



Issue Date June 1, 2005

Audit Report Number 2005-PH-1011

TO: Charlie Famuliner, Director, Richmond Multifamily Program Center, 3FHM

FROM: 
Daniel G. Temme, Regional Inspector General for Audit, Philadelphia Region,
3AGA

SUBJECT: America House, Incorporated, Marshall, Virginia, and Its Subsidiaries Did Not
Comply with HUD Requirements Covering Their HUD-insured Mortgages

HIGHLIGHTS

What We Audited and Why

We completed an audit of America House, Incorporated¹ (America House) and its wholly owned subsidiaries at the request of the director of HUD's Richmond Multifamily Program Center. The objective of our audit was to determine whether America House, Incorporated and its subsidiaries complied with HUD requirements covering their HUD-insured mortgages.

What We Found

America House, Incorporated and its subsidiaries did not comply with HUD requirements covering their HUD-insured mortgages. Contrary to its regulatory agreements with HUD, America House, Incorporated and its subsidiaries failed to make the mortgage payments for their three HUD-insured properties even when the mortgaged properties produced sufficient income to cover the payments. In addition, America House improperly commingled funds in violation of its

¹ America House, Incorporated changed its name to Amerisist Management Company, Limited Liability Company in March 2002.

Regulatory Agreements and did not properly maintain project records. These later actions prevented us from performing a thorough audit of the three HUD-insured properties. America House defaulted on the notes and HUD was compelled to sell the properties at a loss of \$4.1 million in September 2004.

What We Recommend

We recommend that HUD pursue appropriate administrative sanctions against the owner and president of America House, Incorporated and its three wholly owned subsidiaries.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the report with America House during the audit and at an exit conference on May 20, 2005. America House provided its written comments to our draft report on May 25, 2005. The complete text of its response, along with our evaluation of that response, can be found in Appendix A of this report.

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BACKGROUND AND OBJECTIVES

Under Section 232 of the National Housing Act, Congress authorized a mortgage insurance program beginning in 1959 to facilitate the construction and rehabilitation of nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. Through its wholly owned subsidiaries, America House, Incorporated owned and operated three such HUD-insured assisted living facilities. Mr. Charles Rice is the owner and president of America House, Incorporated and its three wholly owned subsidiaries. America House, Incorporated's main corporate office is located at 4252 Manor Drive, Marshall, VA. The three corporations defaulted on their HUD-insured mortgages in 2003, and HUD sold the notes in September 2004 at a loss of \$4.1 million. Information on the three properties related to the HUD-insured mortgages is as follows:

Property	America House, Incorporated Subsidiary	Regulatory Agreements Signed	Units
Manassas, VA	America House One, Incorporated	March 31, 1999	27
Orange, VA	America House Two, Incorporated	February 25, 1999	27
Stephens City, VA	America House Three, Incorporated	July 18, 2000	41
Total			95

The owner and president of America House, Incorporated and its three wholly owned subsidiaries signed each of the following agreements related to the HUD-insured mortgages:

- Regulatory Agreement for Multifamily Housing Projects (HUD-92466);
- Regulatory Agreement for Nursing Homes (HUD-92466-NHL); and
- Agreements of Lease by and Between America House One, Two, and Three (Landlord), and America House, Incorporated (Tenant).

In addition to its three properties with HUD-insured mortgages, America House, Incorporated owned and operated 188 other assisted living units at five other uninsured properties. The objective of our audit was to determine whether America House, Incorporated and its subsidiaries complied with HUD requirements related to their HUD-insured mortgages.

RESULTS OF AUDIT

Finding 1: America House, Incorporated and Its Subsidiaries Did Not Comply with HUD Requirements Covering Their HUD-insured Mortgages

Contrary to their regulatory agreements with HUD, America House, Incorporated, and its subsidiaries failed to make the payments on their HUD-insured mortgages even when the mortgaged properties produced sufficient income to make the payments. America House also improperly commingled funds in violation of its Regulatory Agreements and did not properly maintain project records. This occurred because the owner and operator did not ensure the projects were managed in accordance with HUD requirements. America House defaulted on the notes and HUD was compelled to sell the properties at a loss of \$4.1 million.

America House Had Income But Did Not Pay Its Mortgage

During the period December 2003 until August 2004 America House, Incorporated was in default on its HUD-insured mortgages. Our audit showed however, that during this same period, the mortgaged properties produced a total net income of \$484,377. America House could have used this income to make mortgage payments and possibly avoid default. As stated previously, HUD was compelled to sell the notes at a loss of \$4.1 million. The audit further noted that America House, Incorporated made substantial payments for such personal items as automobile lease payments, country club fees, credit cards, and private schools during the period when the HUD-insured projects were in default. For example, during the period America House, Incorporated was in default of the mortgage it made payments of \$6,000 for country club fees, and more than \$30,000 for private schools.

Under the Regulatory Agreements for Multifamily Housing Projects (HUD-92466), America House and its three subsidiaries agreed to promptly make all payments due under the note and the mortgage. Under the Regulatory Agreements for Nursing Homes (HUD-92466-NHL), America House, Incorporated agreed to make lease payments to its three subsidiaries when due. Under the lease agreements, the three subsidiaries were designated as the landlord and America House, Incorporated was designated the tenant. Notwithstanding the various legal arrangements established by the owner and president of these various corporate

entities, the fact remains that America House, Incorporated often had income to make the mortgage payments but did not do so.

America House, Incorporated Improperly Commingled Funds

Contrary to HUD requirements, America House, Incorporated also commingled project funds with its other non-HUD project funds. America House, Incorporated used a centralized accounting system for its projects and it made disbursements from a centralized account that could not be clearly traced to each project. HUD allows commingling of funds, but only when disbursements from the centralized account can be clearly traceable to each project. An America House official informed us that the company did not maintain separate accounts for each project because he did not believe this was efficient. Since America House, Incorporated did not maintain separate accounts for its projects, project funds were improperly commingled with the other uninsured project funds, and we could not accurately determine the actual cash position of each project.

Personal Expenses Were Paid with Commingled Funds

Under the Regulatory Agreements for Multifamily Housing Projects (HUD-92466), America House and its three subsidiaries also agreed under paragraph 9(g) of the agreement that they would withdraw rents and other project receipts only in accordance with the provisions of their agreement. America House is only permitted to take withdrawals for expenses of the project or for distributions of surplus cash. But, as we noted previously, the audit showed America House, Incorporated made substantial payments for such personal items as automobile lease payments, country club fees, credit cards, and private schools when its HUD-insured projects were in default. And as previously discussed, during the period the mortgage was in default America House, Incorporated made payments from its commingled project fund of \$6,000 for items such as country club fees and more than \$30,000 for private schools.

America House, Incorporated Did Not Properly Maintain Project Records

America House, Incorporated also did not maintain books and records as required by its Regulatory Agreements with HUD. Under paragraph 9(c) of the Regulatory Agreements for Multifamily Housing Projects (HUD-92466), America House and its three subsidiaries agreed to maintain books, contracts, records, documents, and

other papers related to the projects in reasonable condition. This was required in order to permit an examination and inspection at any reasonable time by the HUD Secretary or his duly authorized agents. Our audit showed however, that America House, Incorporated could not provide a check register, cash receipts or disbursement journals.

In summary, the owner and president of America House violated a number of key provisions of his regulatory agreements with HUD which put him in default on his three HUD-insured mortgages. This compelled HUD to sell the notes in September 2004 at a loss of \$4.1 million. As the evidence from the audit demonstrates, these actions could have been avoided.

Recommendations

We recommend that the Director, Richmond Multifamily Program Center

- 1A. Pursue appropriate administrative sanctions against the owner and president of America House, Incorporated and its three wholly owned subsidiaries.

SCOPE AND METHODOLOGY

We performed an audit of America House, Incorporated and its wholly owned subsidiaries in Marshall, Virginia from September 2004 through April 2005 in accordance with generally accepted government auditing standards and included tests of internal controls that we considered necessary under the circumstances.

The audit covered transactions representative of operations from June 2002 through August 2004. We expanded the scope of the audit as necessary. We reviewed applicable guidance and discussed operations with management and staff personnel at America House, Incorporated and key officials from HUD's Richmond Field Office.

To determine whether America House, Incorporated complied with HUD requirements, we

- Reviewed federal requirements, including the Code of Federal Regulations, HUD Handbooks, and the U.S. Code;
- Reviewed the projects' files maintained by HUD's Richmond Field Office to include Regulatory Agreements, Lease Agreements, and Monthly Accounting Reports;
- Performed limited testing of management controls relevant to the audit through inspection, review, and analysis of documents and records, and evaluated the effects of any exceptions;
- Reviewed the projects' books and records to determine the reliability of information; and
- Used computer assisted audit tools to analyze accounting information, review a non-statistical sample of disbursements, and calculate income and expenses of the three projects.

INTERNAL CONTROLS

Internal Control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that internal controls over the following requirements were relevant to our audit objective:

- Making payments when due under the note and mortgage,
- Ensuring disbursements from a centralized account can be traced to each project, and
- Maintaining books and records as required by its HUD Regulatory Agreements.

We assessed the relevant controls identified above. A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, the following are material weaknesses. America House, Incorporated did not

- Make all payments due under the note and the mortgage.
- Ensure disbursements from a centralized account can be traced to each project.
- Maintain books and records as required by its Regulatory Agreements with HUD.

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



Assisted Living Residences

May 25, 2005

Mr. Daniel G. Temme
Regional Inspector General for Audit
U.S. Department of Housing and
Urban Development
Suite 105
100 Penn Square East
Philadelphia, PA 19107-3380

Sent via FAX and US Mail

Re: Audit of America House, Inc.

Dear Mr. Temme:

This is in response to your letter of April 29, 2005, and follows an exit conference held on May 20, 2005 with Mr. John Buck and Ms. Amy Edison of your staff. We understand that you wanted our response to the draft audit findings no later than May 25. Your staff was informative and assisted us in understanding the report, since this is our first experience with an audit.

Having said this, we wish to make several points for the record, in that we understand that both the audit and this letter will become public documents. This will set forth our position on a number of matters, which we believe may be important to the reader.

Comment 1

- While the loans on these properties did go into default, we believe that all could have been worked out at no loss to the government if HUD were in a position to act as a standard commercial lender would have acted. We do not believe that a commercial lender would have sold the notes at auction as HUD did in this instance, and thus do not believe that a loss of this magnitude was inevitable. HUD Richmond helped our company in every way possible, but had to adhere to government policy.

Comment 2

- Your audit states that the our three HUD related properties over the time in question generated net income of \$484,377, and your staff provided to us some calculations to show us how this number was derived. We were unable to tie this number to our records. Additionally, we are unable to verify the reported \$4.1 million loss.

Comment 3

- America House, Incorporated is in the business of owning and managing a number of properties, and many of its corporate expenses are unrelated to the three properties subject to this audit. This corporation did pay for some items noted, like automobile payments and country club dues, as part of normal benefits, but did not pay for private schooling, which was a loan.

Where Independence doesn't have to mean Alone.
(Formerly America House)

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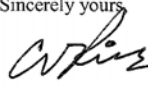
Telephone (540) 364 3900
Fax (540) 364-4900

Comment 4

- It is true that we used centralized operating accounts as part of a centralized accounting system. It was our belief, based on what we had been told by outside auditors, which have audited several of our companies accounted for by this system, that we were operating within HUD guidelines. If we were not, it was certainly not because we intentionally engaged in activities that were in violation of your requirements.

Again, we thank you for the courtesy shown us through this process. We understand that these three properties did not turn out the way we (or HUD) had hoped, and understand the Department's decision to conduct this audit. We will, as always, work with Mr. Famuliner and his office to resolve any open issues.

Sincerely yours



Charles V. Rice
President

OIG Evaluation of Auditee Comments

- Comment 1** America House, Incorporated violated a number of key provisions of its regulatory agreements with HUD which put it in default on its three HUD-insured mortgages. This compelled HUD to sell the notes in September 2004 at a loss of \$4.1 million. As the evidence from the audit demonstrated, this loss of \$4.1 million could have been avoided if America House had in fact complied with the provisions of its regulatory agreements.
- Comment 2** As the audit demonstrated, America House, Incorporated did not maintain its books and records in compliance with its regulatory agreements with HUD. As such, it is understandable why it is having a difficult time accounting for project funds. The OIG calculated the \$484,377 total net income for the period in question on the three defaulted HUD-insured mortgages by using the accounting records America House provided the auditor. The \$4.1 million loss was calculated from actual data from HUD related to the sale of the notes in September 2004.
- Comment 3** Under paragraph 9(g) of its Regulatory Agreements for Multifamily Housing Projects (HUD-92466), America House, Incorporated and its three subsidiaries agreed to withdraw rents and other project receipts only in accordance with the provisions of their agreements. Under the agreements, America House is only permitted to take withdrawals for expenses of the project or for distributions of surplus cash. However, our audit showed America House, Incorporated made substantial payments from its commingled project fund for personal items such as automobile lease payments, country club fees, credit cards, and private schools when its HUD-insured projects were in default.
- Comment 4** America House, Incorporated's centralized accounting system did not comply with HUD requirements because it could not clearly trace disbursements to each project. Further, contrary to HUD requirements, America House, Incorporated did not have an independent audit completed on its activities each year. America House, Incorporated's Vice President for Administration could only provide us with audited financial statements for America House One and Two for the year ending May 2002. The Vice President told us America House, Incorporated did not have sufficient funds to have the audits completed as required.