



Issue Date November 25, 2008
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Audit Report Number 2009-FW-1002
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TO: Gretchen Marchand, Director, Multifamily Housing Division, 6JHMLAX  
Henry S. Czauski, Acting Director, Departmental Enforcement Center, CV  
*Gerald R. Kirkland*

FROM: Gerald R. Kirkland  
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Owner of Ebony Lake Healthcare Center, Brownsville, Texas, Violated Its Regulatory Agreement with HUD

## **HIGHLIGHTS**

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

As part of the Office of Inspector General's (OIG) annual audit plan and because of significant regulatory violations identified at another property owned by an entity related to Century Ebony Lake - GEAC, LLC (owner), we audited Ebony Lake Healthcare Center (project). Our objectives were to determine whether the project's owner (1) transferred funds from the project in violation of its regulatory agreement with the U. S. Department of Housing and Urban Development (HUD) and HUD directives and (2) expended property funds for only reasonable and necessary project expenses in accordance with the regulatory agreement.

### **What We Found**

The owner violated the regulatory agreement when its managers ignored HUD directives by making 96 transfers from the project that totaled more than \$4 million from January through December 31, 2007. Of that \$4 million, \$497,000 had not been repaid to the project as of December 31, 2007. In addition, the managers did not follow the regulatory agreement and instructions from HUD's

Departmental Enforcement Center (DEC) which caused ineligible and unsupported costs of \$340,549 to be charged to the project. The managers' actions also unnecessarily depleted the project's operating resources and increased the risk of default on the project's Federal Housing Administration (FHA)-insured loan. Additionally, the managers' unauthorized transfers during June 2007 prevented \$167,026 from being deposited into the project's residual receipts account. We also found that the owner did not implement the required financial and accounting controls which resulted in incomplete and inaccurate financial records for the project. Consequently, HUD and other stakeholders could not reasonably assess the financial condition of the project.

### **What We Recommend**

We recommend that the Director of HUD's San Antonio Multifamily Program Center require the owner to (1) ensure that unauthorized transfers of funds do not resume, (2) deposit \$657,449 into the project's residual receipts account for the \$497,000 in outstanding transfers and \$160,449 in ineligible costs, (3) provide support for \$180,000 in accrued legal fees, or make the necessary adjustments to the financial records, (4) implement financial and accounting controls, and (5) correct and maintain accounting records in compliance with the regulatory agreement. We also recommend that HUD's Acting Director of the DEC seek civil money penalties and administrative sanctions, as appropriate, against the responsible parties for using project funds in violation of the regulatory agreement.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided the draft report to the owner on October 29, 2008, with comments due by November 14, 2008. We held an exit conference on November 10, 2008. On November 14, 2008, the counsel for the sole member of the owner responded on behalf of the owner. The owner both agreed and disagreed with the findings and recommendations in the draft report. The complete text of the response narrative along with our evaluation is included in appendix B of this report. The owner also provided financial information as attachments to the response that are not included in appendix B, but are available upon request.

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## **BACKGROUND AND OBJECTIVES**

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Ebony Lake Healthcare Center (project) is owned by Century Ebony Lake - GEAC, LLC (owner), a not-for-profit, limited liability company. The Governmental and Educational Assistance Corporation (GEAC) is the sole member and 100 percent owner of Century Ebony Lake - GEAC, LLC. According to the limited liability company's articles of organization, GEAC is responsible for selecting property management and ensuring compliance with HUD requirements. The project, located at 1001 Central Boulevard in Brownsville, Texas, is a 122-bed licensed nursing facility specializing in the care of elderly residents. The project's mortgage is insured by the Federal Housing Administration (FHA) under Section 223(f) of the National Housing Act.

Early in 2004, the U. S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center (DEC) reviewed five HUD-insured projects (including the project) affiliated with GEAC. It found that for fiscal years 2001 through 2003, GEAC violated the terms of the regulatory agreements for all five HUD-insured projects by (1) transferring funds between projects without prior written authorization, (2) disbursing residual receipts which were based on an erroneous computation of surplus cash, and (3) paying excessive management agent fees and unauthorized consultant fees. HUD also questioned legal fees that the owner charged to the project and reminded it that such fees required documentary support. As a result of the review, HUD required the owner to change the management agent on or before December 31, 2004. HUD approved an interim management entity to manage property operations until the project became owner operated on April 1, 2005. The owner contracted with a bookkeeping firm to provide accounting services for the project. It also appointed two managers to represent it and run the project's day-to-day operations. While reviewing the project's fiscal year 2007 financial statements, the owner discovered that the managers were making unauthorized transfers from project accounts. It terminated the managers and contracted with a HUD-approved management agent. The new management agent began managing the project in December 2007.

Our objectives were to determine whether the project's owner (1) transferred funds from the project in violation of the regulatory agreement and HUD directives and (2) expended property funds for only reasonable and necessary project expenses in accordance with the regulatory agreement.

## RESULTS OF AUDIT

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### Finding 1: Managers Improperly Transferred More Than \$4 Million in Project Funds

Property managers appointed by the owner improperly transferred more than \$4 million in project funds to affiliated projects from January 1 through December 31, 2007. Of the \$4 million transferred out, \$497,000 had not been repaid to the project as of December 31, 2007. This condition occurred because the owner did not implement required controls,<sup>1</sup> and because the managers ignored HUD instructions. As a result, fewer project funds were available for mortgage payments, \$167,026 was not deposited into the project's residual receipts account on June 30, 2007, and the risk to the FHA insurance fund was unnecessarily increased.

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#### **Managers Ignored HUD Instructions and the Regulatory Agreement**

The managers repeatedly violated the regulatory agreement<sup>2</sup> and HUD directives when they authorized 96 transactions to transfer more than \$4 million to three affiliated projects during calendar year 2007. DEC previously told the owner in April 2004 that it had to obtain HUD approval before making transfers between projects. However, the owner did not implement controls to help ensure that the unauthorized transfers did not occur again. Additionally, the managers ignored HUD's instructions and continued to transfer funds between projects to meet operational needs. As of December 31, 2007, the managers had not repaid the project for transfers of \$497,000. The owner should repay the outstanding transfers to the project's residual receipts account to help ensure future expenditures are for only eligible property expenses.

#### **The Managers' Actions Kept \$167,026 from Being Deposited into the Residual Receipts Account**

The managers' unauthorized transfers reduced project cash, resulting in a negative surplus cash balance of \$327,974 on June 30, 2007. If the managers had not

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<sup>1</sup> Section 9 (c) of the regulatory agreement requires project funds be used for services, supplies, and materials that are reasonably necessary for the operation of the project.

<sup>2</sup> Section 4(b) of the regulatory agreement states that without prior HUD approval, the owner shall not assign, transfer, dispose of, or encumber any personal property of the project, including rents, and shall not disburse or pay out any funds except for usual operating expenses and necessary repairs.

transferred cash from the project, the surplus cash balance would have been \$167,026. The regulatory agreement requires that surplus cash be deposited into the project's residual receipts account, a restricted access account. Therefore, the managers' unauthorized transfers prevented \$167,026 from being deposited into the project's residual receipts account.

### **The Owner Terminated Managers Responsible for the Transfers**

In a letter dated October 5, 2007, the owner terminated the managers responsible for making the improper transfers after noticing unpaid, interproject transfers on the project's June 30, 2007 financial statements. There were no additional transfers from the project after that date.

### **Conclusion**

Although HUD previously informed the owner to cease making transfers of project funds, its managers ignored HUD's directives and continued to make a significant number of unauthorized material transfers. The unauthorized transfers reduced the amount of available operating funds and prevented \$167,026 from being deposited into the residual receipts account. In addition, the managers' actions increased the risk that the project would not have sufficient funds to pay its mortgage premium; thereby, unnecessarily placed the FHA insurance fund at increased risk.

### **Recommendations**

We recommend that the Director of HUD's San Antonio Multifamily Program Center require the owner to

- 1A. Implement controls over project disbursements to help ensure that unauthorized transfers of funds between affiliated HUD-insured properties do not resume.
- 1B. Deposit \$497,000 from nonfederal funds into the project's residual receipts account.

We further recommend that the Acting Director of HUD's Departmental Enforcement Center

- 1C. Pursue civil money penalties and administrative sanctions, as appropriate, against the owner, operator, and/or their principals/owners for their part in the regulatory violations cited in this report.

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## Finding 2: The Owner Incurred More Than \$340,000 in Questioned Costs

The owner violated the regulatory agreement<sup>3</sup> and did not take appropriate actions to recover project revenues, causing the project to incur questioned costs of \$340,549. The questioned costs included \$140,438 in unauthorized owner distributions; \$20,011 in ineligible costs for flowers, gifts, and excessive management fees; and \$180,100 in unsupported costs for legal and administrative fees. This condition occurred because the owner did not implement the required financial and accounting controls that included HUD's accounting requirements. The owner's actions unnecessarily depleted the project's operating resources and increased the risk of default on the project's FHA-insured loan.

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### **Unauthorized Distributions Totalled \$140,438**

Even though the regulatory agreements require project receipts to be deposited into an account in the project's name, the former owner failed to do so.<sup>4</sup> Instead, the former owner took funds that belonged to the project resulting in unauthorized distributions.<sup>5</sup> When the deposits were made, the project's manager was also a principal of the former owner.<sup>6</sup> Although the project became HUD insured in November 2000, in March and October of 2001 Medicaid and Medicare receipts of \$140,438 were deposited into the former owner's bank account rather than the project's account. The current owner learned about the unauthorized distributions on or before September 20, 2004, but it has not taken appropriate actions to recover the funds.

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<sup>3</sup> Sections 9(b), (c), and (e), require the owner to provide satisfactory project management, keep the books and account of project operations in accordance with HUD requirements, and pay for supplies and services rendered and reasonably necessary for the operation of the project.

<sup>4</sup> Section 9 (h) states that all receipts of the project shall be deposited in the name of the project into a bank insured by the Federal Deposit Insurance Corporation. Such funds shall be withdrawn in accordance with the provisions of this agreement for expenses of the project. Any person receiving funds of the project shall immediately deposit such funds into the project bank account and failing to do so in violation of this agreement shall hold such funds in trust.

<sup>5</sup> Section 16(e) of the Regulatory Agreement: "Distribution" means any withdrawal or taking of cash or other assets of the project other than for mortgage payments or reasonable expenses.

<sup>6</sup> The chief executive officer of Century Care, Inc.,--the project's manager was also the president and director of Brownsville Nursing Center, Inc., --the former owner.



### **Ineligible Expenses Totaled \$20,011**

The owner violated the regulatory agreement when it used \$20,011 for ineligible expenses. For example, the owner paid \$1,601 to send flowers and gifts to the families of deceased residents and project staff which HUD does not consider to be reasonable and necessary operating costs of a project. The owner apparently paid these costs because it was unaware that they were prohibited by HUD. In addition, instead of using the HUD-approved 5 percent management fee rate, the owner used a flat monthly rate, which resulted in \$18,410 in excessive management fees being paid for the month of December 2007. The owner admitted to overpaying the management fee but stated it did so because of bond financing requirements. However, HUD approval of the change in the management fee calculation and payment method was required and had not been obtained.

### **Unsupported Expenses Totaled \$180,100**

The owner violated the regulatory agreement when it could not support \$180,100 in accrued legal expenses and administrative fees. In April 2004, the DEC questioned legal fees that the owner charged to the project, and reminded it that such fees required documentary support. The owner accrued \$180,000 in legal expenses during calendar year 2007, but it could not show that the legal fees were reasonable or for services that were actually rendered. The owner also could not provide support for \$100 that it paid for an interim administrator.

### **Conclusion**

The owner violated the regulatory agreement when it failed to recover project revenues, paid excessive management fees, and did not implement the required financial and accounting controls. The owner's actions caused the property to incur \$20,111 in unnecessary costs and \$140,438 in ineligible distributions. As a result, the project had fewer resources to meet its mortgage obligation, which increased the risk to the FHA insurance fund. Because of the continuing nature of the owner's regulatory violations, we will recommend the owner repay unsupported and ineligible costs to the project's residual receipts account to help ensure future expenditures are for eligible property expenses.

## Recommendations

We recommend that the Director of HUD's San Antonio Multifamily Program Center require the owner to

- 2A. Reimburse from nonfederal funds \$140,438 to the project's residual receipts account for the ineligible distribution.
- 2B. Deposit \$20,011 for the ineligible disbursements cited in this report into the project's residual receipts account.
- 2C. Provide documentation to support \$180,000 in accrued legal fees, or make the necessary adjustments to the financial records to more accurately reflect the financial position of the project.
- 2D. Provide documentation to support the \$100 in unsupported administrative fees cited in this report or reimburse the project's residual receipt account.
- 2E. Implement the required financial and accounting controls to help ensure that responsible project personnel have an adequate knowledge of HUD accounting requirements and that future expenditures comply with the regulatory agreement.

We further recommend that the Director of HUD's Departmental Enforcement Center

- 2F. Pursue civil money penalties and administrative sanctions, as appropriate, against the owner, operator, and/or their principals/owners for their part in the ineligible expenditures cited in finding 2.

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### Finding 3: The Owner Did Not Maintain Complete and Accurate Financial Information

The owner did not maintain complete and accurate financial records resulting in misclassified expenses and assets in the general ledger and in the June 30, 2007 audited financial statements. This condition occurred because the owner did not implement the required financial and accounting controls, and the project's accounting personnel did not accurately account for its operating activities. Consequently, HUD and other stakeholders could not reasonably assess the financial condition of the project.

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#### **Interproject Transfers were Not Recorded on the General Ledger**

The interproject transfers were not recorded in the general ledger because the owner did not implement the required financial and accounting controls. HUD requires the owner to maintain complete and accurate financial information.<sup>7</sup> However, the accounting policies and procedures manuals used by the project's accountants did not include HUD accounting guidelines. Consequently, the project's accountants did not record the transfers in compliance with HUD requirements.

The accountants did not record the unauthorized transfers as interproject receivables in the general ledger. Instead, they kept an (off-book) record of the transfers and made adjusting entries at fiscal year end. For example on June 30, 2007, the accountants reclassified \$495,000 from cash to miscellaneous receivables on the general ledger to account for the decrease in cash related to the transfers still due from affiliated projects. Because the accountants did not record the transfers in the general ledger, evidence of the total amount and number of transfers was determined only after an extensive examination of the project's general ledger accounts and bank records. This method of accounting for interproject transfers is not in compliance with the regulatory agreement because it does not provide for accounting records that are complete, accurate, or in a condition for a proper audit.

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<sup>7</sup> Sections 9 (d) and (e) require the owner to keep the books and account of project operations in a condition for a proper audit and in accordance with HUD requirements. HUD Handbook 4370.2, paragraph 2-3B, requires that financial records be complete, accurate, and updated on a monthly basis.

## The Owner Misclassified Assets and Expenses in the Audited Financial Statements and the General Ledger

The owner misclassified assets and expenses in the project's financial statements and general ledger. HUD requires the owner to maintain complete and accurate financial information<sup>8</sup> and to fully disclose the results of operations and the financial condition of the project in financial reports.<sup>9</sup>

- The project inaccurately classified the unauthorized transfers as miscellaneous accounts receivable in the general ledger and inaccurately reported the transfers as miscellaneous other assets, account 1590, in the June 30, 2007 audited financial statements. HUD designated the 1500 account series to be used for long-term investments.<sup>10</sup> The notes to the financial statements clearly showed that the transactions are notes receivable, thus, the transactions needed to be recorded as such in account series 1150 "Notes Receivable". Also, the owner recorded the decrease in cash associated with the unauthorized transfers as investment activities on the statement of cash flows which does not fully disclose that the owner advanced funds to related parties.
- The project's general ledger recorded the unauthorized distributions of project revenue as a negative notes payable in the general ledger. The independent public accountant reclassified this negative payable as a miscellaneous other assets, account 1590, when preparing the June 30, 2007 audited financial statements. The accounting for this transfer did not disclose that project funds were never deposited.
- The owner misclassified 17 expense items in the project's general ledger and the June 30, 2007 audited financial statements. For example, garbage and hazardous waste expenses were classified under the category for exterminating supplies, telephone expenses were classified under the category for office supplies, pest control expenses were recorded in the general ledger account for garbage removal, and X-ray expenses were recorded in the general ledger account for barber and beauty expenses.

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<sup>8</sup> HUD Handbook 4370.2, paragraph 2-3B, requires that financial records be complete, accurate, and updated on a monthly basis.

<sup>9</sup> HUD Handbook 4370.2, paragraph 3-2, requires that financial reports provide a full disclosure of the results of operations and the financial condition of the project.

<sup>10</sup> HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, Chapter 4.

## **Conclusion**

The owner's failure to maintain complete and accurate financial records prevented HUD and other stakeholders from properly assessing the project's true financial condition. The owner was responsible for implementing the required financial and accounting controls to ensure compliance with the regulatory agreement and HUD requirements.

## **Recommendations**

We recommend that the Director of HUD's San Antonio Multifamily Program Center require the owner to

- 3A. Correct and maintain accounting records in accordance with requirements.
- 3B. Implement the required financial and accounting controls to help ensure that responsible project personnel have an adequate knowledge of HUD accounting requirements and that future expenditures comply with the regulatory agreement.

## SCOPE AND METHODOLOGY

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Our objectives were to determine whether the project's owner (1) transferred funds from the project in violation of the regulatory agreement and HUD directives and (2) expended property funds for only reasonable and necessary project expenses in accordance with the regulatory agreement. We also found that the owner did not implement the required financial and accounting controls which resulted in incomplete and inaccurate financial records for the project.

To accomplish our objectives, we

- Interviewed HUD management and staff.
- Interviewed the owner and current management agent.
- Reviewed applicable regulations, handbooks, and the regulatory agreement.
- Reviewed previous DEC evaluations of the project.
- Reviewed the independent auditor's report for June 30, 2007.
- Reviewed the independent auditor's agreed-upon procedures report dated November 9, 2007.
- Reviewed the San Antonio, Texas, Office of Multifamily Housing project files.

We also

- Used bank records to verify the project's financial information related to the unauthorized transfers.
- Reviewed supporting documentation, including checks and invoices, for a nonrepresentative sample of general ledger transactions that appeared to have an unusually high balance or that appeared questionable.

The owner's contract bookkeeper provided computerized accounting records taken from its accounting software. We used computerized accounting data for information and background purposes only because we found the data to be unreliable. Specifically, the owner did not completely and accurately record more than \$4 million in unauthorized transfers (see finding 1) and misclassified 17 expense items in the project's general ledger (see finding 3). Additionally, we could not readily reconcile the amounts reported on the June 30, 2007, audited financial statements to the project's general ledger. Consequently, the audit results are based on our review of source documentation including checks, invoices, the owner's signed transfer approvals, and bank records.

We conducted the audit between May 27 and August 29, 2008, at the HUD San Antonio field office. The owner and contracted bookkeeper provided the records and documentation via mail, e-mail, and fax. Our audit covered the period January 1 through December 31, 2007, but we expanded our scope as necessary for questionable items.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Controls over compliance with laws and regulations;
- Controls over disbursements; and
- Controls over financial reporting.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Controls over compliance with laws and regulations were ineffective or nonexistent (findings 1, 2, and 3).
- Controls over disbursements did not ensure that property funds were expended for only reasonable and necessary expenses (findings 1 and 2).
- Controls over financial reporting did not ensure that financial records and reports completely and accurately recorded property transactions and fully disclosed the financial position of the property (findings 1 and 3).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1B	\$497,000	
2A	140,438	
2B	20,011	
2C		\$180,000
2D		100
<b>Totals</b>	<b><u>\$657,449</u></b>	<b><u>\$180,100</u></b>

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 those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a 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.



# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

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**SENT BY E-MAIL AND FEDERAL EXPRESS**

November 14, 2008

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Regional Inspector General for Audit  
U.S. Department of Housing & Urban Development  
Regional Office of Inspector General for Audit  
819 Taylor Street, Room 13A09  
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**Re: Draft OIG Audit Report No. 2009-FW-100X  
Century – Ebony Lake – GEAC, LLC**

Dear Mr. Kirkland:

As counsel to Century – Ebony Lake – GEAC, LLC (“Ebony Lake”), we have been directed to forward the response of Ebony Lake to the above referenced OIG draft Audit Report. In that regard, it is important to provide some context.

First, it is critical to note that Ebony Lake has not received any monetary gain from this Project at any time following the acquisition of such Project.

Second, it must be kept in mind that Ebony Lake retained the services of its certified public accounting firm and its back office financial servicer because of their prestige within the health care community and their vast experience in the audit and back office financial services process. As will be discussed later, Ebony Lake does not have, and has never represented that it has, expertise in the day-to-day operation of skilled nursing homes. Accordingly, Ebony Lake retained these two highly respected professional service firms to provide those auditing and financial support services to the Ebony Lake facility. Skilled nursing homes operate a very complicated business that only a limited number of public accounting firms believe they have the expertise necessary to properly audit and certify as to the financial condition and operations of a nursing home.

To attempt to understand the operation at Ebony Lake, one has to have a full comprehension of how the unusual and unique self-management structure arose and HUD's role in approving that structure both in March, 2005 and on a continuing basis through 2007.

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**ATTACHMENT  
SPECIFIC RESPONSES TO FINDINGS  
IN OIG AUDIT REPORT**

**Comment 1**

I. With respect to Finding 1 that “Managers Improperly Transferred More than \$4 Million in Project Funds,” Ebony Lake has, as referenced in the OIG draft audit, self reported to HUD the transfers from Ebony Lake to affiliated entities and terminated the managers responsible for making unauthorized transfers. Ebony Lake believes it has implemented controls and directives to the current property management company to help assure that no future unauthorized transfers are made. However, regarding the recommendations, it should be noted that Ebony Lake has no moneys, other than the balance in its residual receipts account, to make any deposits recommended. Ebony Lake is a single asset entity with no revenues other than those generated by the facility. The sole member of Ebony Lake is a 501(c)(3) exempt nonprofit organization with no assets or funds to make any such deposit. If HUD were to approve a repayment of advances by the affiliated entities that received such advances, it is possible that over time a portion of the \$497,000 could be deposited with Ebony Lake. With the closure of Lynnhaven, there is no possibility of it repaying the advances received from Ebony Lake.

**Comment 2**

II. Ebony Lake respectfully disagrees with or wishes to clarify Finding 1 that “The Owner Incurred More than \$340,000 in Questionable Expenses” and in particular disagrees with or clarifies the following specific findings:

A. Unauthorized Distributions Totaled \$140,438. Ebony Lake had entered into a property management agreement with a management company owned by the former owner and seller of Ebony Lake and one of the many responsibilities of that initial management company was to conduct operations in accordance with HUD requirements. Although the passage of time and the departure of individuals involved in those early years has made it difficult to ascertain precisely what happened, the governing board of Ebony Lake failed to receive financial reports that would have identified that the project receipts were not deposited into an account in the project’s name nor did the early independent audited financial statements disclose this situation. By the time this was discovered on or about September, 2004, the former corporate owner had filed for bankruptcy on February 11, 2004. Ebony Lake did not file any unsecured claim in bankruptcy court based upon the economic realities.

**Comment 3**

B. Ineligible Expenses totaled \$20,011. Ebony Lake disagrees with the finding that \$1,601 for flowers and gifts to families of deceased residents and project staff are unreasonable and unnecessary operating costs for a nursing home. Such expenses are customary for marketing nursing homes and maintaining good will in the community from which it draws residents.

Ebony Lake will reconcile or properly reclassify where appropriate the \$18,410 in “excessive” management fees paid in the month of December 2007 pursuant to adjustments to the General Ledger in order to not only comply with Federal tax requirements for tax-exempt bonds but to, for the entire 12 month fiscal year ended as of June 30, 2008, remain in compliance with HUD’s 5 percent management fee criteria. Ebony Lake disagrees with any finding that management fees must be analyzed monthly rather than at the end of each fiscal year. The property management agreements have

**Comment 4**

been modified and amended to comply with HUD requirements and still preserve federal tax-exemption of interest on the outstanding bonds.

C. Unsupported Expenses Totaled More Than \$180,100. With respect to accrued legal expenses of \$180,000, Ebony Lake was attempting, in the absence of professional liability insurance, to accrue sufficient funds to retain lawyers to represent Ebony Lakes if claims or cases were filed. Ebony Lakes had believed that the accruals were reasonable but, in light of the assertions made by the OIG auditors, Ebony Lake will make appropriate adjustments to the General Ledger to reduce the accrued legal fees to a reasonable, historical level. Based on the audit for the fiscal year ended June 30, 2008, there were no accrued legal expenses reported. That audit reports "Other Accrued Expenses" of \$56,539 and the details in support of those various accrued items are attached as Exhibit 1.

Ebony Lake agrees with the finding related to the \$100 expenditure for an interim administrator. Ebony Lake will deposit \$100 of nonfederal funds to be credited to Ebony Lake's residual receipts account.

**Comment 5**

III. Ebony Lake respectfully submits that it has corrected accounting records in accordance with HUD requirements and implemented required financial and accounting controls as recommended in Finding 3 regarding "The Owner Did Not Maintain Complete and Accurate Financial Information."

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## OIG Evaluation of Auditee Comments

**Comment 1** The owner agreed that the managers improperly transferred project funds from Ebony Lake and has implemented controls and directives to help assure that no future unauthorized transfers are made. However, it also stated that it could not repay \$497,000 to the project because it had no assets or funds available.

We maintain that HUD should require the owner to repay \$497,000 to the project from nonfederal funds and if necessary pursue civil money penalties and administrative sanctions.

**Comment 2** We disagree with the owner's claim that it was not responsible for \$140,438 in unauthorized distributions. The owner was responsible for ensuring that distributions were in accordance with its regulatory agreement with HUD. Hiring a management company to conduct the project operations does not relieve the owner of its responsibility; thus, the owner should reimburse the residual receipts account as stated in recommendation 2A.

**Comment 3** The owner did not agree with the finding and recommendation regarding the \$1,601 it paid for flowers and gifts. It said these expenditures were necessary to maintain goodwill in the community. We disagree. The expenses were not reasonable and necessary operating expenses thus were ineligible and should be repaid as stated in recommendation 2B.

**Comment 4** We are encouraged that the owner agreed to adjust legal fee accruals to historical levels. The owner also provided financial records showing that it made adjustments to the legal fee accruals for the fiscal year ending June 30, 2008. HUD should review the accruals to determine if they are reasonable.

**Comment 5** We are encouraged that the owner has taken steps to implement financial and accounting controls to correct the deficiencies noted in finding 3.