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SAMPLE LETTER TRANSMITTING RESULTS OF FINANCIAL STATEMENT  
REVIEW TO PROJECT OWNER

Mr. Maurice B. Lenez, Owner  
Broken Arms Apartments  
Street Address of Owner  
City, State, Zip

Dear Mr. Lenez:

Subject: Project Number  
Broken Arms Apartments

We have recently completed a review of the Annual Financial Statements of Broken Arms Apartments for the period ending December 31, 1990. Based upon the results of our review, we have found certain conditions which are not in accordance with HUD directives. The specific conditions along with the appropriate corrective actions are defined below.

Finding 1. The auditor reported that the Residual Receipts generated by the project's FY 1989 operations were not deposited with the project's mortgagee within sixty days of the end of the project's fiscal year, as is required by the Regulatory Agreement between the owner and this Department. Our review of the Statements indicates that the 1989 funds have never been deposited. The owner has indicated that Residual Receipts funds were retained in order to make the project's mortgage payments.

Corrective Action Required. Our computation of the project's Residual Receipts for the fiscal year ended December 1989 indicates that a deposit of \$27,100 was due. These funds must be deposited with the mortgagee at the time and the owner must furnish to this office, within 30 days, written verification that this deposit has been made. Verification may consist of a copy of a certified check for the total. You are advised that the Regulatory Agreement does not authorize the owner to retain Residual Receipts for any purpose. All required Residual Receipts funds must be deposited and may be released only with the approval of HUD for selected necessary purposes.

Finding 2. The author's internal control review revealed that the tenant certifications, recertifications, and income verifications associated with the project's subsidy program are not all being performed as required under the terms of the Regulatory Agreement. Certifications and income verifications are required for all tenants at inception of occupancy and annually or biannually thereafter.

Corrective Action Required. Bring required certifications and income verifications current for all tenants within 60 days and thereafter maintain tenant records in accordance with the program requirements. To ensure that the work is being performed correctly and on schedule, we will schedule an on-site Occupancy Review in approximately 60 days.

Finding 3. The auditor's internal control review revealed that project ledger accounts are not being posted on a monthly basis, in accordance with the requirements of HUD Handbook 4370.2. The owner indicated that the project's bookkeeper was being trained to perform this function properly.

Corrective Action Required. Bring postings current within 30 days and perform postings monthly thereafter. Ensure that all financial and accounting requirements are fulfilled. If project staff is not currently capable of performing the functions, the owner should make other arrangements to ensure that all posting is performed monthly and financial records are properly maintained.

Finding 4. The December 31, 1990 Balance Sheet and Note 9 to the Financial Statements indicate that the owner has committed the project to a long-term note in the principal amount of \$44,000, for an unspecified purpose. The Statement of Income and the Statement of Cash Flows identify that project funds in the amount of \$6,500 have been obligated and disbursed for interest on this obligation during the fiscal year. The project's Regulatory Agreement stipulates that the owner may not, without prior HUD approval, incur any liability other than for current operating expenses. HUD has not approved the incurrence of this liability, nor its repayment from project funds.

Corrective Action Required. Advise this office of the purpose for which the liability was incurred, in order that a determination may be made concerning its appropriateness to the project's needs. If it is not determined that the funds were required for a legitimate and essential project need, we may approve the liability and the retirement of the note with project funds. Until such a determination is made, additional project funds may not be used to repay this obligation or the interest thereon. If it is determined that the obligation was not incurred for an appropriate project purpose, the mortgagor will be required to restore to the project funds already paid against the obligation.

Finding 5. The permitted management fee for the project is 5 percent of gross collections, as defined in the Management Agreement. Based on receipts of \$307,000, according to the Statement of Cash Flows, the allowable fee for 1990 is \$15,350. In addition, a fee was payable from

prior years in the amount of \$1,800, for a total allowable fee to be taken of \$17,150. The management fee expensed for the year on the Statement of Income is \$20,600; fees have been paid during the year totaling \$18,510, and the Balance Sheet shows a management fee payable at year's end of \$1,550. Hence, excessive management fees have been accrued and paid for the fiscal year.

Corrective Action Required. Restore to the project the excess fee of \$1,360 already paid to the management agent (i.e., \$18,510 - \$15,350 - \$1,800) and remove the \$1,500 management fee payable carried on the Balance Sheet. The total fee allowed to be paid during the year is the \$15,350 earned plus the \$1,800 prior year payable. Evidence shall be furnished to this office that the \$1,360 has been restored to the project and the payable reversed.

Finding 6. The financial statements reveal an apparent discrepancy between rents accrued and rents collected. According to the Statement of Income, the project accrued tenant rental charges of \$288,800, exclusive of Rent Supplement charges of \$52,200, less vacancies of \$34,000, for net collectible rent from the tenants of \$254,800 for the year. The Statement of Cash Flows indicates that \$254,800 was collected from tenants, 100 percent of the accrual. However, according to the Balance Sheet, tenant receivables at year's end totaled \$4,600, an increase of \$700 over the prior year. This indicates that charges have actually been accrued in the amount of \$255,500.

Corrective Action Required. Clarify the discrepancy described and furnish a summary of rental charges accrued to the tenants for fiscal year 1990. If the discrepancy cannot be resolved in this manner, further corrective actions may be necessary.

Finding 7. The fiscal year end Balance Sheet indicates a security deposit account balance of \$4,600 and a security deposit liability of \$4,750. The project's Regulatory Agreement requires that the balance in the security deposit trust account shall at all times equal or exceed the total outstanding security deposit liability.

Corrective Action Required. Immediately fund the security deposit trust account to the current level of liability and provide confirmation of the funding to this office. The account must be kept fully funded at all times, as security deposit funds belong not to the project but to the tenants.

Finding 8. The project owner has taken unauthorized distributions from project funds during the fiscal year. Sponsor dividends of \$26,950 were taken during the fiscal year when the prior year's remaining liability totaled only \$8,000. No further dividends beyond the \$8,000 were eligible

until after the 1990 books had been closed and surplus cash determined. Surplus cash computations for fiscal years 1989 and 1990 reveal that a portion of the \$26,950 was ultimately earned and available for distribution, but that a portion must be returned:

	1989	1990
12/31 surplus cash at end of prior fiscal year	\$35,100	\$1,800
Distribution earned during FY	14,800	14,800
Distribution unpaid from prior FY	0	8,000
Distribution paid during FY	6,800	26,950
Distribution payable 12/31	8,000	(4,150)
Available for distribution next FY	8,000	0
Residual Receipts deposit required	27,100	5,950

The 1990 Statements indicate no deposit to Residual Receipts was made for 1989.

Corrective Action Required. Deposit in the Residual Receipts account \$33,050 for fiscal year 1989 and 1990 and provide verification that this deposit has been made. The mortgagor is advised that distributions may be taken only after the end of the fiscal year and only from surplus cash then available.

Finding 9. The Balance Sheet and Note 2 to the Financial Statements indicate that the project owner took a loan of \$15,000 from project funds during the fiscal year. The project's Regulatory Agreement prohibits the owner from using project funds for any purpose not related and essential to the operation of the project.

Corrective Action Required. Immediately return the \$15,000 loan to the project account at this time and furnish evidence that this restoration has been accomplished. Evidence may be in the form of a copy of a certified check payable to the project.

Finding 10. As of the fiscal year closing date, the project had sufficient funds to meet its anticipated month-to-month expenses and mortgage payments. However, the project is in moderate danger of experiencing financial problems because of several key facts of operation during the fiscal year. Project rents are established to generate sufficient income to meet normal operating costs and debt service requirements with a 5 percent vacancy and bad debts factor. During fiscal year 1990, the project's vacancy and bad debt loss totaled \$34,250 - i.e., greater than 10 percent of its potential gross income. This higher than expected vacancy and collection loss resulted in an operating deficit. Similarly, project cash needs totaled \$359,020, while the rents were established to provide

for needs of \$341,000 at 100 percent occupancy and \$323,950 at 95 percent occupancy. With a 10 percent plus bad debt and vacancy loss the project

accrued income of only \$307,000, \$52,000 below its actual cash expenditures for the year. The project's two year trend is toward a worsening financial position.

Corrective Action Suggested. In order to improve the project's cash position and ensure future solvency, it is necessary that the owner reduce the vacancy and bad debt loss to within the levels assumed by HUD in rental processing, and analyze project expense to determine if they can be reduced or if a rental increase request is necessary so that project income, at 95 percent occupancy and collection, can support project expenses. If current vacancy factors are due not to project performance, but to market conditions, plans should be proposed to improve project marketability.

Finding 11. Certain project expenses appear unreasonable in terms of the project's fiscal year performance:

- (1) While actual project income decreased \$32,800 from fiscal year 1989 to 1990, due to a vacancy rate increase from .2 percent to 9.9 percent, at the same time the project office staff salaries increased by 50 percent and advertising and leasing expenses remained stable. While an increase in advertising/leasing expense would have appeared warranted, the 50 percent increase in office salaries does not appear justified and did not appear to produce results. We are not aware of any special leasing/outreach efforts undertaken, tenant files are incomplete, and recertifications are past due.
- (2) The Statement of Income for 1989 and 1990 indicate that \$21,000 was incurred for project repairs done by an outside contractor. However, on-site operating and maintenance staff costs did not decrease appreciably in 1990, which suggests that excessive staff may have been employed that year. The HUD Physical Inspection Report of June 1990 did not note any improvement in maintenance conditions nor that project deterioration noted previously had been turned around. In light of the 1990 performance, the office staff and maintenance/operating staff payroll expenses appear excessive.

Corrective Action. Provide breakdown of 1990 office salaries expense and explain 50 percent increase in that line item. Excessive project staffing expenses, as identified above, should be reduced so that only necessary costs are incurred. If contracted repairs are to be continued, project staff should be reduced accordingly to control the overall repair cost. All personnel should be reviewed to ensure that each is performing acceptably those tasks for which employed and that the staff size is appropriate for the

work to be accomplished. The owner is requested to provide this office the results of the review of these excessive costs and a plan for correction.

Finding 12. The project's overall administrative costs are excessive when compared to costs of similar projects and when viewed as a percentage of total income. The excessiveness is due primarily to the staff costs discussed above and to audit costs, which doubled from 1989 to 1990.

Corrective Action. The owner should review with the auditor the reasons for the large increase in fees over a one year period. If the auditor incurred additional work in 1990 because the project books were not in auditable conditions, the owner should repay the project for that portion of the audit fees which were thereby incurred. The owner, operating through the Agent, is responsible for maintaining project books and records in proper condition for audit.

Within thirty days from the date of this letter, please advise us of the actions you have taken with respect to each of the items noted above. If you have any questions, please contact \_\_\_\_\_ in the Loan Management Branch at 000-0000.

Sincerely,

Chief

cc: Management Agent