



U.S. Department of Housing and Urban Development
Office of District Inspector General for Audit
Capital District
Room 3154
451 7th Street, SW
Washington, DC 20410

**AUDIT MEMORANDUM
NO. 98-AO-211-1805**

September 29, 1998

MEMORANDUM FOR: G. Joann Coats, Director, Multifamily Housing Division, District of Columbia Office, 3GHM

FROM: David J. Niemiec, District Inspector General for Audit, 3GGA

SUBJECT: Multifamily Equity Skimming Review
Heather Hills Apartments
FHA Project Number 000-11155
Temple Hills, MD

We completed a review of the books and records of Heather Hills Apartments, a multifamily housing project insured under Section 207 of the National Housing Act. We conducted the review at the request of the former Director, Multifamily Housing Division, District of Columbia Office. Our objective was to determine whether the project owner used project funds in accordance with the regulatory agreement and other HUD requirements.

To achieve this objective, we reviewed the project's audited financial statements for fiscal years 1991 through 1997 and the general ledger, bank statements, and reserve for replacement account records for fiscal years 1994 through 1997. We also reviewed the Regulatory Agreement, applicable HUD Handbooks, physical inspection reports, HUD's commitment to refinance the mortgage in 1996, and other documentation to determine whether project funds were used in accordance with the Regulatory Agreement and other HUD requirements. In addition, we reviewed the Independent Accountants working papers covering the fiscal year 1997 audited financial statements. We discussed the audit with staff from HUD, Tarragon Realty Advisors, Inc., and the Independent Accountant, as necessary. The audit covered the period January 1, 1991 through December 31, 1997.

We determined that Tarragon Realty Advisors, Inc., violated paragraph 6(b) of the Regulatory Agreement by withdrawing \$274,123 in project funds while the project was in a nonsurplus cash position. Paragraph 6(b) specifically prohibits the use of project funds for any purpose other than paying reasonable operating expenses and necessary repairs when the project is in a nonsurplus cash position. During 1997, unauthorized distributions to the general partner

totaled \$274,123. However, because total current obligations exceeded total cash by \$189,703, only that amount should be returned to the project.

The unauthorized cash distributions were made because management's accounting practices allowed the commingling of funds from the Heather Hills project with funds from nonHUD properties. The accounting procedures provided that, from the first through the tenth of the month, project cash account balances exceeding \$5,000 were withdrawn from all projects, deposited into one account, and used to pay operating expenses. From the eleventh to the end of the month, a minimum balance of \$2,500 was maintained. After operating expenses were paid, the remaining balance was used to pay the owner's expenses or was distributed to the owner. Heather Hills is the only HUD project among the 46 projects involved, and the same accounting practices were used for all projects. This practice violates paragraph 6(e) of the Regulatory Agreement which states that distributions can only be made semiannually or annually. They are not to be made monthly.

Finally, the tenant security deposits account was not funded at December 31, 1997. In response to the Independent Accountant's 1997 audit, management agreed to fund the securities deposit account as deposits are collected from new tenants. However, the corrective action does not resolve the deficiency. To comply with the regulatory agreement, the tenant security deposits account must be fully funded.

We discussed these issues with Tarragon Realty Advisors, Inc., staff during our field work. We recommended that Tarragon Realty revise its accounting procedures so that funds from Heather Hills' accounts are not commingled with those of other projects and that the owner repay \$189,703 to the project accounts for the unauthorized distributions taken. We also recommended that the owner fully fund the tenants' securities deposit account.

The Chief Financial Officer, Tarragon Realty Advisors, Inc., provided written comments on September 15, and again on September 18, 1998. He said that they had adopted our recommendations to revise their cash management procedures and to fully fund the tenants' securities deposit account. He added that Heather Hills is now in a surplus cash position and that the project should not be repaid. Based on the documentation provided by the Chief Financial Officer, we concur with these actions.

We recommend that you monitor cash management practices at Heather Hills and review the 1998 audited financial statements to determine whether the project is in a surplus cash position. If the project is in a nonsurplus cash position, then we recommend that you require the owner to repay the project the amount of the surplus cash deficiency cited on line c of the Surplus Cash report. If the owner does not repay the funds or fails to respond within 30 days of your notice, pursue appropriate administrative sanctions and/or referral to the HUD Enforcement Center or the United States Attorney for consideration of litigation.