



U.S. Department of Housing and Urban Development

District Office of the Inspector General
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October 15, 1996
Audit-Related Memorandum No. 97-AT-212-1803

MEMORANDUM FOR: Ed M. Phillips, Director, Multifamily Housing Division,
Tennessee State Office, 4LHM

FROM: James D. McKay
Acting District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Independent Auditor Report of Illegal Acts
Wesley Homes of Lake County, Inc.
Review of Corrective Actions
Tiptonville, TN

We have completed a review of information provided by an Independent Auditor (IA) concerning apparent illegal acts by the former president of Wesley Homes of Lake County, Inc. (WHLCI). WHLCI owns Wesley Homes of Lake County (WHLC), a HUD-assisted, elderly housing development in Tiptonville, Tennessee. The information related to improper diversions of project funds.

The objectives of our review were to determine whether WHLCI had taken appropriate corrective actions - related to the funds, the former president, and any weaknesses in internal controls - and to evaluate the adequacy of IA audit coverage. We interviewed your staff and reviewed the project files in your office. We also interviewed the IA and the current president of WHLCI, and performed a cursory review of the IA's working papers.

SUMMARY

WHLCI's corrective actions were generally adequate, as was IA audit coverage, and we plan no additional audit work pertaining to either WHLCI or the IA. However, we are recommending that you issue a limited denial of participation (LDP) for the former WHLCI president that diverted the funds.

BACKGROUND

WHLC is a 50 unit, Section 202 elderly housing project located in Tiptonville, TN. WHLC was originally sponsored by the Methodist Church and is currently managed by Wesley Housing Corporation of Memphis which is affiliated with the Methodist Church. The management company had no control of the accounts involved in the cash diversions and could not have prevented or detected the diversions.

The IA reported in his audit for the year ended December 31, 1995, an "Accounts Receivable - Other" of \$24,367. He described the amount as reflecting certain transactions unauthorized by the Board of Directors and inappropriate for WHLCI. In a separate report to the HUD Inspector General, he explained that the president of WHLCI maintained a bank account in a local bank in Tiptonville separately from the operating account maintained by the management agent. The funds in the account represented a combination of private donations and project funds left over from construction, plus interest over the years. The president maintained the records for the account. During the year, the IA noted the following transactions involving the account:

- On February 17, 1995, check No. 191 was written to First Exchange Bank in return for certificate of deposit No. 25380, in the name of the president, for "RWV", in the amount of \$25,000, with the president's social security number assigned to the certificate. (The president advised us that RWV stood for Reelfoot Wesley Village, a name he made up for a possible future full-pay retirement center.)
- On February 21, 1995, certificate of deposit No. 25380 was cashed in and replaced by certificate of deposit No. 25402 for \$20,000, also in the name of the president for RWV, using the president's social security number. The \$5,000 which was withdrawn from the original certificate was deposited back into the bank account, net of a \$370 early withdrawal penalty.
- On March 1, 1995, check No. 195 was issued in the amount of \$2,000 to Kentucky Green Nursery to pay for installation of 20 trees. Investigation of this transaction revealed that only 4 trees were installed at WHLC, while 16 were installed at the WHLCI president's residence.
- On March 14, 1995, check No. 194 in the amount of \$1,200 was issued to B. G. Waid Construction Company for transplanting six trees at the WHLCI president's residence.

The IA advised that invoices described in the latter two transactions were addressed to the president, and all checks were co-signed by the secretary/treasurer of WHLCI. (The checks were signed by the president.) The IA also advised that on April 2, 1996, all funds were restored to WHLCI, including interest at six percent, and the president resigned as president and director of WHLCI.

RESULTS OF REVIEW

The IA's description of the events and transactions was accurate. The diverted funds were in an account maintained by WHLCI entitled Cash in Bank - Construction. The current president of WHLCI stated about half of the funds in the account was project funds and half was entity funds (donations). Records were not available for us to verify this. The IA audit for the year ended December 31, 1994, reflected a balance of \$50,801 in the account, with no indication the account was anything but project funds.

The current president (formerly the secretary/treasurer) said that he and the rest of the board had not taken sufficient interest in what the president was doing, but they are much more vigilant now. Internal controls for such a small entity, i.e., two signatures on checks and documentation of disbursements, were and are adequate; individuals were just lax in their enforcement. The president said the former president asked for and received board approval to purchase the certificate at a March 1996 board meeting, but did not tell the board he had already purchased the certificate nearly a year before.

The IA detected the tree transactions by obtaining duplicate invoices directly from vendors. He first requested, but did not receive, invoices to support the disbursements from the former WHLCI president. The IA and the secretary/treasurer confronted the former president with their findings. He admitted the transactions, and claimed he intended to reimburse WHLC for the trees, but had forgotten to do so. He said he purchased the certificate to move the funds out of WHLC to prevent HUD from denying future rent increases.

The board asked for the president's resignation and restoration of the diverted funds. On April 2, 1996, the former president resigned, returned the \$20,000 certificate to the board and made restitution in the amount of \$3,783, including payment for the trees, the \$370 early withdrawal penalty on the certificate, and imputed interest on the funds.

Our cursory review of the IA's working papers indicated they support adherence to AICPA and GAO standards. Based on the actions taken by WHLCI, the IA's work, and our review of WHLCI's internal controls, we plan no further work at WHLCI.

However, we believe you should take appropriate administrative action against the former WHLCI president to preclude future participation in HUD programs. The diversions were contrary to disbursement restrictions in the Regulatory Agreement at paragraphs 7(b), 7(d), 11(a), 11(c) and 11(h). These paragraphs prohibit distribution of any income or assets to officers or directors (paragraph 7(d)), and payments for any services, supplies or material for other than project purposes (all other paragraphs). The former president signed the Regulatory Agreement.

24 CFR 24.700 authorizes Multifamily Housing Division Directors to order an LDP for any program participant or contractor based upon adequate evidence of, among other things, irregularities in past performance in a HUD program, and failure to honor contractual obligations. We believe there is need and adequate evidence of these, and perhaps other, causes for you to issue an LDP against the former president.

RECOMMENDATION

1A. We recommend that you issue an LDP for the former president of WHLCI as provided by 24 CFR 24.700.

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Within 60 days, please furnish this office, for the recommendation cited, a status report on: (1) the corrective action taken; (2) the proposed corrective action 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.

Should you or your staff have questions, please call me at (404) 331-3369 or Rudy E. McBee, Assistant District Inspector General for Audit, at (423) 545-4368.

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