
AUDIT REPORT



THE SANCTUARY MULTIFAMILY EQUITY SKIMMING

GENEVA, OHIO

The General Partner Improperly Used More Than \$43,000 in
Project Funds

2006-CH-1002

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OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



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TO: G. Alan Coupland, Director of Columbus Multifamily Housing Hub, 5EHM

FROM: 
Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: The General Partner of The Sanctuary of Geneva, Ohio Improperly Used More Than \$43,000 in Project Funds

HIGHLIGHTS

What We Audited and Why

We reviewed the books and records of The Sanctuary (project), a 39-bed assisted living facility located in Geneva, Ohio. The review was part of our efforts to combat multifamily equity skimming on the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration insurance fund. We chose the project based upon its negative surplus-cash position since 2002 and indicators of diverted project funds or assets. Our objective was to determine whether the owner/management agent used project funds in compliance with the regulatory agreement and HUD's requirements.

What We Found

Eld-Terra, Incorporated (general partner), the managing general partner of The Sanctuary of Geneva Limited Partnership (owner), improperly used \$38,009 in project funds from February 2003 through January 2005 when the project was in a non-surplus-cash position. The inappropriate disbursements included \$37,000 to the general partner to repay owner advances to the project and \$1,009 in legal services for the general partner. The general partner also lacked documentation to support that an additional \$5,475 in project funds was properly used. We provided the general partner a schedule of the improper disbursements.

What We Recommend

We recommend that the director of HUD's Columbus Multifamily Housing Hub require the general partner to (1) reduce the project's management fee liability for the inappropriate payments, (2) provide documentation to support the unsupported payments or reduce the project's management fee liability for the appropriate amount, and (3) implement procedures and controls to ensure that future repayments of owner advances are made only from project surplus cash or with prior HUD approval and project funds are used according to HUD's requirements.

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 provided our discussion draft audit report to the general partner and HUD's staff during the audit. We held an exit conference with the general partner on October 26, 2005.

We asked the general partner to provide comments on our discussion draft audit report by October 28, 2005. The general partner provided written comments dated October 20, 2005. The general partner disagreed with our finding and recommendations. The complete text of the written comments, along with our evaluation of those comments, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Sanctuary (project) is a 39-bed assisted living facility located in Geneva, Ohio. The project is insured under section 232 of the National Housing Act and its regulatory agreement was executed on February 14, 2001. The project's owner is The Sanctuary of Geneva Limited Partnership (owner). Eld-Terra, Incorporated (general partner) is the managing general partner while the Sanctuary Management Company (management agent) manages the project. Vincent J. Micucci is the owner of the general partner and management agent. The project has been in a non-surplus-cash position since December 2002.

The review was part of our efforts to combat multifamily equity skimming on the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration insurance fund. We chose the project based upon its negative surplus-cash position since 2002 and indicators of diverted project funds or assets.

Our objective was to determine whether the owner/management agent used project funds in compliance with the regulatory agreement and HUD's requirements.

RESULTS OF AUDIT

Finding: The General Partner Inappropriately Used or Lacked Supporting Documentation for the Use of More Than \$43,000 in Project Funds

The general partner improperly used \$38,009 in project funds from February 2003 through January 2005 when the project was in a non-surplus-cash position. The inappropriate disbursements included \$37,000 to the general partner to repay owner advances to the project and \$1,009 in legal services for the general partner. The general partner also lacked documentation to support that an additional \$5,475 in project funds was properly used. The inappropriate disbursements occurred because the general partner lacked effective procedures and controls over the use of project funds. As a result, project funds were not used efficiently and effectively.

The General Partner Repaid \$37,000 in Advances to the Project

The general partner repaid itself \$37,000 in project funds from March through December 2003 when the project was in a non-surplus-cash position. The general partner said the disbursements were made for the repayment of cash advances made to meet the project's payroll needs. The general partner provided a related inter-company temporary advance to divert a crisis. The general partner did not request approval from HUD before the repayment as required by the project's regulatory agreement.

Paragraph 6(b) of the regulatory agreement requires that the owners will not, without prior written approval of the secretary of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except for surplus cash, except for reasonable operating expenses and necessary repairs, and make or receive and retain any distribution of assets or any income of any kind of the project except surplus cash. Page 2-16 of HUD Handbook 4370.2, REV-1, states that the repayment of owner advances when the project is in a non-surplus-cash position will subject the owner to criminal and/or civil penalties.

The General Partner Improperly Paid \$1,009 in Nonproject Legal Expenses

The general partner inappropriately disbursed \$1,009 in project funds for legal services related to the allocation of interest in the project's ownership entity. The services were not reasonable and necessary expenses of the project as required by paragraph 6(b) of the regulatory agreement. The disbursement was made in March 2004 while the project was in a non-surplus-cash position.

The General Partner Lacked Documentation to Support the Use of \$5,475 in Project Funds

The general partner lacked documentation to support that an additional \$5,475 in project funds was properly used. The unsupported disbursements included such items as petty cash, cable television service, and food service. The disbursements occurred between June 2003 and January 2005 while the project was in a non-surplus-cash position. We provided the general partner a schedule of the unsupported disbursements. As of October 13, 2005, the project owed the general partner \$118,090 in management fees.

Recommendations

We recommend that the director of HUD's Columbus Multifamily Housing Hub require the general partner to

- 1A. Reduce the project's management fee liability by \$38,009 (\$37,000 for the repayment of owner advances and \$1,009 in nonproject legal expenses) for the inappropriate disbursements from project funds cited in this finding.
- 1B. Provide documentation to support the \$5,475 in unsupported payments cited in this finding or reduce the project's management fee liability for the appropriate amount.
- 1C. Implement procedures and controls to ensure that future repayments of owner advances are made only from project surplus cash or with prior HUD approval and project funds are used according to HUD's requirements.

SCOPE AND METHODOLOGY

We performed the review at HUD's Cleveland Multifamily Housing Program Center and its Columbus Multifamily Housing Hub, the general partner's office, and the project from March to June 2005. To accomplish our objective, we interviewed HUD's staff, the general partner's employees, and a partner from the project's independent public accountant.

To determine whether the owner/management agent used project funds in compliance with the regulatory agreement and HUD's requirements, we reviewed

- HUD's files for the project;
- The project's audited financial statements for the years ending December 31, 2003, and 2004; and
- The project's financial records such as bank statements, canceled checks, and general ledgers.

We also reviewed Title 12, *United States Code*, sections 1715 and 1735; Title 31, *United States Code*, section 3801; 24 CFR [*Code of Federal Regulations*] Parts 24 and 232; and HUD Handbooks 2000.06, REV-3; 4350.1, REV-1; 4370.2, REV-1; and 4381.5, REV-2.

The review covered the period February 1, 2003, through January 31, 2005. This period was adjusted as necessary. We performed our review in accordance with generally accepted government auditing standards.

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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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 the following internal controls were relevant to our audit objectives:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above.

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

Significant Weakness

Based on our review, we believe the following item is a significant weakness:

- The general partner lacked effective procedures and controls over the use of project funds (see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	<u>\$38,009</u>	
1B		<u>\$5,475</u>
Totals	<u>\$38,009</u>	<u>\$5,475</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation of departmental policies and procedures.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

Mr. Ronald Farrell
Assistant Regional Inspector General
For Audit, Region V
US Department of Housing and Urban Development
The Bricker Federal Building
200 N. High Street, Room 334
Columbus, Ohio 43215-2499

October 20, 2005

Re: DISCUSSION DRAFT AUDIT REPORT ON OIG'S AUDIT OF THE
SANCTUARY OF GENEVA (SOGLP)

Dear Mr. Farrell:

This past Wednesday October 19, 2005 I learned from speaking with Mr. John McNella, the HUD Asset Manager for the SOGLP that HUD permission for temporary related party advances for operating & liability can be repaid when funds become available without notice or permission from HUD. Also, that this practice is witnessed by HUD as needed from time to time from the related parties.

Mr. Farrell, as the Managing General Partner for this property, my interest has always been to provide the best leadership and contribution to make our combined investments in the SOGLP realize a quality asset. The Market Study provided indicated a much stronger market than exists. Our absorption rate has been almost one per month in lieu of the 3-4 indicated by the market analyst. Fill-up has always been the problem demanding substantial capital contributions well beyond forecasts. The partnership has both developer and management fee liabilities owed me. My management staff and I have been working without compensation for almost six years now. I still believe strongly and am committed to the success of the SOGLP. I own Eld-Terra, Inc. that provided a temporary operational & liability advance to the Sanctuary Management Group, LLC (of which I am President) and the Sanctuary of Geneva Limited Partnership (of which I am the Managing General Partner). The condition of this loan was repayment as funds became immediately available. This was certainly not an improper, inappropriate, and in-efficient and action performed from lack of effective procedures as stated in your draft.

Presently, I am somewhat confused after speaking with Mr. McNella. You both represent HUD and are stating opposite viewpoints that reflect severely on my character, ability as a General Partner and in general classifies me with group of developers that in fact do skim profits from HUD assets.

In light of the above statements from Mr. McNella, I respectfully request a revision of your findings to reflect continued commitment I have which is to provide a quality HUD asset and not reflect a developer who misappropriates funds.

In response to your recommendations:

1. Please revise your penalty of "double jeopardy" (financial and character retribution) for saving the project. Should you enforce this recommendation I will not consider future such advances to save the project given the results of these confusing HUD actions to date.
2. My office can and will provide required documentation of unsupported payments.
3. Effective procedures with appropriate controls to ensure proper repayments are in place.

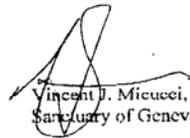
My office and the SOGLP spent the past year providing information to your office at great expense and time deflected from managing the SOGLP. Additional accounting fees were incurred as a result of this audit. I truly support HUD in severely penalizing Developers who misappropriate funds when such conditions occur.

It is now my understanding that this entire audit was the result of my actions of reimbursement of a related party advance for an operation & liabilities advance that is permitted by the Cleveland HUD office. My office is now required to complete many forms, make many responses and be identified with HUD assets that actually have been victimized by misappropriations of funds from unscrupulous developers.

I respectfully request that the actual circumstances and events be represented as I have responded if the audit and findings are still needed after speaking with Mr. McNella.

Mr. Ferrell, we have met and spoken many times and I believe you are a fair person with an open mind. Please do not place such a harsh label on my character and HUD asset.

Respectfully,



Vincent J. Micucci, Managing General Partner
Secretary of Geneva Limited Partnership

OIG Evaluation of Auditee Comments

Comment 1 When HUD's asset manager for the project provided this information to the general partner, the asset manager was unaware that the general partner provided the cash advance to the project. The asset manager was under the impression that the management agent provided the cash advance to the project. Further, HUD Handbook 4370.2, chapter 2, clearly outlines an owner's responsibilities with regard to repayment of owner advances as required by the regulatory agreement. Advances to help a project are encouraged, but repayment must be in accordance with the regulatory agreement and written guidance.