



**U.S. Department of Housing and Urban  
Development, Washington, DC**

**Owner Advances and Distributions in  
Multifamily Housing Programs**



Issue Date: September 17, 2014

Audit Report Number: 2014-KC-0003

TO: Nancie-Ann Bodell, Acting Director of Asset Management and Portfolio Oversight, Office of Multifamily Housing Programs, HT

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: HUD Did Not Always Enforce the Requirements of the Regulatory Agreements and HUD Handbooks Pertaining to Owner Advances and Distributions

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of owner distributions and advances in multifamily housing programs.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



September 17, 2014

## **HUD Did Not Always Enforce the Requirements of the Regulatory Agreements and HUD Handbooks Pertaining to Owner Advances and Distributions**

# **Highlights**

Audit Report 2014-KC-0003

### **What We Audited and Why**

We selected the U.S. Department of Housing and Urban Development (HUD), Office of Multifamily Housing Programs, for audit based on an internal audit suggestion expressing concern that multifamily property owners took unauthorized distributions or owner advances with no consequence. Our audit objective was to determine whether HUD enforced the requirements of the regulatory agreements and HUD handbooks that pertain to owner advances and distributions.

### **What We Recommend**

We recommend that the Acting Director of the Office of Asset Management and Portfolio Oversight provide guidance to multifamily property owners on the requirements of HUD Handbook 4370.1, chapter 2, and regulatory agreements to ensure that distributions are taken only from available surplus cash. In addition, we recommend that the Acting Director develop and implement detailed operational procedures to ensure the repayment of unauthorized distributions and owner advances and for the pursuit of civil money penalties for owners with a pattern of unauthorized distributions or owner advances.

### **What We Found**

HUD did not always enforce the requirements of the regulatory agreements and HUD handbooks pertaining to owner advances and distributions. Of the 54 property owners reviewed, 10 had unauthorized distributions or owner advances that were not required to be repaid. This condition occurred because HUD treated the repayment requirement as a book-keeping correction. Additionally, HUD lacked detailed procedures for implementing HUD Handbook 4370.1, chapter 2.

# TABLE OF CONTENTS

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Background and Objective	3
Results of Audit	
Finding: HUD Did Not Always Enforce the Requirements of the Regulatory Agreements and HUD Handbooks Pertaining to Owner Advances and Distributions	4
Scope and Methodology	7
Internal Controls	8
Appendixes	
A.    Auditee Comments and OIG's Evaluation	9
B.    Criteria	12

## BACKGROUND AND OBJECTIVES

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The U.S. Department of Housing and Urban Development's (HUD), Office of Multifamily Housing Programs, is responsible for the overall management, development, direction, and administration of HUD's multifamily housing programs. Within the Office of Multifamily Housing Programs is the Office of Asset Management and Portfolio Oversight, which is responsible for oversight of multifamily project assets after their development. This office is also responsible for oversight of regulated property ownership and management, routine mortgage servicing, default servicing, acquisition and disposition of loans and properties, and management of properties of which the HUD Secretary is owner or "mortgagee in possession." It serves as the multifamily housing liaison with the Real Estate Assessment Center and the Departmental Enforcement Center and oversees field office and lender servicing activities for HUD-involved properties.

The Policy and Participation Standards Division, under the Office of Asset Management and Portfolio Oversight, is responsible for the development of policy for asset management and disposition through the drafting of regulations, handbooks, and notices to implement law and program policy. The National Housing Act, as amended, and the program regulations are found in 24 CFR (Code of Federal Regulations) Part 241. The National Housing Act authorized Federal Housing Administration (FHA) insurance for mortgage loans to multifamily rental housing and health care facilities. It insures lenders against loss on mortgage defaults and is intended to keep the project competitive, extend its economic life, and finance the replacement of obsolete equipment. The basic instructions are in HUD Handbook 4585.1 and are administered by the Office of Multifamily Housing Development.

HUD Handbook 4370.1, chapter 2, sets forth the policy on owner distributions and advances. A distribution is any withdrawal or taking of cash or any assets of the project other than for the payment of reasonable expenses necessary for the operation and maintenance of the project. Distributions paid in excess of surplus cash or in excess of the amount earned the previous fiscal year plus any distributions unpaid from previous years must be refunded to the project.

The Departmental Enforcement Center establishes general policies, procedures, and guidelines to be followed by its staff charged with enforcing statutory and regulatory requirements governing multifamily properties while processing financial referrals. These policies and procedures cover enforcement procedural requirements, such as issuing a notice of violation and the applicable timeframes, and reference the various available sanctions, such as debarments and civil money penalties, and their applicability. The Departmental Enforcement Center may pursue foreclosure, civil money penalties, double damages, or various other remedies when program violations have occurred. The Departmental Enforcement Center reviews compliance flags pertaining to owner advances and unauthorized distributions that are greater than \$10,000. If the amount is less than \$10,000, then the responsible HUD field office reviews the compliance flag.

Our audit objective was to determine whether HUD enforced the requirements of the regulatory agreements and HUD handbooks that pertain to owner advances and distributions.

## RESULTS OF AUDIT

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### Finding 1: HUD Did Not Always Enforce the Requirements of the Regulatory Agreements and HUD Handbooks Pertaining to Owner Advances and Distributions

HUD did not always enforce the requirements of the regulatory agreements and HUD handbooks pertaining to owner advances and distributions when it allowed 10 of the 54 property owners we reviewed to take more than \$1.2 million in unauthorized distributions without requiring the owners to repay the money. This condition occurred because HUD treated the repayment requirement as a book-keeping exercise. Additionally, HUD lacked detailed procedures for implementing HUD Handbook 4310.1, chapter 2. As a result, the FHA insurance fund was put at greater risk of paying a claim.

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#### **HUD Did Not Always Enforce Regulatory Agreements and HUD Handbooks**

HUD did not always enforce the requirements of the property regulatory agreements and HUD Handbook 4310.1, chapter 2, when it allowed 10 of the 54 property owners reviewed to take more than \$1.2 million in unauthorized distributions without requiring the owners to repay the money. Of the 10 property owners who took an unauthorized distribution, 5 exceeded available surplus cash and took distributions totaling over \$1 million, and 5 were in a negative-surplus-cash position and took distributions totaling \$196,540. HUD did not pursue enforcement tools for any of the 10 property owners.

The Departmental Enforcement Center required 1 of the 10 property owners to repay an unauthorized distribution in 2010 and warned the owner not to exceed available surplus cash in the future. However, the property owner's \$9,204 unauthorized distribution in 2012 did not meet the Departmental Enforcement Center's referral threshold of \$10,000, and the responsible HUD field office did not require the owner to repay the \$9,204 distribution. Furthermore, the responsible HUD field office did not seek enforcement actions against the property owner, which had established a pattern of taking unauthorized distributions.

**Unauthorized distribution by property**

<b>Property identifier</b>	<b>Distribution exceeding prior year surplus cash</b>	<b>Distribution with prior year negative surplus cash</b>	<b>Unauthorized distribution following a warning</b>
<b>A</b>		<b>\$4,950</b>	
<b>B</b>	<b>\$3,162</b>		
<b>C</b>	<b>\$26,477</b>		
<b>D</b>	<b>\$10,561</b>		
<b>E</b>		<b>\$9,204</b>	<b>\$9,204**</b>
<b>F</b>		<b>\$14,000</b>	
<b>G</b>		<b>\$148,386</b>	
<b>H</b>	<b>\$422,496</b>		
<b>I</b>		<b>\$20,000</b>	
<b>J</b>	<b>\$631,754</b>		
<b>Total</b>	<b>\$1,094,450</b>	<b>\$196,540*</b>	<b>\$9,204*</b>

\*The \$196,540 includes the \$9,204

\*\*The Departmental Enforcement Center issued a warning letter after a 2010 unauthorized distribution, but the HUD field office handled the 2012 unauthorized distribution because it was below the Departmental Enforcement Center’s referral threshold of \$10,000.

HUD did not require the unauthorized distributions to be repaid for any of the 10 properties with an unauthorized distribution compliance flag. HUD regulatory agreements state that owners may take a distribution only from available surplus cash. HUD Handbook 4370.1, chapter 2, part 25, states that surplus cash calculated at the end of one fiscal period is not available for distribution until the next fiscal period. HUD Handbook 4370.1, chapter 2, part 23, states that distributions made in excess of available surplus cash must be repaid to the property.

**HUD Viewed the Requirement as a Book-Keeping Exercise and Lacked Detailed Procedures**

HUD viewed the requirement for the repayment of the unauthorized distributions as a book-keeping exercise. The 10 properties ended the fiscal period with surplus cash in each instance in which an unauthorized distribution was taken. HUD stated that since surplus cash existed after the distribution, repayment of the unauthorized distribution would serve only to increase the amount of surplus cash available, and, therefore, the property owners could rightfully take the distribution the next fiscal period. Thus, requiring repayment was a book-keeping exercise, and the distribution did not need to be returned. However, the regulatory agreement and HUD Handbook 4370.1, chapter 2, do not allow for advances of surplus cash.

Further, HUD did not have detailed procedures in place to implement the requirements of HUD Handbook 4370.1, chapter 2, which states that unauthorized distributions must be returned to the property.

In addition, HUD Handbook 4370.1, chapter 2, part 24, states that owners who take a distribution when the project is in a negative-surplus-cash position are subject to civil or criminal penalties. The Departmental Enforcement Center warned the owners of property E in 2010 not to take unauthorized distributions and required the owner to return the 2010 unauthorized distribution. However, the responsible HUD field office did not have procedures to detail how to implement the enforcement actions set forth in the Handbook and pursue a civil money penalty against the owner of property E when it violated the regulatory agreement and took another unauthorized distribution in 2012.

### **FHA's Insurance Fund Was Put at Greater Risk**

As a result of the issues discussed above, the FHA insurance fund was put at a greater risk of paying a claim. This practice of allowing properties to take advances of surplus cash put the property at risk of potentially ending a fiscal period with negative surplus cash and eventually resulting in a default or claim.

### **Recommendations**

We recommend the Acting Director of the Office of Asset Management and Portfolio Oversight

- 1A. Provide guidance to multifamily property owners on the requirements of HUD Handbook 4370.1, chapter 2, and regulatory agreements to ensure that distributions are taken only from available surplus cash.
- 1B. Develop and implement detailed operational procedures to ensure the repayment of unauthorized distributions and owner advances that are not referred to the Departmental Enforcement Center under existing protocol, including the pursuit of civil money penalties and other administrative procedures for owners with a pattern of unauthorized distributions or advances.

## SCOPE AND METHODOLOGY

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Our review period generally covered financial statements from January 1, 2010, through December 31, 2013. We conducted the audit from our office in Kansas City, KS, from February through July 2014.

To accomplish our objective, we

- Interviewed HUD staff;
- Reviewed applicable Federal regulations, HUD handbooks, and regulatory agreements;
- Selected a statistical sample of FHA-insured multifamily properties that received an auditor or system-generated compliance flag for unauthorized distribution or owner advances and reviewed the property financial statements; and
- Reviewed HUD, Departmental Enforcement Center, and auditor comments to the financial statements to determine how the compliance flag was resolved.

We selected a statistical sample from a universe of 5,785 FHA-insured multifamily properties that received a compliance flag between January 1, 2011, and December 31, 2013, for an unauthorized distribution or owner advance. The compliance flags were generated during the annual audit or when the Financial Assessment Subsystem (FASS) automatically generated a system compliance flag. We drew the universe from multiple HUD systems, including (1) FASS – Multifamily, (2) the Integrated Real Estate Management System (iREMS), (3) the Housing Enterprise Real Estate Management System, and (4) the Online Property Integrated Information Suite Data Mart.

From the 5,785 properties, we selected a statistical sample of 95 properties for our review; however, we were able to reach a conclusion after reviewing 54 properties in the statistical sample. Therefore, we did not review the remaining 41. We found issues with 10 of the 54 properties that we reviewed (see finding). The compliance flags for the other 44 properties were either false positives or were properly resolved by the Departmental Enforcement Center or HUD multifamily field office.

We accessed iREMS to obtain property financial statements and HUD comments for the year in which the property received the compliance flag. During our review, we used iREMS to verify the reliability of our computer-processed data. Although we did not perform a detailed assessment of the reliability of the data, we determined that the computer-processed data were sufficiently reliable to be used in meeting our objective because the data in the sampled items were corroborated by documentary evidence available in iREMS.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Controls over repayments of unauthorized distributions.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

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

- HUD lacked detailed operational procedures to implement the required repayment of unauthorized distributions.

# APPENDIXES

## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

	<p>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, DC 20410-8000</p>
OFFICE OF HOUSING	SEP 11 2014
MEMORANDUM FOR:	Ronald J. Hosking, Regional Inspector General for Audit, 7AGA, Lisa Sweeney, Assistant Regional Inspector General for Audit, 7AGA
FROM:	 Nancie-Ann Bodell, Acting Director of Asset Management and Portfolio Oversight, Office of Multifamily Housing Programs, HT
SUBJECT:	Draft Audit Report – HUD Did Not Always Enforce the Requirements of the Regulatory Agreements and HUD Handbooks Pertaining to Owner Advances and Distributions
<p>This memorandum provides comments on the subject draft report. Because the final audit report, once issued, becomes a public document, and our response to recommendations will be dealing with some internal control issues, we will communicate separately our specific plans in the proposed management decision following issuance of the final audit report. Thank you for meeting with us on August 28, 2014, at the Exit Conference and the opportunity to comment on the draft audit report. The goal of our comments would be to enhance our use of your audit work.</p>	
<p>As was mentioned during the Exit Conference please note and make the following changes to your report:</p>	
Comment 1	<ul style="list-style-type: none"><li>• The Office of Asset Management is now the Office of Asset Management and Portfolio Oversight (OAMPO).</li></ul>
Comment 2	<ul style="list-style-type: none"><li>• On page 5 of the draft, please change the header in the table in column 3 from "Distribution with negative surplus cash" to "Distribution with negative surplus cash from prior year."</li></ul>
Comment 3	<ul style="list-style-type: none"><li>• On page 5 of the draft, property identifier 5 in column 4 showing \$9,204 unauthorized distribution needs to be footnoted and the related discussion enhanced to more fully discuss the issue that this distribution was a second instance following DEC involvement because it was below the DEC referral threshold of \$10,000.</li></ul>
Comment 4	<ul style="list-style-type: none"><li>• In the report discussion of the current practice of referrals to the DEC for the problem of owner advances in excess of \$10,000 does not exist. Consequently, the report gives the impression as is discussed on the bottom of page 5, "HUD did not have detailed procedures in place to implement the requirements of HUD Handbook 4370.1, Chapter 2, which states that unauthorized distributions must be returned to the property." Including a reference to the existing DEC referral procedures would clarify the issue and also provide anyone reading your report with the knowledge that the referral practice exists as managed by the DEC. OAMPO holds this practice to be an important deterrent.</li></ul>

**Comment 5**

With respect to the wording of the recommendations, OAMPO suggests 1B and 1C be combined into one recommendation to read, "The OAMPO should develop and implement detailed operational procedures to ensure the repayment of unauthorized distributions and owner advances that are not referred to the DEC under existing protocol, including the pursuit of civil money penalties and other administrative procedures for owners with a pattern of unauthorized distributions or advances." Allowing this change in wording will enable OAMPO to develop a more targeted management plan to implement the issue identified by your audit.

### **OIG Evaluation of Auditee Comments**

- Comment 1** We changed all references to the Office of Asset Management to the Office of Asset Management and Portfolio Oversight.
- Comment 2** We changed the column header to clarify that the unauthorized distribution was taken after a year in which the property had negative surplus cash.
- Comment 3** We added a footnote to the table and detail in the related discussion to explain that the Departmental Enforcement Center required repayment of the first unauthorized distribution and issued a warning letter, but that the second unauthorized distribution was not referred to the Departmental Enforcement Center because the amount was less than \$10,000, and the HUD field office did not require repayment of the second unauthorized distribution.
- Comment 4** We discussed the requirement to refer distributions over \$10,000 to the Department Enforcement Center in the background section on page 3 of the report.
- Comment 5** We combined the recommendations into one to allow for your more targeted management plan, ensuring the Office of Asset Management and Portfolio Oversight implements procedures to ensure repayment of unauthorized distributions and owner advances and pursuit of civil money penalties in the future.

## Appendix B

### CRITERIA

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#### **HUD Handbook 4370.1, REV-2 – Reviewing Annual and Monthly Financial Reports, Chapter 2**

Exhibit 2-14, Part C3

If distributions were paid in excess of surplus cash or in excess of the amount earned the previous fiscal year plus any distributions unpaid from previous years, the excess must be refunded to the project.

Section 2-25, Part A

Owners who take distributions when the mortgage note is in default or when the project is in a non-surplus-cash position are subject to civil or criminal penalties.

#### **HUD Regulatory Agreements**

The requirement is generally found in Section 6 but can vary depending on the regulatory agreement for each property.

6. Owners shall not without the prior written approval of the Secretary:

- (e) Make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except on the following conditions:
  - (1) All distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by the law of the applicable jurisdiction.