



U.S. Department of Housing and Urban Development

District Office of the Inspector General
Richard B. Russell Federal Building
75 Spring Street, SW, Room 700
Atlanta, GA 30303-3388
(404) 331-3369

January 24, 1996

Audit-Related Memorandum
No. 96-AT-212-1806

MEMORANDUM FOR: Daniel A. McCanless, Director, Multifamily Division, 4FHM

FROM: Kathryn Kuhl-Inclan
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Morningside Associates, Ltd.
Review of Receipts and Disbursements
Burlington, North Carolina

We have completed a review of the records of Morningside Associates, Ltd. (Mortgagor), Burlington, North Carolina, for the period January 1, 1991, through June 30, 1995. Our primary objective was to determine if project funds were used for eligible purposes.

BACKGROUND

Morningside Associates, Ltd. owns Creekside Apartments in Burlington, North Carolina. The project has 72 units and is owner managed.

HUD insured the project mortgage of \$830,900 under Section 221d(4) of the National Housing Act. The Mortgagor defaulted on the mortgage in November 1991. The mortgagee assigned the mortgage to HUD in February 1992. The mortgage remained in default until the Mortgagor brought the mortgage current in June 1995. The mortgage was still current as of December 13, 1995.

HUD approved Section 8 assistance for 14 project units under Contract NC 19-L000-140. On October 16, 1995, HUD suspended the Section 8 assistance for 6 of the 14 units because the units were not maintained in accordance with housing quality standards.

The project records were located in Burlington, North Carolina, and Sunnyvale, California.

SCOPE

We interviewed the Mortgagor owner and the project manager to determine available accounting records and controls over receipts and disbursements. For the audit period, we

traced income recorded on the project receipt records to bank deposits, and reviewed bank statements and cancelled checks to determine if project income was used for eligible purposes. We conducted our review from August through October 1995.

SUMMARY

We found no evidence project income was used for ineligible purposes. However, the Mortgagor did not follow effective financial management control procedures. The Mortgagor (1) did not maintain required accounting records, (2) did not provide annual audited financial statements to HUD, and (3) had weaknesses in cash receipts and disbursements procedures. As a result, the Mortgagor did not have proper controls over project assets and did not have sufficient financial information for effective project management or HUD monitoring.

Details of our finding and recommendations are in Attachment 1. We discussed the finding and recommendations with the Mortgagor general partner on October 27, 1995, and provided him a draft of the finding. The general partner's comments are summarized following the finding and are included verbatim in Attachment 2.

Within 60 days, please give us, for each recommendation in the memorandum, a status report on: (1) the corrective actions taken; (2) the proposed corrective actions and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate your cooperation during the audit. Should you or your staff have any questions, please contact Rudy E. McBee, Assistant District Inspector General for Audit, at (423) 545-4368 or Bruce Milligan, Senior Auditor, at extension 4056.

Attachments:

- 1-Finding and Recommendations
- 2-Auditee Comments
- 3-Distribution

FINDING AND RECOMMENDATIONS

Mortgagor Did Not Maintain Effective Financial Controls

The Mortgagor did not follow effective financial management control procedures. The Mortgagor (1) did not maintain formal accounting records, (2) did not provide annual audited financial statements to HUD, and (3) had weaknesses in cash receipts and disbursement procedures. As a result, the Mortgagor did not have proper controls over project assets and did not have sufficient financial information for effective project management or HUD monitoring.

Required Financial Records Not Maintained

The project Regulatory Agreement requires the Mortgagor to keep books and accounts of the operations of the project in accordance with HUD requirements (paragraph 9(d)). HUD requires complete and accurate books and accounts, posted monthly, and use of prescribed accounts for uniformity (Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, chapter 2).

The Mortgagor did not have formal accounting records, including a general ledger, general journal, cash receipts and disbursements registers or other formal books of account and original entry for any of the audit period. For the same period, records did not include two bank statements, three cancelled checks, two bank withdrawal advices, and cash receipt copies for one month. As a result, the Mortgagor did not have proper control over project assets and did not have sufficient information for effective project management.

Required Financial Reports Not Submitted

The Regulatory Agreement requires the Mortgagor to furnish HUD a complete annual financial report based upon an examination of the books and records of the mortgagor within 60 days following the end of each fiscal year (paragraph 9(e)).

The Mortgagor did not obtain or submit to HUD annual audited financial statements for fiscal years ended December 31, 1991, 1992, 1993, or 1994. As a result, both the Mortgagor and HUD lacked sufficient information to determine the results of project operations and the Mortgagor's financial position.

Weaknesses in Control Over Cash Receipts and Disbursements

The Regulatory Agreement requires the Mortgagor to deposit all rents and other receipts of the project in a bank (paragraph 9(g)).

In three instances the site manager made disbursements from cash collections instead of by

check. Also, the site manager indicated the Mortgagor general partner on occasion signed blank checks for use by site personnel. Such practices weakened controls over cash.

Mortgagor Comments

The Mortgagor general partner said he did not submit annual audited financial reports to HUD because they cost approximately \$4,000 and he needed the funds to pay essential operating costs. He said he considered the project's accounting records and financial controls to be adequate. The full text of the general partner's comments is in Attachment 2.

Evaluation of Mortgagor Comments

Submission of annual audited financial statements to HUD is essential for HUD monitoring purposes. The Mortgagor should provide the funds for the audits. The Mortgagor's accounting records and financial controls were inadequate for the reasons stated in the finding.

Recommendations

We recommend that you require the Mortgagor to:

- 1A. Maintain required accounting records for the project.
- 1B. Submit audited financial statements to HUD, or face the imposition of civil money penalties.
- 1C. Deposit all cash receipts, pay all disbursements by check, and stop signing checks in blank.

DISTRIBUTION

Secretary's Representative, 4AS
Director, Multifamily Division, 4FHM
Field Comptroller, 4AF
Director, Field Accounting Division, 4AFF
Field Audit Liaison Officer, 4AFI (Ernest Harry)
North Carolina State Coordinator, 4FS
Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)
Office of the Housing-FHA Comptroller, HF (Room 5132)
ATTN: Audit Liaison Officer (1)
Chief Financial Officer, F (Room 10164) (2)
Deputy Chief Financial Officer for Operations, FO (Room 10164) (2)
Director, Office of Internal Control and Audit Resolution, FOI (Room 10176)
Associate Director, U.S. General Accounting Office, GAO
Joseph A. Barringer, General Partner, Morningside Associates, Ltd.,
525 East Maude Street, #29, Sunnyvale, CA 94086