



U.S. Department of Housing and Urban Development
Office of Inspector General for Audit
Great Plains Region, 7AGA
Gateway Tower II - 5th Floor
400 State Avenue
Kansas City, Kansas 66101-2406

MEMORANDUM NO: 2004-KC-0803

March 4, 2004

MEMORANDUM FOR: Herman Ransom, Director, Office of Multifamily Housing, 7AHM

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

SUBJECT: Owner's Salary
Timberlake Care Center
Section 232 Nursing Home Review
Kansas City, Missouri

INTRODUCTION

We have completed an audit of Timberlake Care Center, a Section 232 Nursing Home located in Kansas City, Missouri. We selected the project based on an audit request from your office that indicated there were unallowable disbursements from project funds. Our overall audit objective was to determine if the owner/management agent used project funds in accordance with applicable requirements. Our office is issuing an audit report, 2004-KC-1002, containing two findings that address the overall objective.

During the course of our audit, we determined that the owner of Timberlake Care Center was receiving a salary from the property. We did not take exception to this in our audit report because HUD had previously approved the salary. However, it appears this salary may not be a reasonable and necessary operating expense of the project. Therefore, we believe you should re-evaluate the appropriateness of paying the owner a salary from operating funds.

METHODOLOGY AND SCOPE

During our audit, we interviewed HUD program staff to obtain background information on the project, and to obtain more details related to the Office of Housing's audit request. We interviewed the project's owner and management staff to gain an understanding of the staff's responsibilities and operational processes. To determine whether project funds were used in accordance with applicable requirements, we reviewed HUD project files for background information, including the Regulatory Agreement, Management Certification, and Management Review performed by HUD on July 30, 2003. The audit covered the period from August 15,

2001, the date Timberlake Care Center obtained the HUD-insured mortgage, through May 31, 2003.

BACKGROUND

Mission Lake Convalescent Center, Inc. owns and operates a 150-bed licensed nursing facility doing business as Timberlake Care Center in Kansas City, Missouri. The project is financed with a mortgage loan insured by the U.S. Department of Housing and Urban Development (HUD), under Section 232 of the National Housing Act. The mortgage was endorsed on August 16, 2001. Timberlake Care Center is an owner-managed property.

RESULTS OF REVIEW

During our audit, we found that the owner was receiving a substantial salary from the property. We did not take exception to this in our audit report since HUD had previously approved the salary. However, the salary may not be reasonable and necessary because the project's administrator performs many of the normal management functions. During our review, we found no indication that the owner was performing any significant management functions that were reasonable and necessary to the operations of the project. HUD approved the salary during the loan origination process. Paying the owner a salary out of operating funds has further contributed to this project's negative surplus cash position.

Timberlake Care Center's Regulatory Agreement with HUD states that "Owners shall not without the prior written approval of the Secretary... b) assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs... 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...."

HUD originally approved payment of the owner's salary as part of the FHA loan application package. Timberlake Care Center included, on HUD Form 9839-A, Project Owner's Certification for Owner-Managed Multifamily Housing Projects, a statement that "This is an owner-managed project and the owners do not take a management fee. The owners are paid a monthly salary as indicated on "salaries charged to the project" which is under tab 52 of the application package." Tab 52 of the application package indicates that the owner was receiving an annual salary of \$150,675.98 at the time the HUD insured loan was endorsed. We found no indication that HUD evaluated the management duties of the owner prior to approving the salary. HUD's current staff was not aware that the salary had been approved.

The Regulatory Agreement is written to provide owners with an incentive to effectively manage a project and maximize its profits. This occurs, in part, by only allowing owners to take distributions from available surplus cash. If the owner does not perform functions that justify receiving a salary, paying that salary circumvents the intention of the regulatory agreement. In this case, HUD needs to evaluate whether the owner is performing duties that justify receiving a salary and then either disallow the salary or determine an appropriate amount to allow.

AUDITEE COMMENTS

The following is an excerpt of the comments provided by HUD. See attachment 2 for the complete text of this response.

HUD intends to compare the owner's salary to other salaries and management fees at other HUD insured nursing homes in order to evaluate the appropriateness of paying the owner such a substantial salary. HUD also intends to review monthly accounting reports to ensure Project Operating Income is only being used for reasonable and necessary operating expenses for the property, and review the Annual Financial Statement that is due to HUD on August 30, 2004. After reviewing all of the above information, HUD intends to issue a decision by September 30, 2004 on whether or not to pursue changes in regard to the owner's salary.

OIG EVALUATION OF AUDITEE COMMENTS

HUD's completion of its planned reviews should ensure that an appropriate decision on whether or not to pursue changes in regard to the owner's salary is made. HUD has provided sufficient information for a management decision; therefore, we have input September 30, 2004 as the planned final action date for both of the recommendations in the Department's Audit Resolution and Corrective Action Tracking System.

RECOMMENDATIONS

We recommend the Director, Office of Multifamily Housing, Kansas City Hub:

- 1A. Identify the management duties performed by the project owner and determine the appropriate amount of salary the owner should receive from operating funds for performing those duties.
- 1B. Restrict the amount paid for the owner's salary to the amount determined in Recommendation 1A.

Attachment 1**Schedule of Questioned Costs and Funds Put to Better Use**

<u>Recommendation Number</u>	<u>Type of Questioned Cost</u>		<u>Funds Put to Better Use 3/</u>
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	
1A		\$150,000	

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.
- 2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.
- 3/ Funds Put to Better Use are costs that will not be expended in the future if our recommendations are implemented.

Attachment 2**Auditee Comments/Management Decision****U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****KANSAS CITY MULTIFAMILY HUB**

Gateway Tower II, Room 300

400 State Avenue

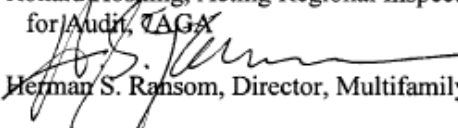
Kansas City, KS 66101-2406

HUD Home Page: www.hud.gov

February 26, 2004

Iowa, Kansas, Missouri,
Nebraska and Oklahoma

MEMORANDUM FOR: Ronald Hosking, Acting Regional Inspector General
for Audit, TAGA

FROM: 
Herman S. Ransom, Director, Multifamily Housing, 7AHM

SUBJECT: **Timberlake Care Center, Project Number 084-22004**

We are writing in response to the memorandum dated February 4, 2004 regarding the owner's salary for subject property and whether this salary is a reasonable and necessary operating expense.

During the loan application, the owner chose to take a salary instead of a management fee. We realized that his choice of taking a salary did not go without saying there should be responsibilities identified in order for the salary to be considered a reasonable project operating expense. In order to evaluate the appropriateness of paying the owner such a substantial salary, we intend to compare his salary to other salaries and management fees at other HUD insured nursing homes. We have received the position descriptions for both the owner and the administrator and intend to review these to determine if the salary is justified.

Due to the negative surplus cash for the past two years on the Annual Financial Statements, we intend to continue to review monthly accounting reports that are submitted to ensure Project Operating Income is only being used for reasonable and necessary operating expenses for the property.

Finally, we will review the Annual Financial Statement that is due to HUD on August 30, 2004. Our plan is to review all information listed above and issue a decision by September 30, 2004 on whether or not to pursue changes in regard to the owner's salary.

If you have any questions, please feel free to contact Mary Ann Garcia, Project Manager, at (913) 551-5593.