for each patient to show deposits and withdrawals from patients' trust funds. However, we found many ledger cards were not accurate nor currently maintained.

To determine the accuracy of trust fund liabilities as shown on the ledger cards, we selected patients whose last names began with A, B, or C, who had been discharged or had expired and whose cards showed an outstanding balance. The sample included 29 patients whose trust fund ledger cards showed a deposit liability of $5,136.50. We examined folders for these patients and found that only $2,366 remained as obligations of Regency.

Regency officials advised us that some of the obligations remain because the patients' bills have not been settled. Other obligations represent cases where no one has filed a claim or the patient left no heirs. Regency officials said that the funds would be returned only if someone filed a claim. They were not aware of the HUD requirement that security deposits be maintained in a separate account.

From a review of bank deposit slips, cash receipts journals, and cancelled checks from refunds of security deposits or patients' trust fund, we determined that Regency often deposited security deposits and patient trust funds in the same bank account where it deposited ordinary income. Moreover, Regency used these funds in its day to day operation.

For instance, the deposit slips on April 10, 1973, for the general fund showed a total deposit of about $7,387. At least $428 of this deposit resulted from receipt of patients' trust funds according to receipts and patient trust fund ledger cards. In addition, we noted six cases in a 2-month period where refunds of patient trust funds had been made from the petty cash account.

Also, we found an envelope in a filing cabinet containing cash and checks which represented patients' trust funds and security deposits placed in the envelope by Regency employees. When brought to the attention of Regency, a deposit of $6,416.93 was made to the patient trust fund account. In addition to the cash found in the envelope, some of the checks had endorsements which made them fully negotiable. One check had been received in December 1972, 8 months prior to deposit in the bank.
We noted another example where a lack of controls permitted a delay in depositing funds to the proper account. On April 17, 1973, the Assistant Administrator of the project deposited patients' trust funds of $2,195.91 in the pharmacy bank account. On the same day, he issued a check from the pharmacy's account to the patients trust fund account to cover this deposit. However, the check was not deposited in the trust fund until July 12, 1973, almost 3 months later, and then it was returned for insufficient funds.

Controls over patient billings

From the Medicare billing summary we selected 11 names of residents who were no longer eligible for Medicare payments and whose files should have been transferred to other billing classes. Five folders were properly transferred but four remained in the Medicare files. We were unable to locate files for the two other patients.

We examined six of the nine files available and found no bills for the past 2 months in three cases. A project official told us that employees had prepared the bills but had not filed them in the folders. We also found that one patient had four files, two Medicaid and two Medicare. This resident had been in and out of the home since 1969 and the employees prepared a new file for each entry.

Our review disclosed that one resident had an outstanding bill of about $5,000. Project officials told us that the resident had money to pay the bill in his savings account but they had misplaced a letter to his bank requesting transfer of funds to his checking account so he could pay the bill.

Collection of delinquent receivables

The Assistant Administrator of the project was responsible for collecting delinquent receivables; however, he advised us that he had not devoted any time to this responsibility because of other assigned duties. Moreover, he said that most of these receivables were uncollectable. Project procedures require that bills be sent during the normal billing cycle with no subsequent mailings for past-due accounts.

Counsel for EDR, at the completion of our review, instructed the Regency Administrator that all delinquent receivables should be turned over to a collection agency.
Intercompany transfers of funds

During the 14-month period ending July 31, 1973, various corporations or individuals affiliated with EDR have received funds of about $263,000 from Regency. During the same period, these corporations or individuals affiliated with EDR transferred about $430,000 to the Regency. Nevertheless, the transfers-out were in violation of the workout arrangement. Between October 1, 1972, and July 1, 1973, six of the 10 required workout payments were not made by EDR and the checks for two of the other payments were returned by the bank for insufficient funds. This increased the total delinquency from $753,606 in December 1972 to $1,111,460 in July 1973.

The following table shows the intercompany transfers for the period as shown in the records of the Atlanta office.
<table>
<thead>
<tr>
<th>Company</th>
<th>Transfers In</th>
<th>Transfers Out</th>
<th>Net difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education Development and Research Corp.</td>
<td>$269,550.73</td>
<td>$44,692.49</td>
<td>$224,858.24</td>
</tr>
<tr>
<td>Hideaway Hills</td>
<td>25,000.00</td>
<td>34,000.00</td>
<td>-9,000.00</td>
</tr>
<tr>
<td>Regency Pharmacy</td>
<td>-</td>
<td>12,500.00</td>
<td>-12,500.00</td>
</tr>
<tr>
<td>Rabhan Associates</td>
<td>25,000.00</td>
<td>39,360.90</td>
<td>-14,360.90</td>
</tr>
<tr>
<td>UIC Construction Corp</td>
<td>35,000.00</td>
<td>28,086.99</td>
<td>6,913.01</td>
</tr>
<tr>
<td>Whighana Nursing Home</td>
<td>15,000.00</td>
<td>9,000.00</td>
<td>6,000.00</td>
</tr>
<tr>
<td>Martin Luther King, Sr. Nursing Home</td>
<td>41,980.00</td>
<td>54,268.70</td>
<td>-9,288.70</td>
</tr>
<tr>
<td>Cinema Systems</td>
<td>-</td>
<td>15,000.00</td>
<td>-15,000.00</td>
</tr>
<tr>
<td>Learning Tree Academy - Athens (LTA)</td>
<td>-</td>
<td>2,000.00</td>
<td>-2,000.00</td>
</tr>
<tr>
<td>Learning Tree Academy - Norwood</td>
<td>-</td>
<td>314.53</td>
<td>-314.53</td>
</tr>
<tr>
<td>Learning Tree Academy - Brunswich</td>
<td>-</td>
<td>4,200.00</td>
<td>-4,200.00</td>
</tr>
<tr>
<td>Texas Skilled Care Center</td>
<td>-</td>
<td>16,194.27</td>
<td>-16,194.27</td>
</tr>
<tr>
<td>Glennwood Nursing Home</td>
<td>-</td>
<td>2,000.00</td>
<td>-2,000.00</td>
</tr>
<tr>
<td>Learning Tree Academy - Ellburg</td>
<td>-</td>
<td>1,000.00</td>
<td>-1,000.00</td>
</tr>
<tr>
<td>World Protein</td>
<td>15,000.00</td>
<td>-</td>
<td>15,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$429,530.73</strong></td>
<td><strong>$262,617.88</strong></td>
<td><strong>$166,912.85</strong></td>
</tr>
</tbody>
</table>

The transfers-out resulted from a check written on Regency's bank account or a bank debit memorandum, both of which were recorded in the cash disbursements journal. We noted, however, that all of these transactions were not identified as an intercompany transfer.
In reviewing cancelled checks and in discussions with the comptroller, we found other instances of project funds totaling $6,300 which were transferred out of the project account. The comptroller told us that these transfers should have been charged to Rabhan Associates, the name used by the president of EDR when he transacts personal business or unincorporated activities.

An attorney for EDR advised us that in order to pay Regency's bills, EDR had to transfer funds to Regency from other subsidiary corporations. He stated that the transfers from Regency to these corporations were repayment of these loans. However, as shown above, eight affiliates of EDR received about $53,200 although they did not transfer funds to Regency.

Section 239 of the National Housing Act prohibits the willful use of rents and other funds derived from the property, while a project is in default and under a reinstatement agreement for any purpose other than to meet actual and necessary expenses.

OTHER OBSERVATIONS

We noted that a former administrator of Regency in 1971 had written himself payroll checks which totaled about $3,000 more than his authorized salary. Regency officials advised us that they were aware of this but prosecution was not attempted in order to avoid bad publicity for Regency. Also, there was a legal question of whether the Administrator could authorize himself additional compensation.

We noted several inconsistencies with acceptable accounting procedures in the handling of cash for the patients trust fund as follows.

--Employees cashed personal and payroll checks in the patients trust fund. In some cases, these employees prepared the deposit slips for bank deposits in the patients trust fund account,

--A clerk, no longer employed, had signed withdrawal slips as authority for cash disbursements to patients from the patients trust fund. We, however, found no evidence in Regency's records to verify that the patients had received these funds. On one occasion a withdrawal slip was dated the day after discharge of the patient, and

--Cash disbursements were made for ordinary expenses from the patients trust fund. The patients trust fund was, however, subsequently reimbursed from petty cash.
An audit of Regency was performed by HUD for the period April 1969 through March 1972 to determine the financial condition of the project, particularly whether income and expenses were properly accounted for.

Because the project's public accounting firm was conducting an audit at the same time, HUD's report did not include an opinion on the financial condition of the project. The report included a summary schedule of income and expenses for the fiscal years ending March 31, 1970, 1971, and 1972. This schedule showed a net loss of about $771,596 for the year ended March 31, 1972, and the HUD auditors rendered an opinion that this presented fairly the results of operations for the year ended March 31, 1972, subject to the adjustments and comments included in the independent auditor's report.

Regency's certified financial statements showed the net loss for the same period to be about $661,921. The HUD audit report also pointed out that improvements were needed in the maintenance of accounting records and that patient's security deposits of $16,347 were not in a separate bank account as required by the regulatory agreement.

The HUD audit report was furnished to the St. Louis Area Office and to the management of the project. About 11 months after issuance of the audit report, however, we found that complete and accurate accounting records were not being maintained. Also, although a separate bank account was established for security deposits, there was no way of knowing whether the account was sufficient to cover the project liability without reconstructing all security deposit transactions.
ST. FRANCIS VILLAGE, INC.

BACKGROUND

HUD approved an application for section 231 mortgage-loan insurance for St. Francis Village, Inc.--a nonprofit elderly housing project sponsored by the Franciscan Tertiary Provinces Foundation (Foundation)--in October 1963 in the amount of $3,954,500. The project, constructed in 1964, consists of 330 rental housing units, a rectory for the resident priest, a large chapel used exclusively by Catholic residents, a cafetorium (a large room used as both a cafeteria and an auditorium), a washateria, and limited recreational and commercial facilities. In addition, a convenience type food store, a beauty shop, a small protestant chapel, a rummage store, and a gift shop are part of the project.

Rental units are of two types: 262 one and two bedroom private cottages with kitchen facilities and 68 apartments, most of which do not have kitchen facilities.

The project has its own water, sewage, and electrical facilities and was built on approximately 62 acres of land adjoining Lake Benbrook, which is about 17 miles from downtown Ft. Worth, Texas. The nearest shopping facilities and residential areas are about 6 miles away. Bus services to shopping and other commercial facilities are provided to project residents at costs ranging from $.50 to $1 a round trip.

HUD's records show that at the time the mortgage insurance application was submitted, HUD estimated that the project would need about $1 million in subsidy over the life of the mortgage to pay the mortgage note. HUD subsequently reduced its estimate to $200,000 and the Foundation entered into a guaranty agreement with the mortgagee which provided that in the event St. Francis Village, Inc. (the mortgagor) defaulted on the mortgage, the Foundation would pay the mortgagee the sum of $200,000. The guaranty agreement also provided that if the Foundation failed to make such payment, and the mortgagee assigned the mortgage to HUD, HUD had the right to demand payment of the $200,000 from the Foundation. In view of the guaranty agreement and a pledge from the Foundation that it would actively conduct fund-raising drives to meet any deficits which might arise in connection with the operation of the project, HUD approved the mortgage insurance application in October 1963.
When the mortgagor defaulted and the mortgage was assigned to HUD in February 1966, full mortgage payments were not being made and the delinquent payments amounted to about $175,000. HUD attributed the original mortgage default to slow rental of project units during the first year when occupancy was only about 20 percent due mainly to the remote location of the project, and to the failure of the Foundation to subsidize project deficits as promised.

In February 1966 when the mortgage was assigned to HUD, HUD requested that the Foundation pay the $200,000 guaranty. The Foundation replied that it did not intend to honor its obligation on any basis other than one contemplating payments if, as and when there was an inclination and ability to pay. HUD records show that after HUD threatened foreclosure action in March 1966, the Foundation paid approximately $10,000 towards the $200,000 guaranty and agreed to commence paying $2,000 per month toward the remainder. The final payment on the total guaranty of $200,000 was made in June 1972.

In November 1967, the mortgagor was still not making full mortgage payments and the original mortgage was modified to defer all principal payments from mortgage inception through December 1968. At that time no principal payments had been made. Also, in November 1967 a forebearance agreement was executed establishing minimum monthly payments retroactively from July 1967 through December 1968, plus any excess of monthly cash receipts over cash disbursements. The amounts payable under the agreement were to be applied against interest. The mortgagor failed to comply with the payment provisions of the agreement which was terminated in November 1968; and as a result, the delinquent interest increased from $403,314 to $453,615 between July 1967 and November 1968.

The mortgage loan was placed under a workout agreement by HUD in November 1968. Under the agreement the project was able to reduce its interest delinquency to $383,467 as of February 1974. At that date, however, the project had still not made any principal payments.

In May 1973, HUD provided the Foundation an opportunity to purchase the property by requesting that it make a cash offer in settlement of the mortgage debt. On February 11, 1974, HUD tentatively accepted a cash offer of $2,231,566 from the Foundation in final settlement of the mortgage note. At that date the unpaid principal and interest on the mortgage loan amounted to $4,337,967.
CONTROL OVER RECEIPTS AND DISBURSEMENTS

Project receipts

HUD approved the construction of a chapel with a portion of the mortgage proceeds. Although we were unable to identify the total cost of the chapel, project records indicated that the facility was valued at $89,000 for fire insurance purposes in November 1966. In the process of obtaining mortgage loan insurance, the Foundation advised HUD that the chapel collections would be treated as project income.

In the first year, chapel funds amounting to about $2,600 were included as project income. However, in subsequent years the chapel funds were accounted for separately by the project and used to pay the salary of a resident chaplain. After September 30, 1967, chapel funds were also used to pay the rental on a five bedroom unit used as a rectory. A payment of $50 per month was also made from chapel funds to cover the cost of chapel utilities. All excess cash was forwarded to the President of the Franciscan Tertiary Provinces Foundation, who was also the President of the Board of Directors of St. Francis Village, Inc.

We found that chapel funds had totaled about $48,000 after the first year. We brought this matter to the attention of officials of HUD's Fort Worth insuring office who, in September 1973, requested the Foundation to redeposit $44,000 into the project account.

Our review disclosed also that potential project income from tenant and commercial facilities was not collected as follows:

a. The five-bedroom unit used as a rectory was originally intended to be rented at a monthly rate of $250. However, no rents were collected for the use of this unit before September 30, 1967. After this date, the unit was rented for $132 per month and increased to $150 per month as of June 30, 1973.

b. Although HUD required that $420 per month be charged for the rental of the commercial facilities located in the project, we noted that rental income was not being collected from these facilities.
c. One tenant was allowed to live in the project without charge while three others received rental discounts. The loss of rental income amounted to $368 per month. The project administrator told us that such rent subsidies are considered necessary for the project to qualify as a nonprofit, tax-exempt corporation. A HUD insuring office official was not certain whether the project administrator was correct; however, we noted that the State of Texas does not consider the project as a tax-exempt corporation.

Project disbursements

Our review disclosed certain project expenses that were either not authorized by HUD or appeared questionable for a project whose mortgage was undergoing reinstatement. Insuring office officials advised us that, if the mortgage was current, these expenses would not be questioned but, because of the financial difficulties of the project, these expenses should have been either reduced or eliminated.

Bus service for project residents

The Foundation offers bus service for the residents to downtown Ft. Worth and outlying shopping centers. The fares charged the residents are not sufficient to cover operating expenses. Round trip fare to Ft. Worth was $1 while the fares to closer shopping centers were $.50 and $.75, respectively. We estimated that the annual loss from the service amounts to about $4,200.

Funds used to publish newspaper

A project newspaper, usually consisting of the front and back of one legal size sheet of paper, is prepared and distributed to local residents and other interested parties at a net cost of about $1,900 per year.

Car allowances to employees

Approximately $2,400 per year is distributed to project employees for car allowances as follows:

--the cafeteria supervisor who used a privately owned vehicle for pick-up and delivery of food supplies and for driving to and from work received a $100 per month car allowance, instead of being reimbursed on the basis of actual miles driven on work related business, and
--the project administrator who was furnished a project-owned car with all expenses paid (maintenance, gas, and other operating expenses), also received a $100 per month car allowance for his personal car, instead of being reimbursed on the basis of actual miles driven on work related business.

**Project facilities used as a convalescent center**

In 1966, the mortgagor established, as part of the project facilities, a convalescent center to care for elderly persons requiring full-time nursing supervision. This service was discontinued in 1970. The convalescent center incurred operating losses amounting to about $34,000 from the time it opened in January 1966 through May 1968. We could not determine from the project records the extent of the operating loss for the remaining period the center was in operation.

**Losses incurred from cafeteria operation**

The cafeteria has operated at a loss since the inception of the project. These losses, excluding utility, depreciation, maintenance, and janitorial costs, have totaled about $39,300 during fiscal years 1966 through 1972. During this period HUD headquarters periodically questioned these losses; however, we found no evidence that the Ft. Worth insurance office had taken any action on the matter.

**HUD Audit Activities**

HUD performed no audits of St. Francis Village, Inc. during the period the project mortgage was under a workout arrangement.
PACIFIC HOLIDAY TOWERS

BACKGROUND

HUD approved an application for section 207 mortgage-loan insurance for Pacific Holiday Towers (Pacific) in July 1962 in the amount of about $5.8 million. The owner-builder subsequently became insolvent and from early 1964 through 1965 only a partially completed building stood on the site. Construction was renewed under a new owner in January 1966 and was completed in April 1967.

Pacific, located in Long Beach, California, is a 17-story apartment building containing 260 dwelling units, a restaurant, a private businessmen's club, and parking facilities. The project is managed by a resident who receives an annual salary of about $8,000 plus free occupancy in an apartment.

From the initial rental date, the project had encountered financial difficulties which ultimately resulted in the assignment of the mortgage to HUD in April 1968. HUD's first bill to the project in September 1968 showed that the mortgage was delinquent in the amount of $376,192. HUD had placed the project under a workout arrangement in May 1968. The arrangement was extended to March 1969 at which time the project owners submitted plans for a formal modification of the mortgage. HUD postponed a decision on this plan and twice extended the existing workout arrangement to analyze the project's potential and formulate a long-range reinstatement plan. In September 1969, HUD approved a modification agreement that required a minimum monthly payment equal to current interest, service charge, and tax accruals plus $25,000 (to be applied against delinquent interest).

In July 1972, HUD initiated foreclosure, after the project defaulted under the modification agreement. In March 1973, however, HUD accepted a cash offer of $4.1 million as payment for the outstanding mortgage obligations on the project. On September 27, 1973, the sale of the project was completed. The Government's loss amounted to about $3.4 million after considering unpaid principal and delinquent interest on the mortgage loan.

CONTROL OVER RECEIPTS AND DISBURSEMENTS

Leases and receipts were not prenumbered and rental receipts were not systematically given to tenants. Therefore, we were unable to determine whether project rents had been collected.

Our review of project disbursements showed that about $2,500 was paid to one of the project owners in December 1972 for real
estate and financing services. According to the project accountant, these expenses were in payment for services provided over a 2-year period for

--efforts to get the three creditors of the project to settle for less than the face value of the debt,

--preparation of financial projections on the project, and

--attempts made to locate sources of funds for refinancing the project.

HUD guidelines state that disbursements of project funds during the reinstatement period should apply to actual physical operation of the project as opposed to strictly administrative expenses pertaining to corporate or financial arrangements and rearrangements. HUD records and our discussions with area office officials indicated that HUD did not question the propriety of these expenditures.

HUD AUDIT ACTIVITIES

At the request of the Los Angeles area office, HUD performed an audit of the project for the period January through September 1970. A report issued in December 1970 pointed out that

--payments were not being made to HUD as required by the provisions of the mortgage modification agreement;

--advertising and elevator maintenance expense appeared questionable;

--internal control over parking fees was inadequate; and

--annual project reports did not disclose that rent free units were being provided to project employees.

At the time of our review, the last three deficiencies had been resolved by HUD. The first deficiency was subsequently resolved when HUD accepted the cash settlement on the project mortgage.
ALLEN MCDONALD FOUNDATION

BACKGROUND

HUD approved an application for section 231 mortgage-loan insurance for the Allen McDonald Foundation (Foundation) in Waco, Texas, in August 1962 in the amount of about $1.7 million. The Foundation is a nonprofit corporation sponsored by the Catholic Diocese of Austin to provide housing, related facilities, and services for elderly persons.

The Foundation purchased the project facilities—a 12-story hotel built in 1929—from the Catholic Diocese of Austin and the Diocese of Galveston who jointly owned the property. The project consists of 205 rental units, a nondenominational chapel, a cafeteria, a snack bar, laundry facilities, and several large rooms used for recreational and commercial purposes. Sixty-five rental units are used to house elderly persons requiring nursing supervision and care. The project provides bus service for residents to shopping and medical facilities and, for the resident's convenience, a small gift shop and beauty shop are located on the premises.

At the time the Foundation applied for mortgage insurance, the Diocese of Austin advised HUD in writing that it would financially subsidize and reasonably assist the project as necessary. Also, in an application for tax-exempt status, the Diocese represented to the State of Texas in August 1962 that if revenues from operations were not sufficient to make payments on the mortgage loan, deficits would be met from funds of the Diocese or by contributions. HUD records showed that the project was approved on the basis of the commitment from the Diocese that it would be held liable for all mortgage payments due; a written agreement to that effect, however, was not entered into by HUD.

The mortgagor—the Foundation—defaulted in May 1964 and HUD was notified by the mortgagee that the project was operating at a loss and that reinstatement of the mortgage was doubtful. Subsequently, HUD requested the Diocese of Austin, in accordance with their prior pledge, to subsidize the project in the amount of the operating losses and all outstanding mortgage payments. In November 1964, however, the Diocese notified HUD that it would subsidize only the project's operating losses and not the mortgage payments. The mortgagee assigned the mortgage note to HUD in March 1965.

It was not until September 1971 that the area office requested a legal opinion from HUD's General Counsel as to whether the Diocese could be required to pay the delinquent mortgage payments. In November 1971, HUD's General Counsel determined that the commitment to HUD by the Diocese was not legally binding and that HUD therefore could not require the Diocese to further subsidize the project.
When HUD accepted the assignment of the mortgage in March 1965, it was delinquent by $49,000 on its loan. HUD negotiated the first workout agreement in March 1967 when the total mortgage delinquency had increased to about $271,379 (about $228,380 represented interest and service charges). The Foundation defaulted under the terms of the first workout agreement which expired in September 1967. From September 1967 to June 1972, HUD allowed the mortgage loan to remain delinquent under subsequent workouts and less formal arrangements; however, the Foundation did not meet the payment provisions of these arrangements.

As of May 1973, the total mortgage delinquency increased to about $834,446 when HUD accepted a cash offer of $625,000 from the Diocese of Austin as a settlement on the mortgage note. The Government's loss amounted to about $1.8 million after considering unpaid principal and delinquent interest on the mortgage loan.

**CONTROLS OVER RECEIPTS AND DISBURSEMENTS**

Funds collected through the operation of the nondenominational chapel were not deposited into a bank account in the name of the Foundation. The project's regulatory agreement prohibited the Foundation, without prior written approval of HUD, from disbursing or paying out any funds of the project except for usual operating expenses and necessary repairs. This agreement did not define the various sources of project income.

The chapel was refurbished with mortgage funds and operating expenses were paid from project income. Residents were not charged for use of the chapel facilities nor were the funds contributed by the residents deposited in the project account. Available project records did not disclose the amount of income from the chapel; however, project officials advised us that receipts amounted to about $1,630 annually. The Dallas area office officials advised us that because mortgage funds had been used to refurbish the chapel, the receipts should have been contributed to project income.

**Reduction in project expenses**

HUD's Dallas area office conducted a review of the operation of the project in 1971 and identified several types of project expenses that could be reduced or eliminated.
Close the nursing care infirmary

The Dallas area office had recommended that the infirmary be closed because it was losing approximately $22,000 per year and was not meeting minimum nursing care requirements. The infirmary was still in operation when the final cash settlement was accepted by HUD in May 1973.

Reduce administrative staff

The area office found that the administrative staff which consisted of six individuals could be reduced to three. In addition, a computer service which was duplicating work performed by the administrative staff could be discontinued. The area office estimated that implementing these actions could reduce administrative expenses by about $21,000 annually. The project, however, had not implemented these changes as of May 1973.

Discontinue payments to the Diocese priests and their retirement fund

Diocese priests officiated at services held in the project chapel and assisted the project administrator in caring for the residents. The project paid the priests for their services and made contributions to their retirement funds. The area office expressed the opinion that these payments did not constitute valid property expenses and recommended that they be discontinued. Annual savings would have amounted to about $2,700. As of May 1973, the project was continuing to make the payments.

Eliminate free meals to employees

The area office estimated that annual savings of about $80,000 would be realized by eliminating free meals to employees. The project records indicated that this change had been implemented.

Discontinue bus services for residents

The expenses incurred by the project for providing bus services to residents amounted to approximately $3,000 per year. The area office had recommended that these services be discontinued. As of May 1973, the project had not discontinued these services.

Unauthorized capital expenditures

The area office found that the project administrator had purchased two washing machines at a total cost of about $7,200 without requesting prior HUD approval as required by the workout agreement.
Also, in March 1971, the project administrator began recarpeting of the project without HUD approval. HUD's review of samples indicated that the carpet and pad were inferior in quality and did not meet HUD's minimum property standards. At the time of the area office review, the project had expended about $8,000 for recarpeting and an additional $17,500 was scheduled for expenditure. HUD allowed the project to complete the recarpeting; however, the carpet and pad was upgraded to meet minimum property standards.

Other expenditures made by the project during the period December 1970 to March 1971 without HUD approval or notification were $3,143 for miscellaneous equipment and $1,883 for capital improvements.

Unauthorized disbursements

We found that $36,060 of funds which had accumulated in the project account during the period August 1972 to May 1973 and which should have been remitted to HUD under the provisions of the workout agreement were transferred to the Diocese of Austin. In May 1973, the Foundation transferred about $26,050 from the project account to the Diocese of Austin. These funds, according to the project administrator, were used as part of the $625,000 payment made by the Diocese to HUD as a settlement on the outstanding balance of the mortgage loan.

The remaining $10,000 was withdrawn and subsequently deposited in a savings account maintained by the Diocese. The project records showed that the Diocese intended to use these funds to pay interest on the bonds sold to obtain funds for the purchase of the project.

HUD AUDIT ACTIVITIES

HUD performed no audits of the Foundation during the period the project mortgage was under a workout arrangement.