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**Audit Memorandum
98-CH-211-1810**

June 2, 1998

MEMORANDUM FOR: Preston A. Pace, Director, Columbus Multifamily Hub, Ohio State
Office

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Burton Plat Apartments
Multifamily Project Operations
Dayton, Ohio

We completed an audit of the operations and management of Burton Plat Apartments. The audit was performed in two phases. Our audit period covered the period of January 1, 1990 through December 31, 1996. Our on-site work was performed from September 1994 to February 1995 for the first phase, and from February 1997 to November 1997 for the follow-up phase. The former Director, Multifamily Division, Cincinnati Area Office requested the audit because management reviews and physical inspections conducted by the Cincinnati Area Office indicated that Burton was making ineligible distributions, Burton's physical condition was deteriorating, and Burton was not complying with other HUD requirements.

Burton Plat is a 42-unit unsubsidized project insured under Section 221(d)(4) of the National Housing Act. Its address is 4533 Frederick Pike, Dayton, Ohio. The original owners signed the Regulatory Agreement on April 20, 1971. The mortgage secured a 40-year loan in the amount of \$535,100. In June 1980, Ridgeview Limited Partnership became owners of Burton Plat. Jerome B. Bohman was the only general partner in the partnership. On April 1, 1993 Jerome B. Bohman and his wife became the sole owners of Burton Plat. Mr. Bohman managed the Project and kept its books. His business address is 1200 Talbott Tower, 131 North Ludlow Street, Dayton, Ohio.

Our audit objective was to determine whether Burton complied with the Regulatory Agreement and other HUD requirements, particularly the provisions related to cash distributions, physical maintenance of the Project, and administrative and financial practices. Our audit included tests of Burton's

compliance with the Regulatory Agreement and HUD requirements. We interviewed HUD's Cincinnati Area Office staff, Burton's General Partner and the principals of its independent public accounting firm. We reviewed the Area Office's inspection reports, monitoring reports, correspondence, and other pertinent information.

We reviewed Burton's cash receipts, all disbursements made from January 1, 1990 through December 31, 1996, and related canceled checks, bank statements, disbursement ledgers, and invoices. We reviewed Burton's independent public accountant's working papers and Burton's financial statements. We also accompanied a HUD staff inspector and a contract inspector on their site inspections.

We concluded that Burton Plat had violated several provisions of the Regulatory Agreement. Specifically, Burton:

- made ineligible distributions totaling \$233,400 when the Project had no surplus cash.
- did not establish a separate bank account for tenant security deposits.
- did not submit audited financial statements as required or submitted them late.
- did not obtain HUD approval for two transfers of physical assets and for rent increases.

The Project's physical condition was deteriorating during the first phase of the audit, but was in satisfactory condition at the end of our follow-up phase.

We presented the draft findings from the first phase of our audit to the General Partner and received written responses. We also held a closing conference with the General Partner on February 2, 1995. We discussed the results of our follow-up phase with the General Partner. He said a closing conference was unnecessary.

On March 21, 1995, we provided a draft report to an Assistant U.S. Attorney in Dayton, Ohio. Because the Project was deteriorating and the owner had made ineligible distributions, we requested that the Assistant U.S. Attorney, as provided in 12 USC 1715z-4a, start actions to recover double the amount of the ineligible distributions, the cost of recovering the damages, and the cost of the audit. However, because of his case load, the Assistant U.S. Attorney was not able to take any actions. Because of the time that had elapsed, we performed a follow-up review of the first audit phase.

In the follow-up review we determined that the General Partner had substantially improved the Project's physical condition between the two audit phases and the Project was in satisfactory condition at the end of the follow-up review. The General Partner continued to make ineligible distributions from the Project and commingle tenant security funds with operating funds. However, the surplus cash deficiency decreased to \$4,700 by the end of the audit period. Burton Plat also did not submit audited financial statements to HUD within 60 days of its fiscal year end and Burton Plat never obtained HUD's approval for the transfer of physical assets and rent increases.

After discussing the matter with the AUSA and staff in HUD's Columbus Multifamily Hub, we do not intend to continue pursuing an equity skimming case under 12 U.S.C. 1715z-4a because at the end of the follow-up review the Project was in satisfactory condition, the General Partner was in the process of making additional improvements, and the nonsurplus cash balance of \$4,700 was not significant. We are recommending that the Columbus Multifamily Hub, Ohio State Office take specific measures requiring Burton to comply with the Regulatory Agreement. We are also recommending that it initiate action to impose civil monetary penalties on Burton because the violations have been long standing and repetitive.

Within 60 days, please provide us a status report for each recommendation in this memorandum. The status report should show (1) the corrective actions taken; (2) any proposed corrective actions and the date to be completed; or (3) why actions are unnecessary. Also please furnish us copies of any correspondence or directives issued because of this audit.

If your staff have any questions, please have them contact me at (312) 353-7832.

RESULTS OF REVIEW

From January 1990 through December 1996, Burton Plat made ineligible distributions totaling \$233,400, when the Project had no surplus cash. Burton also commingled tenant security deposits with operating funds. However, as of December 31, 1996 the surplus cash deficiency was only \$4,700. Most critically, the Project's physical condition was deteriorating during our first audit phase. After the first audit phase, the General Partner made extensive improvements and the Project was in satisfactory condition by the end of our audit. Burton, however, still had not complied with the Regulatory Agreement requirements to submit annual audited financial statements, and to obtain HUD's approval for the transfer of physical assets and for rent increases.

Burton Made Ineligible Distributions

From 1990 through 1996, Burton paid ineligible distributions totaling \$233,400 while it was in a non surplus cash position. The ineligible distributions, made each year, ranged from \$9,600 to \$38,250. The surplus cash deficiency ranged from \$18,100 down to \$4,700 at December 31, 1996, the end of our audit period.

The distributions violated the Regulatory Agreement which states that project owners shall not make, or receive and retain any distribution of the project's assets or any income, except from surplus cash at the end of a semiannual or annual fiscal year. With the exception of surplus cash, project funds must only be used for reasonable operating expenses and necessary repairs.

Although the distributions violated the Regulatory Agreement, the Project's mortgage has never been delinquent and mortgage payments were current as of December 31, 1997. We found no indication that the Project had not been paying its bills. Furthermore, as discussed below, the General Partner had made extensive repairs and the Project was in satisfactory condition. The repairs were also made without using the reserve for replacement account, which was fully funded at \$48,562.

A Separate Account Not Established for Tenant Deposits

As of December 31, 1996, Burton Plat had not established a separate tenant security trust account as required by paragraph 6(g) of the Regulatory Agreement. The amount in its operating account was \$4,847 less than the amount of security deposits tenants had paid to Burton. Tenants had deposited \$14,940, but the operating account had a balance of only \$10,093.

The Project's Physical Condition Was Substantially Improved

The General Partner substantially improved the Project's physical condition between the two audit phases. At the time of the first phase, Burton Plat was severely deteriorating. The estimated cost of repairs exceeded \$55,000. In February 1997, a HUD contract inspector estimated the cost of correcting Housing Quality Standards violations to be \$23,470. We reinspected the Project on November 12, 1997 and by then the most critical Housing Quality Standards violations had been

corrected. The estimated cost of correcting the remaining Housing Quality Standards violations was \$1,820. This estimate included \$1,120 for replacing entry doors, \$550 for replacing cracked and uneven sidewalk sections, and \$150 for caulking.

Between audit phases, the General Partner refurbished and painted apartment interiors. He installed new kitchen appliances and new carpeting. He also made substantial exterior repairs and improvements to correct dangerous violations of HUD's Housing Quality Standards. The General Partner paved the parking lots, replaced a leaning retaining wall, repaired another brick wall adjacent to concrete stairs, and replaced and reinforced rotting wood balconies.

Burton Violated Other Regulatory Agreement Requirements

Burton Plat did not comply with the Regulatory Agreement's requirements regarding the submission to HUD of financial statements, and obtaining HUD's approval for the transfer of physical assets, and rent increases. Burton has constantly failed to submit audited financial statements within 60 days of its fiscal year as required by paragraph 9(e) of the Regulatory Agreement. From 1980 through 1993, Burton only submitted the audit financial statements for fiscal years 1990 and 1991 to HUD. Both of the audited statements were submitted late. After our first audit phase, Burton submitted audited financial statements for fiscal years 1992 through 1994 to HUD. However, it has not yet submitted audited financial statements for fiscal years 1995, 1996, and 1997 to HUD. The failure to submit timely audited financial statements denied HUD its most effective tool in identifying ineligible distributions and other violations of HUD requirements.

In a letter dated November 7, 1997, the Assistant Secretary for Housing-Federal Housing Commissioner informed the General Partner that HUD would seek civil monetary penalties against Burton's owner because audited financial statements for 1995 had not been submitted. On December 23, 1997, the General Partner requested an extension until March 3, 1998 to submit the audited financial statements for fiscal years 1995, 1996, and 1997. On March 18, 1998, a partner of the certified public accounting firm told us the audit would be completed by the end of April 1998.

Burton had not requested HUD's approval for transferring physical assets as required by paragraph 6(a) of the Regulatory Agreement. Ownership of Burton's physical assets had been transferred twice. In 1980, the original owners transferred ownership to Ridgeview Limited Partnership with Jerome B. Bohman as General Partner. In 1993, the physical assets were transferred to Mr. Bohman and his wife as General Partners. Mr. Bohman said he had recently prepared the request for HUD's approval of the transfers of assets, but lost it. On March 19, 1998, he said he was redoing the forms.

The Project increased rents without requesting HUD's permission as required by paragraph 4(a) of the Regulatory Agreement. However, the rents during the first phase were in line with HUD guidelines and appeared to be reasonable for that area of Dayton. We did not evaluate the rents during the second audit phase.

Civil Monetary Penalties May Be Applied

Under 12 USC 1735f-15, the Secretary can impose civil monetary penalties of up to \$25,000 for each knowing and material violation of the Regulatory Agreement. The penalties may be imposed for Regulatory Agreement violations discussed in this memorandum including: making ineligible distributions, failing to deposit tenant security deposits in a separate bank account, failing to submit audited financial statements, and transferring physical assets without HUD approval.

We do not intend to continue pursuing an equity skimming case for several reasons. The nonsurplus cash balance of \$4,700 was not significant. Most importantly, the Project was in satisfactory condition and the General Partner was in the process of making more improvements.

We provided a summary of our follow-up results to the AUSA and the Director of the Multifamily Housing Division, Cincinnati Area Office. They both thought it advisable to drop the equity skimming case and impose civil monetary penalties. The AUSA said that since Burton was now well-maintained and properly financed, it was very doubtful that we could succeed in Federal court. The judge would probably regard it as a “no harm-no foul” situation. He was closing the equity skimming case and suggested we impose administrative remedies. He would consider reopening the case if circumstances change.

We conclude that the civil monetary penalties should be imposed for each of the Regulatory Agreement violations described in this memorandum. The violations have been long standing and repetitive.

Recommendations

We recommend that the Director, Columbus Multifamily Hub, Ohio State Office, assure that the General Partners:

- A. Reimburse the Project for the surplus cash deficiency.
- B. Limit future distributions to the amount of surplus cash available.
- C. Set up a separate tenant trust fund account and fund it to at least cover the amount of all tenant security deposits.
- D. Submit audited financial statements for fiscal years 1995, 1996, and 1997.
- E. Obtain HUD approval for the transfers of physical assets and rents currently being charged.

We also recommend that the Director, Columbus Multifamily Hub, Ohio State Office:

- F. Initiate the process for imposing appropriate civil monetary penalties on the Project as permitted by 12 USC 1735f-15.
- G. Take any other administrative action deemed appropriate, such as temporary denial of participation.

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