



Issue Date	March 21, 2008
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Audit Report Number	2008-FW-1008
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TO: Gretchen Marchand
Director, Multifamily Housing Division, 6JHMLAX

William J. Daley, Regional Counsel, 6AC

Henry S. Czauski, Acting Director of Departmental Enforcement Center, CV

Gerald R. Kirkland

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

SUBJECT: The Owner of Century Mission Oaks, San Antonio, 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, we audited Century Mission Oaks (project). Our objectives were to determine whether the project's owner-manager, Century Mission Oaks GEAC, LLC (owner), complied with the regulatory agreement with the U. S. Department of Housing and Urban Development (HUD) during fiscal years 2005 and 2006. Specifically, we wanted to determine whether the owner (1) adequately supported and documented that project expenditures were reasonable and necessary, (2) obtained HUD approval for any distributed funds, and (3) maintained the books and records to properly account for revenues and expenses.

What We Found

The owner did not support and document that project expenditures were reasonable and necessary because it ignored HUD requirements, lacked the expertise and knowledge to operate a HUD-insured project, and displayed poor cash management skills. As a result, the owner could not support more than \$2.9

million in expenses, incurred \$65,524 in ineligible expenses, and improperly transferred \$197,000 in project funds to an affiliate. As a result, fewer project funds were available for mortgage payments, and the risk to the Federal Housing Administration insurance fund was unnecessarily increased.

Further, the owner did not ensure that the project's books and records were properly maintained. Financial records were missing; general ledger entries were incomplete, misclassified, and/or unsupported with revenues and payroll expenses overstated; and there were conflicting records. As a result, HUD and other stakeholders could not accurately assess the financial condition of the project.

What We Recommend

We recommend that the Director, San Antonio Multifamily Program Center, require the owner to (1) provide support for or make necessary adjustments to its financial records to remove \$2.7 million in unsupported expenses and expense accruals recorded in its books, (2) provide support for or reimburse \$272,753 in unsupported costs, (3) deposit \$262,524 for the ineligible disbursements and unauthorized transfers, into the project's reserve for replacement account (4) correct and accurately maintain its accounting records, and (5) implement procedures and controls to ensure that future disbursements for project expenses comply with requirements. We also recommend that HUD's Regional Counsel in coordination with the Director of the San Antonio Multifamily Program Center and the OIG pursue double damages remedies against the responsible parties for the ineligible disbursements and unauthorized transfers. Further, the Acting Director of HUD's Departmental Enforcement Center should pursue civil money penalties and administrative sanctions, as appropriate, against the owner for its part in the regulatory violations cited in this report.

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 our draft report to the owner on January 31, 2008, and held an exit conference with project officials on February 15, 2008. We requested a written response by February 19, 2008, and extended the due date to February 25, 2008. The owner generally disagreed with the findings. The owner's response included almost 700 pages of documents and data; thus, we only included the summary of the comments and our evaluation in Appendix B. The additional information is available upon request.

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BACKGROUND AND OBJECTIVES

Century Mission Oaks (project) is a 150-bed skilled nursing facility specializing in the treatment of geri-psychiatry care, located at 3030 South Roosevelt in San Antonio, Texas. The project's mortgage is insured by the Federal Housing Administration (FHA) under Section 223(f) of the National Housing Act. Governmental and Education Assistance Corporation (GEAC) created Century Mission Oaks GEAC, LLC, which is the project owner.

Early in 2004, the U.S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center reviewed five HUD-insured projects (including Century Mission Oaks) 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. As a result of the review, the management agent was terminated, effective December 31, 2004. Since then, GEAC has not been able to contract with a suitable management agent. The project became owner operated on April 1, 2005. Two off-site employee-managers ran the day-to-day operations. The owner contracted with a firm to provide bookkeeping services.

Our objective was to determine whether the owner complied with its regulatory agreement with HUD during fiscal years 2005 and 2006, July 1, 2004, through June 30, 2006. Specifically, we wanted to determine whether the project's owner (1) adequately supported and documented that project expenditures were reasonable and necessary, (2) obtained HUD approval for any distributed funds, and (3) maintained the books and records to properly account for revenues and expenses.

RESULTS OF AUDIT

Finding 1: The Owner Incurred More Than \$3 Million in Questionable Expenses

During the project's fiscal years 2005 and 2006, the owner incurred more than \$3 million in ineligible and unsupported expenses because it ignored HUD requirements, lacked the expertise and knowledge to operate a HUD-insured project, and displayed poor cash management skills. As a result, fewer project funds were available for mortgage payments, and the risk to the FHA insurance fund was unnecessarily increased.

Ineligible Expenses Totaled \$65,524

The owner incurred ineligible expenses totaling \$65,524.¹ These expenses included payments for consulting contracts that were not approved by HUD, late fees, parties for project employees, excessive payroll processing fees, and overpayments to a software contractor.

The on-site project administrator and the owner entered into and paid \$36,581 for two consulting contracts without HUD's approval. Further, they did not solicit bids as required² for one of the contracts, the cost of which was greater than \$10,000.

The purpose of the two contracts was to increase reimbursements from Medicare and the state of Texas. HUD believes that an owner-managed project, such as this one, should have the capacity to provide these services. Further, the regulatory agreement prohibits entering into any contract for such services without HUD approval. In addition, the owner could not provide a copy of one of the contracts. Finally, the Departmental Enforcement Center reminded GEAC in 2004 that HUD approval was required before entering into consulting contracts and required it to reimburse the project for those consulting fees incurred without HUD's approval. Since the owner ignored HUD's requirement and did not get approval or properly procure the services, the payments of \$36,581 were ineligible expenses.

The owner paid late fees of \$10,392 for overdue mortgage payments because it made most of the fiscal year 2006 (July 1, 2005, to June 30, 2006) mortgage payments about 60 days late. The owner claimed that the late fees for mortgage and utility expenses are reasonable and necessary expenses given that reduced Medicaid reimbursements created cash flow problems. However, from June 21,

¹ Paragraph 9(c) of the regulatory agreement requires that expenses be reasonably necessary for the operation of the project and not exceed the amount ordinarily paid for such expenses.

² HUD Handbook 4381.5, REV-2, paragraph 6.50(a).

2005, to November 30, 2005, the owner inappropriately transferred a total of \$197,000 to an affiliate (Finding 2). Thus, the funds were not available to make the mortgage payments in a timely manner. For example, the owner inappropriately transferred \$42,000 to the affiliate between June 21 and June 29, 2005. This \$42,000 could have been used to substantially pay the July 1, 2005, mortgage payment of \$52,621. However, the payment was not made until August 31, 2005.

The utility companies assessed another \$1,501 in late fees, and the owner admitted to having received cutoff notices. The owner blamed the late water and electricity payments on cash flow problems. If the owner had not made the inappropriate transfers, the funds would have been available to make the mortgage and utility payments in a timelier manner. Since the funds were not available because of the owner's actions, the late fees were not ordinary and reasonable expenses, as claimed by the owner, and the payments were ineligible.

The owner also paid \$13,651 for employee parties and \$2,376 in excessive payroll fees because it did not exercise good cash management procedures. The payroll servicer charged the same base fees each time it processed checks regardless of whether there was one check or many checks. The owner allowed the payroll servicer to process the two managers' checks separately from those of other project employees. In addition, when the owner took over management of the project, the servicer processed one or two employees' pay separately from the rest of the project's employees for several pay periods. Paying for employee parties and extra processing fees to process payroll checks separately are not reasonable and necessary expenses.

Further, the software company that the project used for tracking Medicare and Medicaid revenue overbilled the owner by \$1,023. The owner paid the ineligible excess cost because it did not realize that it was overbilled.

The table below summarizes the ineligible expenses.

Ineligible expenses	
Description of expense	Ineligible amount
Unapproved consulting contract fees	36,581
Late fees	11,893
Employee parties	13,651
Excessive payroll processing fees	2,376
Overpayments to software contractor	1,023
Total ineligible expenses	\$65,524

Unsupported Expenses Totaled More Than \$3 Million

The owner could not properly support expenses totaling more than \$3 million. These expenses included paid expenses and expense accruals for payroll, legal

fees, a contract for duplicative management services, the manager's payroll, other general expenses, and audit fees.

Payroll disbursements were overstated due to \$2.4 million in expense accruals. The payroll disbursements recorded in the general ledger were \$2.4 million greater than the payroll disbursements identified by the project's payroll bank account. The excess payroll disbursements were unsupported.³

Legal expenses totaling \$351,013 were unsupported. Of this amount, \$296,352 were accrued expenses. The owner did not provide evidence that the legal services were received. The remaining \$54,661 appears to have been paid. The owner provided support for \$776 of this amount, but its allocation plan was not reasonable, and the actual allocations did not follow the allocation plan. The regulatory agreement prohibits the owner from making payments for any services unless such services were actually rendered and are reasonably necessary for the project's operation. Further, the Departmental Enforcement Center cited GEAC during 2004 for unsupported legal fees and reminded it that such fees require support. Since the owner did not show that the services were actually rendered and necessary, the \$351,013 in legal expenses was unsupported.

The owner paid a contractor \$137,149 to provide project management functions at the same time that it was owner managed and should have had the capacity to provide any required management services. In addition, the owner did not solicit bids as required by HUD; thus, it could not assure HUD that the project paid the best price for the service. Therefore, the payments to the contractor were unsupported.

The owner paid salaries totaling \$54,864 for two employees to manage the project and make decisions on its behalf. However, the owner did not show support for their employment with job descriptions, employment contracts, performance appraisals, timesheets, or any other method for determining how much time they worked for the project. Thus, the \$54,864 was unsupported.

In addition, the owner incurred \$25,008 in miscellaneous expenses that it could not support. These miscellaneous expenses included \$5,618 in payments through six checks, professional fees accounts of \$8,391, minor equipment lease accounts of \$4,301, trade accounts payable of \$2,563, a miscellaneous expense of \$4,062, and a waste service payment of \$73.

Other unsupported costs included \$3,537 more in accrued audit fees than the amount invoiced during the review period and payments totaling \$1,071 to the on-site project administrator and the maintenance supervisor.

³ The overstated expenses are further explained in finding 3 of this report.

The table below summarizes the unsupported expenses:

Unsupported expenses

Description of expense	Unsupported expenses paid	Unsupported expenses accrued	Total
Excessive payroll expenses		\$2,451,323	\$2,451,323
Legal expenses	\$ 54,661	296,352	351,013
Payments for management services	137,149		137,149
Salary payments	54,864		54,864
Unsupported general expenses	25,008		25,008
Unsupported audit fees		3,537	3,537
Project employee payments	1,071		1,071
Total unsupported expenses	\$272,753	\$2,751,212	\$3,023,965

Conclusion

The owner incurred the ineligible costs of \$65,524 and unsupported costs of more than \$3 million when it ignored HUD requirements, lacked the expertise and knowledge to operate a HUD-insured project, and displayed poor cash management skills. Specifically, the owner (1) ignored requirements that HUD approve consulting contracts; (2) entered into management contracts for services that should have been performed by the owner and did not solicit bids to ensure that it received the services at a competitive price; (3) did not keep sufficient records to support legal costs, payments, and payroll; and (4) did not pay bills in a timely manner, thus incurring unnecessary late fees.

Recommendations

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

- 1A. Deposit \$65,524 for the ineligible/inappropriate disbursements cited in this report, into the project's reserve for replacement or a restricted capital account that requires HUD approval for the releases of the funds.
- 1B. Provide documentation to support the \$272,753 in unsupported disbursements cited in this report or reimburse the project's reserve for replacement or restricted capital account that requires HUD approval for the release of the funds for the applicable portion.
- 1C. Provide documentation to support the \$2,751,212 in unsupported expenses recorded in the general ledger or make adjusting entries to the financial records to reflect the true financial position of the project.
- 1D. Implement procedures and controls to ensure that future disbursements for project expenses comply with the regulatory agreement and HUD's requirements.

We also recommend HUD's Regional Counsel, in coordination with HUD's Director, San Antonio Multifamily Program Center, and HUD's Office of Inspector General,

- 1E. Pursue double damages remedies against the responsible parties for the ineligible/inappropriate disbursements that were used in violation of the project's regulatory agreement.

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

- 1F. 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.

Finding 2: The Owner Improperly Transferred \$197,000 in Project Funds without HUD Approval

The owner inappropriately transferred \$197,000 in project funds to an affiliate when it ignored HUD prohibitions against such transfers. As a result, fewer project funds were available for mortgage payments, and the risk to the FHA insurance fund was unnecessarily increased.

The Owner Ignored HUD Instructions and the Regulatory Agreement

The owner transferred \$197,000 to Ebony Lake, another HUD-insured project, in violation of previous HUD instructions and the regulatory agreement.⁴ The Departmental Enforcement Center identified other unauthorized transfers in 2004 and notified GEAC that it had to repay the projects and obtain HUD approval before making fund transfers between projects. The owner ignored the instructions and continued to transfer funds between projects to meet operational needs.

The owner made the transfers without notifying its contracted bookkeeping firm. Representatives of the bookkeeping firm discovered the transfers in August 2006 when they could not balance the accounts. The owner may have then attempted to conceal the transfers when it instructed them to record the transfers in accounts payable rather than an interfund transfer account.

By making the unauthorized transfers, the owner reduced the amount of the project's operating funds available and increased the risk that the project would not have sufficient funds to pay its mortgage premiums, thus placing the FHA insurance fund at increased risk.

⁴ Paragraph 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.

Recommendations

We recommend that the Director, San Antonio Multifamily Program Center,

- 2A. Require the owner to reimburse the project \$197,000 from nonfederal funds.

We also recommend HUD's Regional Counsel, in coordination with HUD's Director, San Antonio Multifamily Program Center, and HUD's Office of Inspector General,

- 2B. Pursue double damages remedies against the responsible parties for the unauthorized transfers under Title 12 U.S.C., section 1715z-4a, for knowingly disregarding the regulatory agreement and previous HUD instructions.

Finding 3: The Financial Condition of the Project Could Not Be Reasonably Assessed

The owner did not maintain complete and accurate books and records as required by the regulatory agreement and other HUD requirements.⁵ This condition occurred because the owner lacked the expertise to properly account for operations of a HUD-insured project. As a result, the project's financial data were unreliable, its accounting records did not support its financial statements, and HUD could not reasonably assess the financial condition of the project.

The General Ledger Account Balances Conflicted with Other Financial Records

The project's general ledger balances were unverifiable for fiscal years 2005 and 2006 because they conflicted with financial statement balances. The general ledger and cash disbursements journal also showed overstated revenue and payroll disbursements when compared to third-party sources, such as bank statements and Medicare and Medicaid funding documents.

Conflicting Balances

General ledger accounts and financial statement account balances for assets, liabilities, and expenses did not agree. For example, the general ledger accounts receivable for patient care for fiscal year 2006 reported a \$267,685 balance, while the financial statement reported a \$657,099 balance for the same account. The \$389,414 difference was unsupported. Also, in fiscal year 2006, the general ledger cash account reported a \$67,171 balance, while the financial statement reported a \$49,609 deficit⁶ for the same account. The \$116,780 difference was unsupported. There were other smaller unsupported differences between the general ledger and the financial statements.

Overstated Revenue and Payroll Disbursements

Our review of the project's bank statements and other third-party documents found that revenues and payroll disbursements were overstated on the general ledger accounts and cash disbursements journal. The general ledger reported more than \$1.1 million more in Medicare and Medicaid revenue for fiscal years 2005 and 2006 than funding reported by Medicare and Medicaid providers. The excess revenue did not reconcile to deposits in the bank accounts. The independent auditors did not discover the excess revenue in their annual audits because they did not trace cash receipts reported in the general ledger and annual financial statements back to supporting documentation. Instead, they used analytics to determine the veracity of reported receipts. In addition, the project's payroll cash account recorded salary and benefit payments totaling more than \$6.7

⁵ HUD Handbook 4370.2, chapter 2, paragraph 2-3(B)

⁶ Since the balance was a deficit, it was reported in the financial statements as a bank overdraft.

million, while the payroll bank account records showed a little more than \$4.3 million. The bookkeeper did not provide any support to completely reconcile the difference.

The Owner Ignored Adjusting Entries and Misclassified Expenses

The owner ignored reclassification adjusting entries made by the independent auditors to prepare 2005 and 2006 financial statements. The project's fiscal year 2006 accounting records resumed with fiscal year 2005 balances as though the reclassification entries had not occurred. As a result, the general ledgers for both years did not support the audited financial statements. The independent auditors did not respond to inquiries regarding the reclassifications.

Further, the owner misclassified at least 28 accounts on the annual financial statements. For example, security expenses were classified under the category for exterminating supplies, vehicle expenses were classified under the category for miscellaneous administrative expenses, and telephone expenses were classified under the category for office supplies. HUD provided specific accounts for all of these expenses in its chart of accounts.⁷

The Accounting System Contained Conflicting Data

The project's accounting system contained conflicting data and could not generate a complete and accurate check register. For example, the system generated two check listings for the same period. The total dollar value of the checks was the same, but the check numbers, check amounts, and check payees were different. The owner could not explain the discrepancy.

The Owner Could Not Provide Records in a Timely Manner

During our review, we continuously had difficulty obtaining records despite repeated requests over a six-month period and issuing a subpoena in August 2007 to obtain complete records for our review period. For example, the owner did not provide financial records for the period July 1 through December 31, 2004, until after we completed our fieldwork in November 2007. Further, the only record provided for the period was the general ledger. While the general ledger might account for some of the unsupported costs, without the supporting documents, we

⁷ HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, chapter 4.

could not assure ourselves of its accuracy; thus, we did not review it. We will provide these records to HUD.

Delays in obtaining information also occurred because in violation of requirements, the owner required the contracted bookkeeper to submit documents to it for review before they were provided to us.

Conclusion

The conflicting account balances, overstated revenues and payroll disbursements, unrecorded adjusting entries, misclassified expenses, and inadequate accounting system are all indications that the owner lacked the capacity to account for a HUD-insured project. Further, they prevented HUD and other stakeholders from assessing the project's true financial condition. Although the owner contracted with a bookkeeping firm, the owner was responsible for ensuring that the books and records were maintained in accordance with requirements.

Recommendations

We recommend that the Director, San Antonio Multifamily Program Center, require the owner to

3A. Correct and maintain accounting records in accordance with requirements.

SCOPE AND METHODOLOGY

Our objective was to determine whether the owner complied with the regulatory agreement with the U.S. Department of Housing and Urban Development (HUD) during fiscal years 2005 and 2006. To accomplish our objective, we

- Interviewed HUD management and staff.
- Interviewed the owner's employee-managers.
- Reviewed applicable regulations, handbooks, and the regulatory agreement.
- Reviewed previous Departmental Enforcement Center evaluations of the project.
- Reviewed the independent auditor's reports for the years ending June 30, 2005 and 2006.
- Reviewed the San Antonio, Texas, Office of Multifamily Housing files for the project, including monthly accounting reports.

We also

- Selected a sample of 60 cancelled checks for review, using ACL statistical software, a 95 percent confidence level with a plus or minus 5 percent precision, and an expected error rate of 0 percent, to determine whether the disbursements were properly approved, supported, and recorded. However, since we did not have a complete universe for the review period and we concluded that the financial data were unreliable, we did not project our results to the universe of disbursements.
- Reviewed the general ledger accounts with significant changes (between the two years in our scope); identified transactions (in those accounts) over \$1,000 that were not self-explanatory in the description, payments to employees, and payments to contracted firms that did not appear ordinary; and reviewed the supporting documentation provided by the project.
- Used computer-assisted auditing techniques and compared the trial balances in the general ledger to the balances reported in the annual financial statements, compared the Medicare and Medicaid revenue reported in the annual financial statements to the amounts reported by the Center for Medicare and Medicaid Services and the Department of Aging and Disability Services, compared the check registers provided to the cash disbursements journals, and determined that the computer-processed data were significantly unreliable.
- Used the project bank statements to identify and trace all fund transfers.
- Compared the bank statements from the payroll account to the payroll cash disbursements journal.

We conducted the audit between June 8 and November 30, 2007, at the HUD San Antonio field office. The owner's representatives provided the records and documentation via mail, e-mail, and fax. Our audit covered the period July 1, 2004, through June 30, 2006. However, the audit was under a scope limitation because the project's owner did not provide any financial records for the period July 1 through December 31, 2004, until we had completed our field work. To complete our review in a timely manner, we did not review these records. We will provide these records to HUD. In addition, the owner restricted our access to project employees and documents. Finally, the owner, its bookkeeper, and its auditors did not respond to many of our

requests for information throughout the audit. They responded only after they received the draft report and after we held an exit conference to obtain their input.

We extended the deadline for the owner's written response at its request. Along with its response, the owner submitted 699 pages of documents. We reviewed all of the documents and made appropriate changes to the audit report. The owner submitted several more documents after the deadline that we were unable to fully analyze. We will forward them to HUD for further review and resolution.

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

INTERNAL CONTROLS

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.

Relevant Internal Controls

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

- Controls over compliance with laws and regulations;
- Controls over cash management, including accounts payable and accounts receivable; 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 to prevent the owner from overriding HUD regulations did not exist.
- Controls to ensure that books and records were maintained in accordance with requirements did not exist.
- Controls over cash management were poor.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1A	\$ 65,524	
1B		\$272,753
1C		\$2,751,212
2A	<u>197,000</u>	<u> </u>
Totals	<u>\$262,524</u>	<u>\$3,023,965</u>

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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February 22, 2008

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**Re: Draft OIG Audit Report No. 2008-FW-100X
Century – Mission Oaks – GEAC, LLC**

Dear Mr. Kirkland:

As counsel to Century – Mission Oaks – GEAC, LLC (“Mission Oaks”), we have been directed to forward the response of Mission Oaks to the above referenced OIG draft Audit Report. Based upon a review of the OIG draft Audit Report and the voluminous responses the professional financial advisors of Mission Oaks have sent to the OIG, and in light of the tenor and nature of the two telephone conferences between the OIG and the professional financial advisors of Mission Oaks, a number of concerns have arisen which Mission Oaks believes need to be addressed.

First, Mission Oaks was surprised and disappointed by the sharp and often pejorative language that appears in the findings and recommendations of the draft Audit Report. If someone unfamiliar with the facts and circumstances of the Mission Oaks operations were to read this draft Audit Report or the final Audit Report if it contains similar language, he or she might well conclude that Mission Oaks must have “looted” the Project for a \$3,800,000 monetary gain to Mission Oaks. Obviously, this is not the situation. Mission Oaks has not received any monetary gain from this Project at any time following the acquisition of such Project. It is hoped that the OIG would modify the final Audit Report by removing any such sharp and pejorative language.

Second, it was abundantly clear from the findings and recommendations contained in the draft Audit Report that rather significant communication problems were underlying the conclusions reached by the OIG. This difficulty in communication could not have become more clear than during the telephone conference of February 20, 2008 among OIG and Mission Oaks representatives. At that time, the OIG auditors and the financial professional

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OIG AFD-01026
*Only admitted in Wisconsin

Comment 1

Comment 2

Mr. Gerald R. Kirkland
February 22, 2008
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advisors representing Mission Oaks could not reach agreement on nearly all the issues leading to the major monetary and accounting findings contained in the draft Audit Report. Even after the exchange of hundreds of pages of backup and supporting data, the parties appeared no closer to reaching an agreement. We do understand, however, that ongoing discussions between the OIG audit staff and the financial services firm since February 20, 2008 have been more promising and we are hopeful that this is the case.

It must be kept in mind that Mission Oaks 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, Mission Oaks does not have, and has never represented that it has, expertise in the day-to-day operation of skilled nursing homes. Accordingly, Mission Oaks retained these two highly respected professional service firms to provide those auditing and financial support services to the Mission Oaks 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. Mission Oaks has been troubled that initial communications were not successful with the OIG audit staff and has some concern that the complexity of auditing skilled nursing homes is a significant factor in this apparent communication problem.

Third, the entire draft Audit Report is presented out of context with three critical matters, namely, (i) the standards by which the skilled nursing home industry is measured with particular reference to Texas skilled nursing homes similar in size to Mission Oaks; (ii) the circumstances underlying the unusual and unique management structure at Mission Oaks during much of the OIG audit period and the open and continuous relationship with the HUD Departmental Enforcement Center in Fort Worth and with the San Antonio and Fort Worth HUD Program Centers; and (iii) the fact that the State of Texas not only had failed to increase Medicaid reimbursement rates for the period from September 2001 to March 2006 but had approved a 1.7% decrease in such rates for the period from September 2003 until March 2006, all of which contributed to cash flow shortages and impacted the timing of many regularly scheduled payments including mortgage and utility payments.

Two examples provided by the Texas Healthcare Association as expressed in per patient days (the industry benchmark) provide context with respect to measurement standards for skilled nursing homes:

1. Direct Staffing Costs (2005 data)
 - a. Mission Oaks - \$63.21 ppd.
 - b. The 110 Texas nursing homes of 150 beds or more - \$73.38 ppd.

c. This average savings or favorable cost differential of \$10.17 ppd when multiplied by the average daily census of 137 at Mission Oaks would represent an annual average savings of \$508,551 compared to its industry wide peer group.

d. Mission Oaks salaries were 86% of the average of its industry wide peer group.

2. Fully loaded operating costs (2005 data)

a. Mission Oaks - \$103.57 ppd.

b. Texas Peer Group - \$112.80 ppd.

c. Favorable variance of \$9.23 ppd.

d. $137 \text{ daily census} \times \$9.23 \times 365 = \$461,546$ favorable variance to its industry wide peer group

Comment 3

Consequently, to describe the Mission Oaks payroll expenses as “excessive” or “inflated” is misleading. Simply because the OIG auditors are unable to agree with the data provided by Mission Oaks’ financial services firm on certain accounting entries and procedures does not alter the conclusion that Mission Oaks has been able to control its staffing costs far better on average than its industry wide peer group.

To attempt to understand or audit the operation at Mission Oaks, 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. Mission Oaks, by its organizational structure, is now and was always intended to be, an investor owner, not an owner operator. The charitable mission of Mission Oaks is to assist in the development and preservation of housing to serve the most needy segments of the population in the San Antonio area. By virtue of the fact that over 80% of all the residents in Mission Oaks have been covered by the Medicaid reimbursement program, Mission Oaks clearly has satisfied the spirit and express purpose of its charitable mission.

In order to accomplish this charitable mission, Mission Oaks has had to engage the services of experienced independent third party management companies. From the date of acquisition of the Project until late 2004, Mission Oaks, with HUD's approval, had engaged the services of the management company owned by the previous facility owner. When Mission Oaks became aware of some irregular transfers made by that management company, it sought advice from HUD as to the most appropriate method to proceed. Due to the requirements of HUD Notice H-04-15, issued August 3, 2004 (sometimes referred to as the McCullough memorandum), replacing this third party manager as directed by HUD proved

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infeasible. The HUD HUB Director granted a 90 day waiver of the requirements of H-04-15 to allow Mission Oaks and HUD to find a satisfactory solution to the dilemma created by H-04-15. At a meeting held at the offices of HUD Departmental Enforcement Center (DEC) in Fort Worth, Texas on March 31, 2005, it was determined by the assembled group that Mission Oaks could employ individuals at its facility and also engage "support" services from experienced third party entities and that such a "self managed" structure would not require compliance with the professional liability insurance provisions of H-04-15. DEC representatives as well as staff from the Fort Worth HUD Program Center were in attendance in person at this March 31, 2005 meeting and staff from the San Antonio HUD Program Center participated by telephone conference. The "support" entities retained by Mission Oaks following this meeting were specifically discussed at this meeting and referred to as the third party entities to provide the "support" services referred to above.

Accordingly, Mission Oaks employed Robert Ryan and Diane Ryan, principals of a highly regarded health care consulting firm, to oversee, as employees of Mission Oaks, the management and operations of its facility. The skill and experience of the Ryans seemed to match the particular and difficult idiosyncrasies of Mission Oaks. HUD worked closely and successfully with the Ryans following the implementation of this "self-managed" system. Because Mission Oaks and HUD shared two common objectives, namely (1) to insure the health and safety of the fragile residents in the nursing home and (2) to mitigate to the greatest extent possible any potential loss to the HUD insurance fund, this "self-managed" system appeared to be the only pragmatic, workable structure available at that time in light of the professional liability insurance requirements set forth in H-04-15 and the economic improbability of obtaining such professional liability insurance in Texas at that time.

Comment 4

In June of 2006 and June of 2007, this "management" arrangement was reaffirmed by letter to the Fort Worth HUD Program Center. Thus, at each step in the establishment and continuation of this unusual and unique "management" structure, HUD was fully informed and certainly had every opportunity to object to it at any time. Each year, the independent certified public accountants performed audits on Mission Oaks according to HUD policies and submitted the same to HUD annually. If at anytime HUD had harbored concerns similar to those contained in the OIG audit, HUD had every opportunity to raise them. To the contrary, Mission Oaks continued to operate the Project assuming it had the approval of HUD.

Comment 5

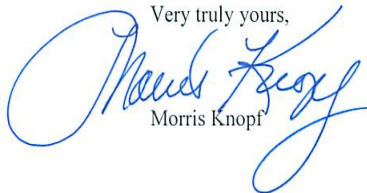
Because of the stagnant and sometimes decreasing Medicaid reimbursement revenues during the OIG audit period, Mission Oaks had to manage this cash flow shortage in order to first meet, on a timely basis, the needs of the residents and secondly to make payment, albeit it sometimes late, on legal obligations such as the FHA mortgage and utility services. Any resulting late payment fees related to these legal obligations were ordinary and reasonable expenses under these circumstances.

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Comment 6

With the above facts and circumstances as a frame of reference, it should come as no surprise that Mission Oaks was surprised and disappointed by the tenor and content of the OIG draft Audit Report. Mission Oaks is also having difficulty understanding the OIG recommendations in the draft Audit Report that accrual dollars be reimbursed as if such accruals had been actual cash items. Mission Oaks will respond individually to each finding in the Audit Report and that response is attached hereto and incorporated herein and designated as "Attachment". Because of the strict time frame within which to respond to the draft Audit Report, the response will not be able to address results of ongoing discussions between the OIG audit staff and the financial services firm representing Mission Oaks but Mission Oaks is appreciative of the effort to achieve agreement on a number of matters. Mission Oaks remains hopeful that the final OIG Audit Report, while including this entire response and attachments, will be modified to more appropriately reflect the accounting and financial services procedures as the professional financial advisors of Mission Oaks have attempted to explain them. Thank you for your time and consideration.

Very truly yours,



Morris Knopf

MEK/vaw
Enclosure

/730762

cc: Ms. Joanna Varenhorst (By E-Mail Only)

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ATTACHMENT
SPECIFIC RESPONSES TO FINDINGS
IN OIG AUDIT REPORT

I. Mission Oaks respectfully disagrees with Finding 1 that “The Owner Incurred More than \$3.8 Million in Questionable Expenses” and in particular disagrees with the following specific findings:

A. Ineligible Expenses Totaled \$65,524. Although Mission Oaks acknowledges that direct HUD approval was not obtained for the retention of Cash Recovery Consultants and Kelly Coyle & Associates, such firms are customarily and routinely retained in the long-term skilled nursing home industry. With respect to Cash Recovery Consultants, this service firm was only paid IF it collected additional new Medicare reimbursement revenues. Their fees of \$32,481 would, by virtue of the contract, support the receipt of additional income of approximately \$64,000 for the Project.

The retention of Kelly Coyle & Associates was also an effort to realize additional revenues by obtaining a special Medicaid “add-on” rate or other project specific reimbursement revenues but those efforts were terminated after incurring \$4,100 in fees because the State of Texas finally adopted a Medicaid reimbursement increase in 2006. For both of these contracts, see the attached supporting information designated as Exhibit 1.

Given the net revenue increase resulting from the retention of Cash Recovery Consultants and the *de minimus* fees paid to Kelly Coyle & Associates, and based upon a belief that, after the transition on April 1, 2005 to a self-managed operation, the HUD Program Center was aware of and acquiesced in the usual and customary retention of such service firms, Mission Oaks believes it acted in good faith and in the best interests of the Project to improve the revenues and thus the bottom line of the Project (see discussion in covering letter regarding the March 31, 2005 meeting with various HUD personnel). Mission Oaks believes that the service contracts referred to in this OIG finding were related to increasing revenues and were usual and customary arrangements and reasonably necessary in the long-term skilled nursing home industry. However, as a result of this finding, Mission Oaks will direct its current third party management agent, Transition Health Services, to meet with the HUD Program Center to receive guidance on which of the numerous employment arrangements customarily and reasonably utilized by nursing homes are subject to HUD prior approval and bid solicitation.

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Comment 7

Comment 5

Mission Oaks believes that the late fees for mortgage payments and utilities were necessary and reasonable due to managing tight cashflow against the pressing needs, and resulting expenses, of the special residents in the Project and should not be treated as ineligible payments but rather as ordinary and reasonable expenses in meeting its legal obligations. (See discussion in covering letter regarding the stagnant and decreased Medicaid reimbursement rates and the impact of cash flow shortages on timely payments).

Comment 8

Comment 9

Mission Oaks disagrees that the \$13,651 designated by OIG as “employee parties” constitutes ineligible expenses. In support of this position, please see the information attached as Exhibit 2. Mission Oaks also disagrees that the excessive payroll fees of \$1,553.04 related to employees payroll checks were inappropriate under the circumstances. Please see the information attached as Exhibit 3 in support of this position.

Mission Oaks agrees that the payroll processing fees of \$822.96 related to compensation of the Ryans were excessive.

B. Unsupported Expenses Totaled More Than \$3.8 Million.

Comment 10

Mission Oaks disagrees that payroll expenses recorded in the general ledger were \$2,396,460 greater than the payroll expenses reported by the payroll bank account. In support of this position, please see the information attached as Exhibit 4. Mission Oaks understands that its professional financial services firm and the OIG audit staff are close to an agreement that will reconcile the differences stated in the draft Audit Report and lead to a conclusion that there are only *de minimus* unsupported payroll expenses

Comment 11

Mission Oaks disagrees that there are unsupported expenses of \$730,260. In support of this position, please see the information attached as Exhibit 5. Mission Oaks also understands that its professional financial services firm and the OIG audit staff are close to an agreement that these expenses are supported by data provided. However, if further additional information describing the nature of the expenses is still required, Mission Oaks will gather and provide such information to OIG and HUD as soon as available.

Comment 12

Mission Oaks disagrees that \$450,610 in legal expenses were unsupported. In support of this position, please see the information attached as Exhibit 6.

Comment 13

Mission Oaks disagrees that the \$128,149 paid to Transition Health Services to perform certain distinct support functions during the self-management period was inappropriate based upon the oral approvals given to Mission Oaks by the HUD Program Center representatives and representatives of the Departmental Enforcement Center at and following the March 31, 2005 meeting in Fort Worth, Texas. The necessity of retaining Transition Health Services to provide clinical and operational management functions to assist Mission Oaks in self-managing the Project was discussed and understood by HUD at that time. Please see a letter dated April 4, 2005 directed to Mr. E. Ross Burton and Mr. Tommy Visage, attached as Exhibit 7, reciting the outcome of the March 31, 2005 meeting and in particular acknowledging the need to subcontract for

certain distinct supportive services. Mission Oaks received no communications from HUD Program Center or Departmental Enforcement Center that this understanding was inaccurate. The relationship with Transition Health Services during the audit period is such a subcontract. Furthermore, please see a letter dated June 28, 2007 from the Chief Manager of Mission Oaks directed to Ms. Mary V. Walsh, attached as Exhibit 8, which letter states that, "...as you are aware, each of [the Century Care LLC Projects] has also individually contracted with other firms for a broad range of financial services support and nursing home regulatory support." Again, Mission Oaks received no communications from HUD that such contracts were inappropriate. Mission Oaks reasonably relied on these implicit approvals of the utilization of companies such as Transition Health Services to perform certain distinct support functions.

Comment 14

Mission Oaks disagrees that the salaries totaling \$54,864 for the Ryans were inappropriate since HUD was fully advised from March 31, 2005 through 2007 of their employment and had approved such employment and salary allocation. See Exhibits 7 and 8 and the letter dated June 16, 2006 from Mission Oaks to Ms. Mary V. Marsh attached as Exhibit 9. HUD has been fully apprised of the manner of calculating the aggregate cost of self-management fees so that the salaries paid to the Ryans and the subcontract fee paid to Transition Health Services would not exceed 5% of cash collected thereby keeping Project "management" expenses at the same level as had been incurred with independent third party managers. Mission Oaks believed it was absolutely reasonable to rely on HUD's approval of this arrangement.

Comment 15

Mission Oaks disagrees that miscellaneous expenses of \$43,008 are unsupported. In support of this position please see the information attached as Exhibit 10.

Comment 16

Mission Oaks disagrees that the \$3,537 in accrued audit fees is unsupported. In support of this position, please see the information attached as Exhibit 11.

Comment 17

Mission Oaks disagrees that the \$1,071 paid to on-site project administrator and maintenance supervisor was inappropriate and is working with its financial services firm and the independent auditing firm to provide additional support for those expenses.

Comment 18

II. Mission Oaks respectfully disagrees with Finding 2 that "The Owner Improperly Transferred \$197,000 in Project Funds without HUD Approval." Mission Oaks acknowledges and agrees that Century - Mission Oaks - GEAC, LLC received, from time to time during the OIG audit period, advances of moneys totaling \$197,000 from Century - Ebony Lakes - GEAC, LLC in order to maintain operations at the Mission Oaks facility and thereby avoid placing the residents at risk or subjecting the Project to foreclosure thereby placing the FHA insurance fund at risk. Please see the information attached as Exhibit 12 regarding the advances and pay-backs. Because revenues increased, Mission Oaks, based upon discussions with Departmental Enforcement Center in 2004, believed it was appropriate to pay back as promptly as possible the advances made by Century - Ebony Lake - GEAC, LLC. KEEP IN MIND that, as a result of discovering the advances and pay-backs, Mission Oaks (a) requested and accepted the resignation of the Ryans as employees, (b) has, with HUD's approval, engaged the services of Transition Health Services as third party manager and (c) has

directed Transition Health Services to make certain that no advances or pay-backs are made in future years.

III. Mission Oaks respectfully disagrees with certain items in Finding 3 that "The Financial Condition of the Project Could Not Be Reasonably Assessed" and accepts certain other items, as hereinafter described:

C. The General Ledger Account Balances Conflicted With Other Financial Records.

Comment 19

1. Conflicting Balances. Mission Oaks believes the issues raised by OIG have been resolved by discussions between OIG and the financial services firm retained by Mission Oaks and a review of the previously attached Exhibits. To the extent possible, Mission Oaks will continue to make available representatives from its financial services firm and its independent auditing firm to clarify this matter with OIG or HUD.

Comment 20

2. Inflated Revenue and Payroll Expenses. Mission Oaks disagrees that revenues and payroll expenses were overstated. In support of this position, please see the communication dated February 18, 2008 attached as Exhibit 13. If additional clarifying information is required, Mission Oaks will make available representatives from its financial services firm and its independent auditing firm to clarify this matter with OIG or HUD.

Comment 10

3. The Owner/Ignored Adjusting Entries and Misclassified Expenses. Mission Oaks will take, or cause Transition Health Services to take, necessary steps prior to the end of the current fiscal year to assure that appropriate reclassifications from the June 30, 2007 audit have been made, that the general ledgers are consistent with the audited financial statements as of June 30, 2007 and that the auditor's account reclassification software will cause Project expenses to be classified for audit purposes consistent with the HUD Chart of Accounts.

4. The Accounting System Contained Conflicting Data. Mission Oaks will direct Transition Health Services to take appropriate actions to assure that the Project's accounting records are accurate and complete in all material respects.

5. The Owner Could Not Provide Records in a Timely Manner. Mission Oaks acknowledges that there were some delays in providing records, information and documentation to OIG. This was due in part to the termination of Century Care Inc. as the third party management agent as directed by HUD effective December 31, 2004. This prior third party management agent was unable to transfer electronically the general ledger for the period from July 1, 2004 to December 31, 2004. By the time the paper form of the general ledger was located, OIG had concluded its fieldwork. Further, due to the complexities in

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accounting and auditing long term skilled nursing homes, expectations as to fair and reasonable time frames within which to produce records and documents were perhaps unreasonable. However, Mission Oaks did forward that general ledger to the OIG audit staff as soon as it was received.

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OIG Evaluation of Auditee Comments

Comment 1 The owner stated that the language in the draft report is sharp and pejorative, and reads as if Mission Oaks "looted" the project for a \$3.8 million monetary gain, and requested that the OIG modify the language of the final report. The OIG disagrees with the owner's assertion. The report identified ineligible and unsupported expenditures, and discrepancies between the owner's accounting records and reports. The regulatory agreement requires project funds be used for reasonable and necessary expenses, and that the books and records be maintained in reasonable condition for proper audit. The report findings are directly related to these regulatory requirements. However, we revised some of the language in the report.

Comment 2 The owner stated that there were significant communication problems underlying the OIG conclusions. As stated in the report, the owner, its bookkeeper, and its auditors did not respond to many of our requests for information throughout the audit. In addition, the owner restricted our access to project employees, and documents.

Comment 3 The owner's comment does not address the findings in the report because the findings are related to unsupported payroll disbursements recorded in the general ledger and excessive payroll processing fees.

Comment 4 HUD's knowledge of the management arrangement does not excuse the owner from complying with the regulatory agreement. There is no evidence that HUD waived any of the regulatory agreement requirements regarding reasonable and necessary expenditures.

Comment 5 The owner claimed that the late fees for mortgage and utility expenses are reasonable and necessary expenses given that reduced Medicaid reimbursements created cash flow problems. The OIG maintains its position that the expenses are ineligible. Paragraph 1 of the regulatory agreement requires the owner to promptly make all mortgage payments due. The owner paid late fees of \$10,392 for overdue mortgage payments because it made most of the fiscal year 2006 mortgage payments about 60 days late. During about this same time period, the owner inappropriately transferred \$197,000 to an affiliate. If the owner had not made the inappropriate transfers, the funds would have been available to make the mortgage and utility payments in a timelier manner and improve cash flow. Since the funds were not available because of the owner's actions, the late fees were not ordinary and reasonable expenses and the payments were ineligible. We revised the finding to clarify that the late fees were incurred because the owner made inappropriate transfers to an affiliate.

Comment 6 The owner stated that it does not understand the OIG's recommendations to reimburse accrued amounts. In the recommendations, the OIG did not intend for the owner to reimburse the project for accrued amounts. We clarified the language in the report.

Comment 7 While the owner agreed with the finding that it did not obtain HUD approval prior to entering into the consulting contracts, it believes that one of those contracts resulted in a net increase to revenue, and the other contract cost was minimal. The regulatory agreement prohibits entering into any contract for such services without HUD approval. The Departmental Enforcement Center reminded GEAC in 2004 that HUD approval is required before entering into

consulting contracts. Since the owner did not obtain HUD approval or properly procure the services, the payments of \$36,581 were ineligible expenses.

Comment 8 The owner claimed that the employee parties were actually for resident activities and to pay a \$44,210 payable that it could not immediately pay to a food vendor. However, the owner was not able to explain why the expenses were posted to the account for "food purchases - employee health and welfare", or the nature of the resident activities. In addition, we noted on one of the receipts that at least \$22 was paid for dog supplies, including a collar, leash, food, and treats. Further, the contracted bookkeeper told us that the account is used for food purchased for facility employees for recognition and employee parties. There is another account in the chart of accounts that is specifically used to record expenses for food purchased for resident activities. The OIG maintains its position that the expenses were for employee parties.

Comment 9 The owner claimed that the additional processing fees occurred because the project had to pay employees whose time was not reported to the payroll processor on time or due to special circumstances. Each time one or two employee payrolls were processed separate from the rest of the project employees, the payroll processor charged the project all of the base processing fees again (in addition to the per employee fees). Understandably, there will be circumstances that may warrant special processing of payroll checks; however, Mission Oaks did not change payroll processors during the audit and no additional processing fees occurred until the project became owner-managed. Thus, it seems that either Mission Oaks did not require special payroll processing, or it was not assessed additional fees for processing these payrolls. The OIG maintains its position that the additional processing fees were excessive and ineligible.

Comment 10 The owner disagreed that payroll expenses recorded in the general ledger were \$2.4 million greater than recorded in the payroll bank account. After the exit conference, the owner provided additional documentation and claimed that all but \$71,895 of the \$2.4 million was attributable to accrual, reversing, and adjusting entries in the payroll general ledger. The additional documentation contains numerous adjustments including amounts that may be unrelated to payroll expenditures and needs further review and analysis. The owner's failure to provide the documents in a timely manner, despite several requests, led to our determination that the \$2.4 million was unsupported. We will provide the documentation to HUD for review. Until HUD has completed its review, the OIG maintains its position that the \$2.4 million is unsupported.

Comment 11 After the exit conference, the owner provided support for \$730,260 in accrued accounts payable; thus, we removed this issue from the report.

Comment 12 The owner disagreed that there were unsupported legal expenses totaling \$450,610. The owner provided a copy of an ongoing lawsuit regarding medical negligence to the OIG on December 13, 2007, after our field work was complete. This ongoing litigation was not disclosed in the notes to the financial statements, which is a violation of the Accounting Standards Board Financial Reporting Standard 12. Further, the owner told us on November 19, 2007, that there were no pending legal claims during our review period.

The owner accrued \$18,750 per month for legal expenses and reported it under its account for insurance incident claims. The accrual basis described in the owner's response does not provide a reasonable basis for the accrued amount because it did not provide any actuarial or insurance

information that was used to determine the amounts. The OIG maintains its position that the owner should provide further support for its accrued amount of \$126,178, or reverse the accrual.

Based on our review of additional support provided by the owner, we changed the total unsupported legal expenses to \$351,013. Of this amount, \$296,352 was accrued expenses, and \$54,661 was actually paid.

The owner stated in its response that it will remove the double booked expenses and over accrued expenses. In addition, the owner admitted to miscoding some of the expenses. The owner also claimed that \$53,180 of legal expenses is the result of a loading balance as of December 31, 2004, provided by the previous management agent. The owner did not provide any supporting documentation showing that the expenses were removed, reversed, reclassified or justified. The owner should provide support to HUD. The OIG maintains its position that these expenses are unsupported.

Comment 13 The owner disagreed that the \$128,149 paid for a management contract was inappropriate because HUD's lack of response to its disclosure implied approval for the contract. The OIG maintains its position that the contract is unsupported because the owner did not solicit bids prior to entering into the contract. Therefore, the owner cannot assure HUD that it obtained the services at the best possible price. Also, the documentation provided with the owner's response for other questioned costs revealed an additional \$9,000 paid to the contractor. We adjusted the report accordingly.

Comment 14 Regardless of HUD's knowledge of the employment arrangement, the OIG maintains its position that the salary is not supported. There were no job descriptions, employment contracts, performance appraisals, timesheets, or any other method for determining how much time the employees worked for the project.

Comment 15 The owner disagreed that miscellaneous expenses of \$43,008 are unsupported, and provided additional documentation. We reviewed the documentation, and reduced the questioned amount by \$18,000.

Comment 16 The owner disagreed that the audit fees were over accrued. However, there was no logical basis for the accrual. Further, the contracted bookkeeper agreed with our conclusions on February 20, 2008, and stated that an adjustment to the over accrual should be made to the financial records.

Comment 17 The owner did not provide any documentation supporting that the \$1,071 paid to the on-site project administrator and maintenance supervisor is reasonable and necessary.

Comment 18 The owner admitted that \$197,000 in unauthorized transfers were made and claimed that they were the result of reimbursement to another HUD insured project for unauthorized loans made during our review period. The owner also stated that the transfers were done in order to maintain operations at the project. The OIG reviewed the documentation provided, and maintains its position that the owner improperly transferred \$197,000 in project funds without HUD approval. It is irrelevant whether the funds were transferred to pay a loan to another project.

Comment 19 Contrary to the owner's statement the OIG and the contracted bookkeeper did not resolve the issues regarding the conflicting balances between the general ledger accounts and the financial statement balances. Neither the owner nor the contracted bookkeeper provided any documentation that resolved the issue. Thus, we maintain our position that the general ledger accounts and financial statement balances did not agree.

Comment 20 The owner disagreed that the Mission Oaks revenues are overstated. The owner provided numerous documents reconciling the accounting records to the general ledger. On February 29, 2008, after the exit conference, the owner provided additional documentation, including numerous schedules with detailed calculations. Again, due to repeated delays by the owner in providing documentation, we were unable to review the information without further delaying the audit. We will provide the documentation to HUD. Pending review and analysis by HUD, we maintain our position that the \$1.1 million in Medicare and Medicaid revenues was excessive.