



U.S. Department of Agriculture
Office of Inspector General
Great Plains Region
Audit Report

Rural Housing Service
Rural Rental Housing Program
Insurance Expenses
Washington, D.C.



Report No.
04801-6-KC
December 2000



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: December 18, 2000

REPLY TO
ATTN OF: Audit No. 04801-6-KC

SUBJECT: Rural Housing Service
Rural Rental Housing Program Insurance Expenses

TO: Jill Long Thompson
Under Secretary
Rural Development

THROUGH: Leroy Jones
Acting Director
Financial Management Division
Rural Development

This report represents the results of the subject audit. The written response, dated November 21, 2000, has been incorporated into the Findings and Recommendations section of the report. The complete text of the response is attached as exhibit E. The responses and our comments are presented in the Findings and Recommendations section of the report and explain actions necessary to accept management decisions on Recommendations Nos. 1, 2, 3, 4, 6, 7, and 8. We have accepted the management decision for Recommendations Nos. 5 and 9.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing corrective actions taken or planned and the date when final action is anticipated. Please note that the regulation requires management decisions to be reached on all findings and recommendations within 6 months from the date of report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the assistance you and your staff provided to us during our review.

/S/

JAMES R. EBBITT
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

RURAL HOUSING SERVICE RURAL RENTAL HOUSING PROGRAM INSURANCE EXPENSES WASHINGTON, D.C.

REPORT NO. 04801-6-KC

RESULTS IN BRIEF

We initiated this audit as a followup to our recent joint review of the Rural Rental Housing (RRH) Program under a Presidential Initiative.

The primary objective of this review was to determine if the Rural Housing Service (RHS) had adequate internal controls to ensure insurance costs charged to RRH projects were appropriate and to ensure proper disclosure of identity of interest (IOI) entities. We further determined if selected management companies had accurately reported insurance costs to the RHS.

Of 22 States that we surveyed, 10 had not developed complete statewide databases suitable for comparing project costs. Three of the 10 States, California, Minnesota, and Virginia, supplied data from some area offices. Although Rural Development has a new computer system under development, we concluded that immediate actions are needed to identify and service high cost projects.

Field visits to two management companies, which we identified as having high insurance costs, disclosed that one insurance agent charged projects significantly more than the insurance company's premium amount. Management company officials stated that they did not realize they were paying more than the premium amount for the projects' insurance coverage. Based on information provided by the insurance agency and the management company, the RRH projects were charged approximately \$652,000 in excess premiums. At 5 percent interest, the excess premiums would amount to an estimated \$75,800 of lost interest earnings to the projects. The insurance agent began refunding the overcharges after our contact with him. During our review, the insurance agent returned \$381,417 (\$376,013 attributable to RRH projects) to the management company.

We also found the management company charged projects twice for worker's compensation insurance in Mississippi. The management company employees were aware that the management fee included reimbursement for worker's compensation expenses. However, on reports submitted to servicing officials, the management company left the line item for worker's compensation blank and incorrectly included worker's compensation in the line item for property and liability insurance. Therefore, it

was not apparent to Rural Development that worker's compensation costs of over \$122,000 were reimbursed twice.

The management company charged over \$25,000 to the projects for an Errors and Omissions insurance policy and fidelity coverage that should have been paid by the management company. The management company and insurance agent charged the projects an annual percentage interest rate of up to 35 percent, resulting in insurance financing expenses of about \$18,500 without Rural Development consent.

We found that the second management company had established a \$25,000 insurance deductible which exceeded the deductible allowed by regulations and resulted in a \$21,500 loss to the project. This company failed to disclose its IOI construction firm and improperly charged projects for fidelity coverage. (See exhibit A for a summary of the monetary results of our audit.)

KEY RECOMMENDATIONS

We recommended RHS instruct the States to (1) assemble and analyze insurance cost data until adequate information is received from the Multi-Family Information System (MFIS) to allow meaningful cost comparisons of individual expenses and follow up on unusually high or low reported costs, (2) require management companies to properly classify expenses on form 1930-7 (Multiple Family Housing Project Budget) to ensure accurate reporting and to allow for meaningful comparison of costs, (3) require the cited management companies to limit insurance charges to projects to only those that are actual and necessary and allowed under terms of the management agreement, and (4) ensure management companies are obtaining insurance policies with deductibles that meet regulations. In addition, RHS servicing officials should require the management companies to repay projects for the unallowable charges.

AGENCY RESPONSE

On November 21, 2000, RHS officials provided written comments to the draft report expressing general concurrence with the recommendations (see exhibit E for the response). However, RHS did not concur with our recommendation to amend an instruction to require comparison of line item expenses such as insurance expense. RHS advised that efforts were under way to ensure MFIS is able to provide managers with cost data. RHS planned to use internal reviews to ensure servicing officials are complying with existing regulations for analyzing costs, determining if projects are operated according to the approved budgets, monitoring borrower compliance with reporting requirements, and ensuring project operations are conducted to meet the actual needs and necessary expenses of the property.

RHS also plans to provide instructions to the servicing officials on actions to be taken on the specific conditions noted in our report including recovery of improper charges to projects.

OIG POSITION

While RHS' response is positive, we are concerned whether reliance on internal reviews is sufficient to provide overall corrections for the conditions noted in this report. It may take several years to complete internal reviews of all SO's. We request additional information on steps RHS plans to take to improve servicing of unusually high or low expenses, correction of information in data bases, and reduction of unjustified expenses. In addition, we need specific determinations and billings where appropriate for the questioned costs in exhibit A.

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INTRODUCTION

BACKGROUND

The Rural Rental Housing (RRH) Program was established to provide affordable housing to low and moderate income persons in rural areas.

As of June 30, 1999, the Multi-Family Housing (MFH) Program had 451,089 units of which 249,805 were assisted with Rural Housing Service (RHS) rental assistance. The RRH Program is administered through the RHS National Office in Washington, D.C., and 47 Rural Development State offices (SO) nationwide.

Instruction 1930-C was published in the Federal Register in 1980 to direct servicing of RRH projects. Borrowers must submit yearend financial reports, audits, and statements of budget and cash flow. The forms manual insert for form 1930-7 (Multiple Family Housing Project Budget) provides instructions for completing the form and provides specific examples of allowable charges that can be made to RRH projects. Loan agreements provide basic requirements for maintaining the physical condition of projects. As agents for borrowers, management companies assume responsibility for meeting loan objectives and complying with all applicable laws, regulations, and loan covenants. Management agreements specify allowable compensation for management companies. Instruction 426.1 provides insurance requirements for real property used as security for RHS loans.

As part of this audit, we reviewed two management companies: 1) Sun Belt Management Company (Sun Belt), located in Albertville, Alabama, managed about 189 RRH projects in 7 States, including 83 in Mississippi; and 2) Southeastern Management Company, Inc. (Southeastern), headquartered in Glen, Mississippi, managed 15 RRH projects in Mississippi.

OBJECTIVES

The primary objective was to determine if RHS had adequate internal controls to ensure insurance costs charged to RRH projects were not excessive and to ensure proper disclosure of identity of interest (IOI) entities. We further determined if selected management companies had accurately reported insurance costs to RHS.

SCOPE

We selected 22 States for preliminary review and database analysis based on their having the largest number of units financed. According to Automated Multi-Family Accounting System records, these States represented 75 percent of the total RRH financed units. The 22 States were Alabama, Arkansas, California, Florida, Georgia,

Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, and Virginia. We initiated fieldwork on November 8, 1999.

With the cooperation of the national office, we requested SO's to provide any available data detailing project insurance costs to assess internal controls. We consolidated this information into databases to allow comparison by State or management company. To improve the accuracy of our data, we had SO's verify the accuracy of selected data (normally the 15 highest and 15 lowest reported insurance costs) by comparing insurance expenses reported in databases to insurance expenses reported on form 1930-7. While the corrected data could still contain errors, we considered it satisfactory for our purposes of identifying unusually high or low insurance costs.

After analysis and review of the States' insurance expense data along with interviews, we judgmentally selected two management companies for review. First, we selected Sun Belt for review because their projects' insurance costs exceeded the State averages in Tennessee, Georgia, and Kentucky. Secondly, we selected Southeastern for review because their projects, when managed by the previous management company, had the highest property insurance average in Mississippi. (See exhibit B for a list of management companies and other sites visited.)

We reviewed the management companies' insurance activities for 1997 and 1998, and we expanded our coverage to other periods, as appropriate. We judgmentally selected the management companies, projects, and transactions reviewed in order to review recent transactions, unusual transactions, large-dollar transactions, and a variety of circumstances. When we identified potentially adverse conditions, we reviewed additional transactions and periods to evaluate the impact.

We conducted this audit in accordance with Government Auditing Standards.

METHODOLOGY

We interviewed Rural Development officials to obtain background information, policies, procedures, and an understanding of the internal controls over project insurance expenses.

As shown above we obtained and analyzed project expense data in order to identify unusually high or low costs. After reviewing databases, we selected two management companies for review. At the selected management companies, we interviewed management company officials and representatives of the insurance agencies, and we reviewed insurance documents and other management company records.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1

RHS NEEDS TO TAKE IMMEDIATE ACTION TO CONTROL INSURANCE EXPENSES

FINDING NO. 1

States were either not aware of or did not react to significant variances in insurance cost per unit for similar RHS projects. This occurred because they had either not assembled and/or

not used the required statewide databases to determine the reasonableness of insurance costs. As a result, RHS projects within the States were vulnerable to insurance overcharges (see Finding No. 2).

Instructions require the SO staff to assemble, analyze, and distribute a statewide database of actual MFH operation and maintenance costs for determination of cost reasonableness that reflects variable characteristics of project operation.¹ Instructions also require servicing officials to gather, maintain, analyze, and distribute a database of actual MFH operation and maintenance expense for determination of expense reasonableness that reflects variables of project operation and characteristics.²

As the following table shows, only 12 of the 22 States we queried had assembled the data required to compare insurance costs among projects within their States.

STATES <u>WITH</u> COMPLETE DATABASES		STATES <u>WITHOUT</u> COMPLETE DATABASES	
Arkansas	Missouri	Alabama	Louisiana
Georgia	New York	California	Minnesota
Illinois	North Carolina	Florida	South Carolina
Kentucky	Ohio	Indiana	Texas
Michigan	Pennsylvania	Iowa	Virginia
Mississippi	Tennessee		

However, it was apparent that not all 12 States had fully analyzed the data for reasonableness. The 12 States provided us their statewide data for our analysis and 3 of the 10 States without complete statewide data (California, Minnesota, and Virginia) were able to provide us data from some area

¹ Instruction 1930-C, 1930.117 (c) (5).

² Instruction 1930-C, 1930.117 (a)(12).

offices. Our analysis of the data, included in exhibit D, showed dramatic ranges from under \$10 to over \$600 in the per-unit costs of insurance.

Because there was such a dramatic range between the high and the low per unit insurance cost, we had 14 SO's (12 SO's which provided statewide databases and 2 SO's which provided data from area offices) compare property insurance data they provided us to the projects' actual budgets. As shown in exhibit C, 12 States had errors in the data they provided. Error rates ranged to over 53 percent.

Officials in States, which had not assembled statewide data, said they were relying on or planned to use the Multi-Family Information System (MFIS) to analyze costs. We were told that even though budget line items were entered individually, MFIS does not allow comparison of individual budget line items. MFIS allows comparison of budget subtotals to calculated norms; however, since there are variables besides insurance (real estate taxes, special assessments, and other taxes, licenses, and permits) in form 1930-7's "Sub-Total Taxes and Insurance" (line 40), servicing officials agreed this was not an effective means of insurance cost comparison.

MFIS2, the revised version of MFIS, currently operating in all but 50 sites, is designed to allow for, the comparison of individual line items and the analysis of project budgets and actual figures with results of the analysis available on-line or through reports. Although the MFIS2 does allow comparison of individual budget line items, officials stated the Rural Housing Service Administrative Notice (AN) 3552, Program Related Issues for MFIS2 Training, provides that MFIS2 will perform analysis on subtotal line items.

RECOMMENDATION NO. 1

Instruct personnel responsible for development and maintenance of the MFIS to ensure the system is able to provide managers' data showing each individual line from the form 1930-7 (such as insurance expenses) and State and regional comparison of line items. Instruct the States to assemble and analyze insurance cost data, as required, until adequate information is received from the MFIS to allow meaningful cost comparisons of individual expenses. Amend AN 3552 to require comparison of line items as needed (such as insurance expense).

Agency Response

In the written response to the draft report (see exhibit E) RHS officials stated essentially as follows:

Efforts are under way to ensure MFIS is able to provide managers with cost data by use of a data warehouse. Implementation is scheduled by September 30, 2001.

Amendment of AN 3552 is not necessary. MFIS provides both an analysis of the subtotal line items and comparison of individual line items. In addition, regulations require the SO's to assemble, analyze,

and distribute statewide databases of actual MFH operation and maintenance costs for determination of cost reasonableness that reflects the variable characteristics of project operations. Internal reviews will place greater emphasis on enforcing the above requirements.

OIG Position

We need additional information before we can concur with the proposed management decision. We believe the conditions noted in this report (including noncompliance with the regulations cited by RHS) warrant instructions to all SO's of the need to review individual costs in addition to subtotal items. The existing AN is unclear on the ability of the system to review line items. To achieve a management decision, we need the steps RHS plans to take to advise servicing officials of MFIS' abilities to compare line items and to encourage servicing officials to take full advantage of the tools offered by MFIS.

RECOMMENDATION NO. 2

Instruct the SO's to follow up to determine the reasons for unusually high or low insurance costs, to provide servicing instructions as necessary to management agents, and to correct the databases where errors exist. Require SO's to determine if high insurance charges can be supported by premium amounts and if the premium amounts are excessive when compared to other insurance companies.

Agency Response

RHS officials noted that a memo instructing the cited SO to review the insurance costs will be issued and costs reviewed after the 2000 actuals are received. Regulations require servicing officials to determine if the project is being operated according to the approved budget. Internal reviews will place greater emphasis on enforcing the above requirements. Anticipated date is April 30, 2001.

OIG Position

We are concerned whether reliance on internal reviews is sufficient to provide overall corrections for the conditions noted in this report. It may take several years to complete internal reviews of all SO's. RHS' reply indicates corrective action will be limited to one SO. We believe all SO's could benefit by instructions on their responsibility to identify and service unusual project costs and tools available to meet this responsibility. We request additional information on steps RHS plans to take to improve servicing of unusually high or low expenses, correction of information in data bases, and reduction of unjustified expenses.

CHAPTER 2

MANAGEMENT COMPANY PRACTICES INCREASED PROJECT INSURANCE COSTS AND GOVERNMENT EXPOSURE

Reviews at two management companies which we identified as having unusually high insurance costs, revealed that one management company (Sun Belt): (1) overpaid an insurance agent \$652,448 out of project accounts for projects in seven States; (2) improperly paid over \$122,000 for worker's compensation insurance costs out of project accounts in Mississippi because compensation for this cost was included in their management fee and should have been paid by the management company; and (3) paid questionable costs of over \$25,000 out of project accounts in seven States for an Errors and Omissions insurance policy that should have been a cost of the management company. The second management company (Southeastern) caused a \$21,500 loss for one project in Mississippi by purchasing property insurance with excessive deductibles and failed to disclose its IOI construction firm. Both Sun Belt and Southeastern improperly charged projects for fidelity insurance coverage.

We attributed these conditions to oversight by servicing officials not being sufficient to identify excessive and improper charges to the projects by the management companies and vendors.

The overcharges jeopardized the integrity of the RRH Program in several ways. First, sufficient funds may not be available to repair physical deterioration of apartment complexes. As a result, tenants may be living in housing that is not maintained or repaired in a timely manner which, if left unchecked, could result in housing with health and safety deficiencies and could also threaten the Government's security interests in the properties. Misuse may also burden low-income families with higher rents. Finally, the Government's rental assistance subsidy costs are increased.

FINDING NO. 2

PROJECTS WERE CHARGED MORE THAN THE PREMIUM AMOUNT FOR INSURANCE

Sun Belt's insurance agent (Agency A) charged Sun Belt projects more than the premium cost including his commission³ for worker's compensation insurance. The agent said he estimated the costs in advance of receiving the premium notice from the insurance company, charged Sun Belt based on the estimate, and

never refunded the difference when he paid the premiums. In addition to the projects being overcharged \$652,448, the excess premiums at 5 percent

³ A representative of the National Association of Insurance Commissioners told us insurance agents negotiate their commission with insurance companies. This commission is then included in the rate on the policy. An employee of the Alabama Department of Insurance stated the commission is normally included in the premium on the policy.

interest would result in an estimated \$75,800 of lost interest earnings to the projects.⁴

Sun Belt stated they first obtained insurance through Agency A in 1976, and all worker's compensation insurance had been obtained through Agency A since May 1994. Agency A would bill and the projects would pay for all policies in December; however, the worker's compensation premium was not due and the policy coverage did not begin until May 10 of the following year giving Agency A use of project funds interest free for several months.

On February 3, 2000, the vice president of Agency A told us that he estimates the worker's compensation costs for Sun Belt managed projects in December for coverage which will not begin and not be paid to the insurance company until May of the following year. On February 3, Agency A could not provide documentation of any refunds made to Sun Belt or the projects. Subsequently Agency A began sending checks to Sun Belt. The vice president told us that the checks represented the difference between what he charged Sun Belt and what he paid to the insurance company.

As of June 20, 2000, the agent had returned a total of \$381,417 (\$376,013 attributable to RRH projects) for the 1996-97, 1997-98, and 1998-99 policy years. The insurance agent stated that he went back to the first year of available information and compared the amount he charged Sun Belt to the amount he actually paid to insurance companies.

The agent stated he had not refunded the overcharge for the 1999-2000 insurance as he was waiting for the yearend "audit" by the worker's compensation insurance company.

In December 1999, Agency A billed Sun Belt \$250,855 for the May 2000-01 insurance period. Before Agency A provided the policy in May, Sun Belt replaced Agency A as their insurance agent. The policy from the new agent cost \$23,498 for a period from May 10, 2000, to January 1, 2001. We calculated the policy would cost \$36,342 for an entire year. Sun Belt said they expected to receive a check from Agency A refunding the full amount of the 2000-01 insurance period. We estimated that of the \$250,855 to be refunded by Agency A, \$199,429 represents a refund due the RRH projects after the cost of the new policy is deducted.

⁴ We estimated lost interest based on a five percent rate of interest compounded annually, from the time Agency A overcharged for insurance to the earlier of the time Agency A refunded the difference or May 1, 2000. Our estimates do not reflect that some projects financed insurance through Agency A.

The table below shows worker's compensation overcharges for 1999-01 which have not been refunded as of June 20, 2000.

Year	Premium Billed Projects	Premium Paid to Insurance Companies	Refund/ Overcharge	RRH Refund/ Overcharge
99-00	\$166,610	\$87,373	\$79,237	\$77,006
00-01	\$250,855	\$36,342	\$214,513	\$199,429

A representative of the insurance company told us that normally the insured writes checks to the insurance company and not the agent. Therefore, under normal operations, Sun Belt would have paid the insurance company directly in the amount stated on the policy. The insurance company would then pay the commission to the agent. Moreover, any unearned premium would be returned directly to the management company.

In addition to the refunds of overcharges in excess of premiums for 1996 through 1999, the insurance agent forwarded to Sun Belt a \$33,292 check, dated January 20, 2000, payable to the insurance agent from the worker's compensation insurance company for the 1998-99 policy. This check represented a refund from the insurance company to the agent based on the insurance company's "audit" of the worker's compensation activities.

RECOMMENDATION NO. 3

Instruct the servicing officials to 1) require the cited management company to verify that amounts paid for insurance policies match the premium stated on the face of the policy and to write checks to the insurance company, not the agent; 2) require the management company and Agency A to provide a full accounting for all insurance costs since 1994; 3) determine if Agency A should be barred from providing insurance to RRH projects; and 4) ensure the unallowable costs and any applicable interest are properly refunded to the projects.

Agency Response

A memo instructing the servicing officials as cited in Recommendation No. 3 will be issued by January 31, 2001.

OIG Position

We can reach a management decision after the agency bills the management company for unallowable costs and applicable interest.

FINDING NO. 3

**PROJECTS PAID MANAGEMENT
COMPANY'S WORKER'S
COMPENSATION INSURANCE
EXPENSES**

Sun Belt improperly used Mississippi project funds to pay worker's compensation insurance. This went unnoticed by Rural Development servicing officials because Sun Belt incorrectly included worker's compensation on the projects' budget line with property and liability insurance. As a result, Sun Belt's 83 Mississippi projects paid over \$122,000 that

should have been paid by Sun Belt.

Mississippi Administrative Notice (AN) No. 946, dated December 8, 1999, established a maximum management fee for the management of Mississippi projects. The AN states "all administrative expenses on form 1930-7 except complex auditing expenses (line 21), legal expenses (line 23), and office furniture and equipment (line 27) will be paid from the new administrative management fee." (We noted that similar provisions have been in effect in Mississippi since January 1994.)

The administrative expense section on form 1930-7 (Multiple Family Housing Project Budget) includes lines 19-33. Worker's compensation is line 31. This line was left blank on the project budgets indicating that worker's compensation was not included in the administrative expense section. However, we found that Sun Belt had incorrectly included the amount for worker's compensation costs in another section with property and liability insurance which made it not readily apparent that this cost was being paid by the projects.

Mississippi SO officials agreed the AN requires that management companies pay the worker's compensation costs out of their management fees.

Sun Belt officials stated all projects pay worker's compensation premiums based on project salaries, and those payments are made directly to the insurance agent. They stated that in Mississippi, projects pay worker's compensation premiums and Sun Belt had never reimbursed the projects for the cost of worker's compensation. The Sun Belt staff was aware of Mississippi AN No. 946 that increased the management fee in return for the management company assuming the cost of administrative line items in the budget (except for audit, legal, and office furniture). The staff stated based on company policy, they had never recorded worker's compensation expenses on the worker's compensation line item of form 1930-7. Instead, they reported the cost of worker's compensation insurance as property and liability insurance (line 37 of the form).

After researching the issue, Sun Belt officials were receptive to corrective action. During our audit, Sun Belt officials advised that Sun Belt would pay about \$9,000 in worker's compensation premiums for Mississippi RRH projects for 2000 that in the past had been charged to the projects.

RECOMMENDATION NO. 4

Instruct the Mississippi SO to require the cited management company to fully account for and recover the improper worker's compensation expenses charged to projects since 1994.

Agency Response

A memo instructing the Mississippi SO to require the cited management company to fully account for and recover the improper worker's compensation expenses charged to projects since 1994 will be issued by March 30, 2001.

OIG Position

We can reach a management decision after the agency bills the management company for the unallowable costs.

RECOMMENDATION NO. 5

Instruct servicing officials to require management companies to properly classify expenses on form 1930-7 to ensure accurate reporting and to allow for meaningful

comparison of costs. Perform checks to ensure management companies are not duplicating costs.

Agency Response

In the written response to the draft report, RHS officials stated essentially as follows:

An administrative notice will be issued prior to submission of 2002 budget cycle requiring management companies to properly classify expenses on form 1930-7. The regulations require agency officials to monitor the borrower's compliance with regulations concerning reporting requirements. Also, regulations require project operations to be conducted to meet actual needs and necessary expenses of the properly. Internal reviews will place greater emphasis on enforcing the above requirements. The anticipated date is June 30, 2001.

OIG Position

We concur with the management decision.

FINDING NO. 4

PROJECTS PAID PREMIUMS FOR INSURANCE WHICH WAS NOT NEEDED FOR THEIR OPERATION

The two management companies that we visited paid insurance costs, from project accounts that should have been paid by the management companies. According to management company personnel, they overlooked specific terms of the management agreement or had not considered if the

coverage was a necessary expense related to project operations. As a

result, Sun Belt projects paid \$25,208 for an Errors and Omissions insurance policy during 1997-2000 that should have been paid by Sun Belt. Plus, both Sun Belt and Southeastern projects paid an undetermined amount for fidelity coverage which should have been paid by the management companies.

Instructions provide that “project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under Agency regulations.”⁵

According to the insurance agent for Sun Belt, the Errors and Omissions policy was basically protection for the management company and covered professional liability. He told us that if managers and owners made a bad decision, this coverage would protect them from potential lawsuits from syndicators. A Sun Belt employee told us this policy would protect the owner’s tax credits if the Government would seek repayment due to ineligible tenants.

The Errors and Omissions policy covering the owner or manager is a cost of doing business as a management company. Therefore, the management company, not the projects, should bear the costs.

Instructions provide that the premium of a management agent’s fidelity coverage for the agent’s principals and employees will be the management agent’s business expense (i.e., it is included within the management fee).⁶ Our review of the agreement for the Falcon Crest Associates project managed by Sun Belt showed the management company was to furnish fidelity coverage. There was no specific breakout for fidelity coverage in the blanket insurance policy. Sun Belt staff stated that the entire cost of the blanket policy was paid by projects. They further stated that it appeared the management company should provide fidelity coverage at its own expense.

A similar condition existed at Southeastern. The management agent stated fidelity coverage for both management company and onsite employees was provided in the projects’ package insurance policy. After reviewing the management agreement for the Choctaw Mounds project, he acknowledged that projects were paying for fidelity coverage that the management agent was required to pay.

Mississippi SO officials agreed that management companies should pay these costs.

⁵ Instruction 1930-C, 1930.106.

⁶ Instruction 1930-C, exhibit B, XV A 13.

RECOMMENDATION NO. 6

Instruct servicing officials to require the cited management companies to limit insurance charges to projects to only those that are actual and necessary and allowed under terms of the management agreement. Require Sun Belt to repay projects for the Errors and Omissions insurance. Require both Sun Belt and Southeastern to determine and repay projects the amounts paid for fidelity insurance.

Agency Response

Review of the insurance charges by Sun Belt will be made after the audits are received by the cited projects.

OIG Position

A management decision can be achieved when we are advised of actual or planned actions along with timeframes for the agency to provide necessary instructions to the two cited management companies. In addition, the agency needs to bill the two management companies for the unallowable costs.

FINDING NO. 5

UNAPPROVED FINANCING COSTS PAID BY PROJECTS

Sun Belt, without the consent of Rural Development, paid finance charges out of 69 projects' accounts to Agency A. According to the vice president of Agency A and supporting invoices, those projects without available funds for the full cost of insurance made a 25 percent downpayment and then paid the remaining balance in 9 monthly installments. Agency A charged \$30 per installment or \$270 per project. Depending on the amount financed, Agency A received an effective interest rate of up to 35 percent. Also, if the insurance charges had not been inflated (Finding 2), the need for finance charges totaling about \$18,500 for 1999 and 2000 would have been reduced or eliminated.

When income from typical project operations is not sufficient to meet normal cash requirements, the borrower is responsible for reducing expenditures, seeking consent for authorized withdrawals from the reserve account, and/or providing other funds to meet project budget requirements.⁷ The State of Mississippi Office of the Attorney General issued an official opinion stating that State regulations do not permit an insurance agent to pay an insurance premium for a client and then bill the client for the premium paid plus any finance charges for amounts that are past due to the agent.

Sun Belt staff stated that they evaluated each project on a case-by-case basis and that insurance premiums were financed when projects did not have enough money. The staff noted that using reserve funds to pay insurance costs could result in the project being placed on a workout plan or deplete the reserve account. A Sun Belt employee stated that Sun Belt had never asked Rural Development for approval to finance insurance costs.

⁷ Instruction 1930-C, exhibit B, XII A.

The Mississippi SO officials agreed that the financing costs charged to the projects were inappropriate.

RECOMMENDATION NO. 7

Instruct servicing officials to require a full accounting of finance charges and require Sun Belt to repay the projects for the unallowable finance charges. Instruct servicing officials to

ensure the cited management company reduces expenditures or obtains consent before incurring finance charges.

Agency Response

A memo to the cited servicing officials will be issued addressing a full accounting of finance charges by Sun Belt and repayment of any unallowable finance charges by January 31, 2001.

OIG Position

We can reach a management decision after the agency bills the management company for the unallowable costs.

FINDING NO. 6
EXCESSIVE DEDUCTIBLE
INCREASED GOVERNMENT
EXPOSURE

Southeastern purchased insurance with deductibles exceeding the maximum required by regulations for 15 projects. According to the management agent, this occurred because Southeastern was unaware of regulations that limited the deductible to not more than one-fourth of 1 percent of the insurable value. As a

result, one project incurred uninsured damages of \$21,500 (\$25,000 - \$3,500). In addition, the Government was at increased risk because of the increased risk of all 15 projects.

Regulations and instructions provide that project insurance deductibles may be up to one-fourth of one percent of the insurable value with a maximum deductible of \$5,000.⁸

The vice president of the management company advised that several projects had heavy insurance losses the year previous to purchasing coverage with a \$25,000 deductible. He stated that he could have negotiated a smaller deductible than \$25,000, but the policy would have cost a lot more. He stated Southeastern never set aside funds in an escrow as a reserve for the increased deductible nor had they obtained approval from Rural Development for the \$25,000 wind/hail deductibles.

On June 1, 1999, wind and hail damaged Choctaw Mounds. The statement as to full cost of repair or replacement was about \$41,721. After subtracting the \$25,000 deductible, two insurance checks totaling about \$16,721 were

⁸ Instruction 426.1 II 1 c (2) (i).

issued. On January 19, 2000, Rural Development authorized a withdrawal from the reserve account to repair the damage. On February 9, 2000, Rural Development inspected the project and determined the repairs were satisfactorily completed.

The insurance policy schedule of values lists Choctaw Mounds' building limit as \$1,400,000. The maximum deductible allowed by regulation for Choctaw Mounds was \$3,500 (\$1,400,000 multiplied by 0.0025).

The Mississippi SO officials agreed that the \$25,000 deductible was inappropriate.

We noted that as of March 2000, the insurance policy specified wind/hail deductibles of \$5,000 for all projects. Therefore, all 15 Southeastern projects had excessive deductibles ranging up to \$3,500 (\$33,684 total) over the maximum deductible allowed by regulations.

RECOMMENDATION NO. 8

Have the SO instruct the cited management company on the maximum deductibles and ensure management companies are obtaining insurance policies with deductibles that meet regulations. Instruct the SO to require the management company to reimburse the project for the loss caused by the excessive deductible.

Agency Response

A memo to the cited SO will be issued addressing the maximum deductibles by January 31, 2001.

OIG Position

We can reach a management decision after the agency bills the management company for the unallowable costs.

FINDING NO. 7

IOI'S NOT DISCLOSED

Southeastern had not timely disclosed an IOI construction division that was used to repair insured damage nor had it disclosed on forms 1944-30 (IOI Disclosure Certificate) and 1944-31 (IOI Qualification) that it used an IOI for maintenance and repairs, painting and decorating, grounds maintenance, and long-term improvements. The management company considered the disclosure unnecessary. As a result, servicing officials were unable to evaluate if the IOI relationships were in the best interests of the Government.

The management agreement stipulates that the agent discloses to the owner and Rural Development any and all identities of interest that exist or will exist between the agent and the owner, suppliers of material and/or services, or vendors in any combination or relationship. Regulations state that

debarment actions will be instituted against entities that fail to disclose an identity of interest.⁹

A management company official noted that the Southeastern Management Construction Division was owned entirely by Southeastern Management and that the construction division operated out of the Southeastern Management Company's office. Southeastern Management Co., Inc., Construction Division was listed on the construction contract for the insurance repairs at Choctaw Mounds.

The audit reports showed the projects paid Southeastern Management Company for maintenance and repairs, painting and decorating, grounds maintenance, and long-term improvements. A management company official confirmed that Southeastern charged projects for maintenance and grounds services provided by the management company. The project's IOI forms did not list an identity of interest for such services. The official stated that since they reported that the management company had an IOI with the owner of the projects, they believed the IOI disclosure was adequate since the construction division was part of the management company.

As of our January 31, 2000, field visit, servicing officials were unaware of Southeastern disclosing any construction IOI. After our field visit, we were provided an IOI disclosure form dated October 15, 1999, listing a construction identity of interest. Based on our review, there was no evidence servicing officials had received any disclosure of Southeastern's construction IOI prior to January 31, 2000.

The Mississippi SO officials confirmed the IOI entities were not properly disclosed.

RECOMMENDATION NO. 9

Have the servicing officials obtain a complete description of the IOI relationship and determine if the IOI may continue to provide services to the projects.

Agency Response

A memo to the cited servicing office will be issued addressing the IOI relationship by January 31, 2001.

OIG Position

We concur with the management decision.

⁹ 7 Code of Federal Regulations 1930-C, exhibit B, V B 2 d, dated January 1, 2000.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Finding No.	Description	Amount	Reference
2	Excessive Insurance Premiums and Interest	\$728,248	1/
3	Improperly Charged Worker's Compensation	\$122,295	1/
3	Mississippi Worker's Compensation Premiums Paid by Sun Belt	\$9,000	2/
4	Errors And Omissions Insurance Policy	\$25,208	1/
5	Unapproved Financing Costs	\$18,500	1/
6	Excessive Deductible	\$21,500	1/

1/ Questioned Costs, Recovery Recommended

2/ Management or Operating Improvements/Savings

EXHIBIT B – SITES VISITED

Rural Development State Office	- Des Moines, Iowa
Rural Development State Office	- Jackson, Mississippi
Rural Development Area Office	- Indianola, Iowa
Rural Development Area Office	- Centerville, Iowa
Rural Development Area Office	- Greenville, Mississippi
Rural Development Area Office	- Huntsville, Alabama
Sun Belt Management Company	- Albertville, Alabama
Insurance Agency A	- Albertville, Alabama
Southeastern Management, Inc.	- Glen, Mississippi

EXHIBIT C – ERRORS IN DATA PROVIDED

STATE	PROJECT PROPERTY INSURANCE AMOUNTS VERIFIED	PROJECT PROPERTY INSURANCE AMOUNTS IN ERROR	PERCENT IN ERROR
Illinois	28	15	53.6%
Michigan	28	15	53.6%
Mississippi	28	15	53.6%
Georgia	28	12	42.9%
Arkansas	29	11	37.9%
Minnesota	31	10	32.3%
Virginia	28	7	25.0%
Missouri	30	7	23.3%
Ohio	30	7	23.3%
New York	29	5	17.2%
Kentucky	30	1	3.3%
Tennessee	30	1	3.3%
North Carolina	29	0	0.0%
Pennsylvania	31	0	0.0%

EXHIBIT D – HIGH/LOW INSURANCE PROJECTS

Project	No. of Units	Insurance ¹⁰	Ins/Unit ¹¹	State
Poplar Grove Hsg	18	\$ 7,968	\$ 443	AR
Hughes Villas	20	\$ 6,603	\$ 330	AR
Hughes Manor	32	\$ 9,571	\$ 299	AR
Brauer Estates	50	\$ 14,709	\$ 294	AR
Nimrod Square	24	\$ 6,971	\$ 290	AR
MKW, Inc.	40	\$ 11,189	\$ 280	AR
NE Randolph Dev.	18	\$ 4,929	\$ 274	AR
Davis Manor	24	\$ 6,540	\$ 273	AR
Elaine Terrace	15	\$ 3,133	\$ 209	AR
Hermitage Apts.	126	\$ 22,396	\$ 178	AR
Riverridge Apts.	15	\$ 2,600	\$ 173	AR
The Lodge	125	\$ 20,160	\$ 161	AR
Oak Grove Apts.	23	\$ 3,509	\$ 153	AR
Sherwood /DUMAC	30	\$ 4,542	\$ 151	AR
Monticello Apts.	24	\$ 3,516	\$ 147	AR
Deer Run Apts.	24	\$ 3,018	\$ 126	AR
Woodridge Estates	24	\$ 3,000	\$ 125	AR
Broadway Apts.	16	\$ 1,588	\$ 99	AR
Deer Run Apts.	28	\$ 2,663	\$ 95	AR
Pine Cove Apts.	31	\$ 2,823	\$ 91	AR
River Valley Apts.	12	\$ 919	\$ 77	AR
Woodbrook Apts. I	40	\$ 2,135	\$ 53	AR
Oakland Manor	48	\$ 2,547	\$ 53	AR
Quail Run Apts.	36	\$ 1,892	\$ 53	AR
Gates Manor	32	\$ 1,705	\$ 53	AR
Summerhill II	4	\$ 130	\$ 33	AR
Kelly Homes	48	\$ 1,484	\$ 31	AR
Lincoln Terrace	22	\$ 585	\$ 27	AR
Tower Apts.	-	\$ -	\$ -	AR
George Smith/Towncreek	12	\$ 2,900	\$ 242	GA
Tower Mgmt Village	42	\$ 9,937	\$ 237	GA
Barnesville Hsg Auth	72	\$ 16,895	\$ 235	GA
Calhoun Assoc. II	24	\$ 4,670	\$ 195	GA
Sessoms Apts.	4	\$ 771	\$ 193	GA
Byron Apts.	24	\$ 4,515	\$ 188	GA
Oakcourt Apts.	6	\$ 1,100	\$ 183	GA
Park Meadows Apts.	22	\$ 3,810	\$ 173	GA
Westview Apts. II	32	\$ 5,475	\$ 171	GA
Westview Apts. I	48	\$ 8,138	\$ 170	GA

¹⁰ All insurance costs were verified by servicing officials as being correct.

¹¹ Reasons for zero insurance amounts include cash method of accounting, project was new, or project was consolidated with another project.

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Sandalwood Assoc	52	\$ 8,851	\$ 170	GA
Landmark Manor	40	\$ 6,473	\$ 162	GA
Jasper County Assoc	24	\$ 3,270	\$ 136	GA
Village Oaks	40	\$ 5,129	\$ 128	GA
Cuthbert Elderly Hsg	32	\$ 2,669	\$ 83	GA
Barnesville Assoc	48	\$ 3,850	\$ 80	GA
Eastman Ltd	24	\$ 1,808	\$ 75	GA
Lott Dev Amberwood I	56	\$ 3,254	\$ 58	GA
South Moultrie Ltd	69	\$ 3,813	\$ 55	GA
Crossfield Apts.	48	\$ 2,622	\$ 55	GA
Blackshear Apt II	46	\$ 2,463	\$ 54	GA
D&Y - By-Pass	24	\$ 1,296	\$ 54	GA
Westview III	37	\$ 2,013	\$ 54	GA
Oak Lane Villas	26	\$ 1,376	\$ 53	GA
Green Meadows Apts.	32	\$ 1,635	\$ 51	GA
Sylvania Apts. Ltd.	36	\$ 1,709	\$ 47	GA
Oakview Apts.	24	\$ 1,004	\$ 42	GA
Ashford Court Apts., L.P.	24	\$ 940	\$ 39	GA
Wolf Lake	10	\$ 5,904	\$ 590	IL
Winn G	24	\$ 9,149	\$ 381	IL
Perry	8	\$ 2,214	\$ 277	IL
Winchester	16	\$ 4,322	\$ 270	IL
Cobden	12	\$ 3,081	\$ 257	IL
Beardstown	32	\$ 8,104	\$ 253	IL
David-John	6	\$ 1,514	\$ 252	IL
Jonesboro	14	\$ 3,464	\$ 247	IL
Pin Oak	8	\$ 1,877	\$ 235	IL
Tamms	12	\$ 2,823	\$ 235	IL
Park Pl	8	\$ 1,689	\$ 211	IL
Odell	8	\$ 1,512	\$ 189	IL
Village Gr	48	\$ 5,800	\$ 121	IL
Village Apts.	12	\$ 1,292	\$ 108	IL
Mt Zion	24	\$ 2,391	\$ 100	IL
Bridgeport	6	\$ 600	\$ 100	IL
Benton Pk	24	\$ 2,396	\$ 100	IL
St Francis	6	\$ 550	\$ 92	IL
Tolono	16	\$ 1,355	\$ 85	IL
Irvington2	8	\$ 620	\$ 78	IL
Sumner	10	\$ 752	\$ 75	IL
St. Libory	16	\$ 1,137	\$ 71	IL
Woodlawn	12	\$ 720	\$ 60	IL
Mt Vernon	48	\$ 2,049	\$ 43	IL
Shannon	12	\$ 503	\$ 42	IL
Worden	16	\$ 496	\$ 31	IL
Countryside2	8	\$ 216	\$ 27	IL
Heritage	8	\$ 75	\$ 9	IL
Walnut Grove	24	\$ 7,754	\$ 323	KY
Falcon Ridge	32	\$ 8,809	\$ 275	KY

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Henley Park	22	\$ 5,344	\$ 243	KY
Spring Ridge	20	\$ 4,794	\$ 240	KY
Westview	20	\$ 4,693	\$ 235	KY
Riverview Inc	32	\$ 7,386	\$ 231	KY
Bracken Creek	40	\$ 8,983	\$ 225	KY
Judamica Eaglewv	31	\$ 6,979	\$ 225	KY
Heritage Square II	24	\$ 5,170	\$ 215	KY
Quail Hollow2	24	\$ 5,124	\$ 214	KY
Oakridge (Peggy Brown)	31	\$ 6,648	\$ 214	KY
Redbird Mission	8	\$ 1,635	\$ 204	KY
Adair Hills	19	\$ 3,830	\$ 202	KY
Eagle View	14	\$ 2,811	\$ 201	KY
Bashford	48	\$ 3,353	\$ 70	KY
Garden Springs	16	\$ 882	\$ 55	KY
Cedar Grove	36	\$ 1,978	\$ 55	KY
Somerset Whills 2	16	\$ 877	\$ 55	KY
Somerset Whills 1	32	\$ 1,734	\$ 54	KY
Somerset Holly Sq	18	\$ 972	\$ 54	KY
Pcha1	28	\$ 1,500	\$ 54	KY
Pike Villa	48	\$ 2,418	\$ 50	KY
Pine Grove I	48	\$ 2,419	\$ 50	KY
Church Street	39	\$ 1,957	\$ 50	KY
Pcha2	24	\$ 1,100	\$ 46	KY
Somemv Sycsq	12	\$ 524	\$ 44	KY
Corbin Ltd	30	\$ 1,285	\$ 43	KY
Union Villa	10	\$ 44	\$ 4	KY
Allen I	8	\$ 35	\$ 4	KY
Wind II	8	\$ 35	\$ 4	KY
Oakhill	24	\$ 8,205	\$ 342	MI
Salt2	24	\$ 6,377	\$ 266	MI
Salt1	24	\$ 6,307	\$ 263	MI
Monroe	23	\$ 5,441	\$ 237	MI
Grant Senior	24	\$ 5,442	\$ 227	MI
Coloney Junction	24	\$ 5,442	\$ 227	MI
Nrthgate	22	\$ 4,760	\$ 216	MI
Country View Homes	36	\$ 7,481	\$ 208	MI
Rivapt	31	\$ 6,293	\$ 203	MI
Sunset	6	\$ 1,167	\$ 195	MI
Wildwood North	18	\$ 3,428	\$ 190	MI
Washington Manor	12	\$ 2,185	\$ 182	MI
Rollfam	24	\$ 3,861	\$ 161	MI
Greenpark Townhouses	8	\$ 1,081	\$ 135	MI
Whitehall Colby	48	\$ 5,085	\$ 106	MI
Otsego Manor	25	\$ 1,722	\$ 69	MI
Lakeside	64	\$ 3,832	\$ 60	MI
Meadow Hills	48	\$ 2,872	\$ 60	MI
Birch Lake NHT	48	\$ 2,856	\$ 60	MI
Galesburg	120	\$ 6,747	\$ 56	MI

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Wooded View	40	\$ 2,242	\$ 56	MI
Maple Glen	88	\$ 4,759	\$ 54	MI
Vintage	104	\$ 5,375	\$ 52	MI
Thornwild Apts II	24	\$ 1,105	\$ 46	MI
Thornwild Apts I	40	\$ 1,737	\$ 43	MI
Village View	24	\$ 829	\$ 35	MI
Hudson2	23	\$ 632	\$ 27	MI
Eastbrook	12	\$ 81	\$ 7	MI
Ashby Apts. Assn. II	8	\$ 1,878	\$ 235	MN
Clarissa Manor, Inc.	8	\$ 1,816	\$ 227	MN
Milona Homes	2	\$ 450	\$ 225	MN
Ashby Apts. Assn.	8	\$ 1,615	\$ 202	MN
Norplain	8	\$ 1,594	\$ 199	MN
Sanborn	12	\$ 2,338	\$ 195	MN
Belview	8	\$ 1,543	\$ 193	MN
Rothsay HSG II	8	\$ 1,504	\$ 188	MN
Altura Comm	4	\$ 731	\$ 183	MN
Spring-Field Apts.	12	\$ 2,171	\$ 181	MN
Rivercrest	24	\$ 4,304	\$ 179	MN
Lake Benton	8	\$ 1,429	\$ 179	MN
Rivers Edge-Se	16	\$ 2,821	\$ 176	MN
Northland Housing	16	\$ 2,627	\$ 164	MN
Eastown Ptsp	16	\$ 2,342	\$ 146	MN
Petersen Harold	11	\$ 1,364	\$ 124	MN
McCarthy & Assoc	16	\$ 1,694	\$ 106	MN
N. Lights P.R.	12	\$ 1,100	\$ 92	MN
Mower Cty 2 HRA	8	\$ 680	\$ 85	MN
Chokio3	6	\$ 496	\$ 83	MN
Northbridge	48	\$ 2,961	\$ 62	MN
Belle Haven	16	\$ 857	\$ 54	MN
Ploeger-Westview	16	\$ 842	\$ 53	MN
Osakis Community Manor	24	\$ 1,248	\$ 52	MN
Windsor Greens	18	\$ 940	\$ 52	MN
Oak Court	24	\$ 1,211	\$ 50	MN
Clay Housing	16	\$ 744	\$ 47	MN
Burnside	32	\$ 1,391	\$ 43	MN
Cedardale North	16	\$ 667	\$ 42	MN
Ridgecrest Apts.	16	\$ 608	\$ 38	MN
Pleasant View	12	\$ 365	\$ 30	MN
McCune Apts.	4	\$ 1,861	\$ 465	MO
Weeks Apts.	12	\$ 3,702	\$ 309	MO
New Madrid GA	40	\$ 11,357	\$ 284	MO
Alba Hsg Assoc	20	\$ 5,064	\$ 253	MO
Hsg Assoc Hollister	16	\$ 3,910	\$ 244	MO
Old Oaks Apts.	12	\$ 2,790	\$ 233	MO
Puxico SCH	16	\$ 3,465	\$ 217	MO
Eugene Gldn Acres	8	\$ 1,694	\$ 212	MO
Humphreys Sr	12	\$ 2,492	\$ 208	MO

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Oakmoore Dev. Co.	12	\$ 2,500	\$ 208	MO
Hickory Hills Villa	30	\$ 6,124	\$ 204	MO
L. Griffin Mms	6	\$ 1,206	\$ 201	MO
Everton Sch	12	\$ 2,213	\$ 184	MO
Urbana Housing	20	\$ 2,479	\$ 124	MO
Puxico Prop.	16	\$ 1,158	\$ 72	MO
Shelbyville RRH	32	\$ 1,925	\$ 60	MO
Laplata RRH	60	\$ 3,181	\$ 53	MO
Brookview/Elsberry	24	\$ 977	\$ 41	MO
Morrisvl Sch	20	\$ 817	\$ 41	MO
Brookview Wville II	24	\$ 909	\$ 38	MO
Rose Park Assn	73	\$ 2,663	\$ 36	MO
Buena Vista Homes	32	\$ 1,150	\$ 36	MO
Lockwood Hsg	20	\$ 673	\$ 34	MO
Brookview Mfield II	20	\$ 687	\$ 34	MO
North Callaway Sr. Citz	40	\$ 1,349	\$ 34	MO
Archie Sr Housing	48	\$ 1,592	\$ 33	MO
New Franklin Sr.	64	\$ 2,051	\$ 32	MO
Meadowland Mt V	20	\$ 586	\$ 29	MO
Knox Co. Sr.	20	\$ 127	\$ 6	MO
Stonewall Apts.	24	\$ 10,355	\$ 431	MS
Moun Bayou Par	22	\$ 9,053	\$ 412	MS
Bay St.Louis E	48	\$ 19,665	\$ 410	MS
Pontotoc Ridge	24	\$ 9,350	\$ 390	MS
Ms Hsng Winst	16	\$ 6,033	\$ 377	MS
Waveland Ltd	48	\$ 17,464	\$ 364	MS
Metcalfe 2 Ltd	24	\$ 8,449	\$ 352	MS
Miller Mnr	24	\$ 8,378	\$ 349	MS
Winona Snr Apt	24	\$ 8,228	\$ 343	MS
Valley Ridge	52	\$ 17,008	\$ 327	MS
Myrtles Apts.	24	\$ 6,583	\$ 274	MS
Nicholson Apt	32	\$ 8,658	\$ 271	MS
Sanders Estate	24	\$ 5,286	\$ 220	MS
Oakridge Prk I	40	\$ 8,640	\$ 216	MS
Metcalfe House	48	\$ 9,196	\$ 192	MS
Pine West Ltd	48	\$ 9,159	\$ 191	MS
Bay Springs II	24	\$ 4,522	\$ 188	MS
Coldwater Est	24	\$ 3,788	\$ 158	MS
Ellisvle Hsg	32	\$ 5,000	\$ 156	MS
Collins Housing	36	\$ 5,424	\$ 151	MS
Hattiesburg Hsg	32	\$ 4,724	\$ 148	MS
Sunrise Apts.	24	\$ 2,466	\$ 103	MS
Minor L Ayres	2	\$ 189	\$ 95	MS
Holly Spgs Assoc	20	\$ 1,093	\$ 55	MS
Mac Associates	16	\$ 843	\$ 53	MS
Cryst Spr Fam	40	\$ 2,038	\$ 51	MS
Iuka Apts. Ltd	78	\$ 2,955	\$ 38	MS
Magee Ltd	48	\$ -	\$ -	MS

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Harbourtowne Assoc.	46	\$ 20,130	\$ 438	NC
Cypress St. Apt. Assoc	2	\$ 690	\$ 345	NC
Princeville Developm	24	\$ 6,669	\$ 278	NC
Gibson Manor Assoc	24	\$ 5,786	\$ 241	NC
Southport II	24	\$ 5,623	\$ 234	NC
Albe-Melbourne	8	\$ 1,803	\$ 225	NC
Albe-Amster	4	\$ 848	\$ 212	NC
Pait-Dublin	4	\$ 848	\$ 212	NC
Pine Ridge Associates	44	\$ 9,253	\$ 210	NC
CDBH LP Of Belhaven	38	\$ 7,839	\$ 206	NC
Better Homes For Hav	60	\$ 12,075	\$ 201	NC
Marshburn & Manning	50	\$ 9,884	\$ 198	NC
Spruce Pine Housing	31	\$ 5,887	\$ 190	NC
Ridge Wood Associates	16	\$ 692	\$ 43	NC
Community Investors	52	\$ 2,179	\$ 42	NC
Cedar Village LP	28	\$ 1,042	\$ 37	NC
Rockmoor Associates	12	\$ 443	\$ 37	NC
Housing Opportunities	40	\$ 1,376	\$ 34	NC
Park Terrace	50	\$ 1,625	\$ 33	NC
Oakwood Village GP	28	\$ 762	\$ 27	NC
Long Creek Court Ltd	14	\$ 100	\$ 7	NC
Northwestern Regional	19	\$ 100	\$ 5	NC
Fairmont W-C-K Limit	26	\$ 120	\$ 5	NC
Maiden Apartments	20	\$ 107	\$ 5	NC
L.L. Phase 2	20	\$ 45	\$ 2	NC
Wintergreen Apts.	-	\$ -	\$ -	NC
Wickford Associates	-	\$ -	\$ -	NC
Pecan Grove Association	-	\$ -	\$ -	NC
Jonesville Housing	-	\$ -	\$ -	NC
A102	11	\$ 7,100	\$ 645	NY
W03	51	\$ 26,588	\$ 521	NY
S04	24	\$ 10,336	\$ 431	NY
H010	20	\$ 8,324	\$ 416	NY
A010	24	\$ 9,944	\$ 414	NY
A104	8	\$ 3,278	\$ 410	NY
H05	38	\$ 15,514	\$ 408	NY
N01	16	\$ 6,463	\$ 404	NY
W04	58	\$ 21,405	\$ 369	NY
A100	20	\$ 7,095	\$ 355	NY
A063	14	\$ 4,939	\$ 353	NY
A047	8	\$ 2,759	\$ 345	NY
K01	32	\$ 10,675	\$ 334	NY
A071	12	\$ 3,165	\$ 264	NY
D01	24	\$ 3,901	\$ 163	NY
X52	24	\$ 3,680	\$ 153	NY
S03	26	\$ 3,204	\$ 123	NY
A33	60	\$ 6,831	\$ 114	NY
A63	44	\$ 2,759	\$ 63	NY

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Marionsr	40	\$ 2,500	\$ 63	NY
A030	40	\$ 2,386	\$ 60	NY
A040	40	\$ 2,368	\$ 59	NY
X107	28	\$ 1,475	\$ 53	NY
A024	41	\$ 1,971	\$ 48	NY
X108	24	\$ 1,003	\$ 42	NY
X05	48	\$ 1,925	\$ 40	NY
X93	24	\$ 859	\$ 36	NY
A7	16	\$ 465	\$ 29	NY
Bernard	32	\$ 897	\$ 28	NY
The Berwick	49	\$ 9,760	\$ 199	OH
McArthur Manor	24	\$ 4,510	\$ 188	OH
Washington CH	50	\$ 9,385	\$ 188	OH
The Mills Ltd	60	\$ 9,529	\$ 159	OH
Sidney Dev Co.	56	\$ 8,824	\$ 158	OH
West Lafayette	49	\$ 7,662	\$ 156	OH
Broad Oak Ltd	40	\$ 6,192	\$ 155	OH
Saxonburg Dev Co	60	\$ 9,264	\$ 154	OH
Hi-Land I	16	\$ 2,457	\$ 154	OH
Buckeye House	27	\$ 3,960	\$ 147	OH
Centerburg Com	24	\$ 3,480	\$ 145	OH
Galion Assoc.	36	\$ 4,789	\$ 133	OH
Sue Ellen Apts.	32	\$ 2,194	\$ 69	OH
Apple Hill	40	\$ 2,470	\$ 62	OH
NCR	68	\$ 4,156	\$ 61	OH
Pataskala Green Apts.	32	\$ 1,958	\$ 61	OH
West Unity Ltd	24	\$ 1,086	\$ 45	OH
Amanda Acres	58	\$ 2,593	\$ 45	OH
Shire Crest	24	\$ 1,045	\$ 44	OH
Union Terminal	48	\$ 2,075	\$ 43	OH
Emmitt Station	39	\$ 1,664	\$ 43	OH
Loudon Bluffs	40	\$ 1,716	\$ 43	OH
Wood Village	52	\$ 2,182	\$ 42	OH
Greenwood	40	\$ 1,686	\$ 42	OH
Sheridan	40	\$ 1,622	\$ 41	OH
W Liberty Homes	76	\$ 3,083	\$ 41	OH
Laynecrest	48	\$ 1,875	\$ 39	OH
Lawrence Manor	60	\$ 1,767	\$ 29	OH
Danville	48	\$ 1,142	\$ 24	OH
Bainbridge Manor	48	\$ 1,089	\$ 23	OH
Tuscarora II	12	\$ 3,386	\$ 282	PA
Girardville Towers	16	\$ 4,483	\$ 280	PA
Strickler	12	\$ 2,938	\$ 245	PA
Battles	42	\$ 10,310	\$ 245	PA
Yad - Green	46	\$ 10,039	\$ 218	PA
Meyersdale Assoc.	20	\$ 4,299	\$ 215	PA
Greenfield	36	\$ 7,677	\$ 213	PA
ACHA Mcintosh	12	\$ 2,505	\$ 209	PA

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Applewood II	16	\$ 3,278	\$ 205	PA
Pine Grove	24	\$ 4,930	\$ 205	PA
Yad - Highland	33	\$ 6,676	\$ 202	PA
Indian (Brown)	20	\$ 3,920	\$ 196	PA
EEI – Trucksville	13	\$ 2,497	\$ 192	PA
Sycamore	22	\$ 4,225	\$ 192	PA
Summit Manor	24	\$ 1,071	\$ 45	PA
Parkview	24	\$ 1,075	\$ 45	PA
Scottown	20	\$ 892	\$ 45	PA
Woodside	32	\$ 1,403	\$ 44	PA
Pursel I	24	\$ 1,054	\$ 44	PA
Pursel II	24	\$ 1,054	\$ 44	PA
Timberhaven	24	\$ 1,054	\$ 44	PA
Warren (Arling)	48	\$ 2,029	\$ 42	PA
Lehigh	34	\$ 1,416	\$ 42	PA
Lake City	44	\$ 1,760	\$ 40	PA
South Shore II	28	\$ 1,047	\$ 37	PA
Columbia	45	\$ 1,674	\$ 37	PA
Findlay Park	15	\$ 125	\$ 8	PA
Fox Hunter II	32	\$ 221	\$ 7	PA
Mercer Ltd.	24	\$ 149	\$ 6	PA
Martinsburg I	16	\$ -	\$ -	PA
Northern Area	20	\$ -	\$ -	PA
Gainesboro Village	30	\$ 10,713	\$ 357	TN
Whiteville RRH Corp.	14	\$ 4,517	\$ 323	TN
Sha-Lei Apartments	6	\$ 1,878	\$ 313	TN
Twin Oaks Apartments II	24	\$ 6,981	\$ 291	TN
Joel Algood Apartments	16	\$ 4,445	\$ 278	TN
Roxborough Manor	24	\$ 6,621	\$ 276	TN
Buffalo River Apartments	24	\$ 6,045	\$ 252	TN
Cannon Manor	10	\$ 2,377	\$ 238	TN
Harber-Laman Apts. #2	8	\$ 1,795	\$ 224	TN
Harber-Laman Apts.	8	\$ 1,794	\$ 224	TN
Colonial House	27	\$ 5,685	\$ 211	TN
Oakview Apartments	24	\$ 5,050	\$ 210	TN
Martin Street Apartments	24	\$ 4,862	\$ 203	TN
Rolling Meadow Apartments	24	\$ 2,246	\$ 94	TN
Maplewood Apartments II	16	\$ 730	\$ 46	TN
Mountain View Apartments	48	\$ 2,076	\$ 43	TN
Oak Apartments	24	\$ 996	\$ 42	TN
Creekwood Apartments	24	\$ 1,018	\$ 42	TN
Bluff Springs Apartments	24	\$ 828	\$ 35	TN
Lauderdale Apartments	24	\$ 733	\$ 31	TN
Village Apartments	51	\$ 1,491	\$ 29	TN
Crowne Point Apartments	37	\$ 1,001	\$ 27	TN
West Hills Apartments	12	\$ 267	\$ 22	TN
Manor West Apartments	12	\$ 267	\$ 22	TN
Ridgecrest Apartments	12	\$ 267	\$ 22	TN

Project	No. of Units	Insurance¹⁰	Ins/Unit¹¹	State
Morningside Apartments	4	\$ 87	\$ 22	TN
Hohenwald Housing Auth.	36	\$ 460	\$ 13	TN
Trenton Tower Apartments	16	\$ 170	\$ 11	TN
Troy Place Apartments	16	\$ 170	\$ 11	TN
Country Villa Apartments	12	\$ -	\$ -	TN
College Green Apts.	32	\$ 7,692	\$ 240	VA
Cannery Row Apts.	9	\$ 2,000	\$ 222	VA
Pine Street Village II	27	\$ 5,400	\$ 200	VA
Surry Village III	8	\$ 1,506	\$ 188	VA
Jordan Dev.	27	\$ 5,028	\$ 186	VA
Washington Sq. Apts. P2	6	\$ 950	\$ 158	VA
Harbour North Apts.	120	\$ 18,537	\$ 154	VA
Skyline Manor Apts.	32	\$ 4,800	\$ 150	VA
Second Harbor North	120	\$ 17,508	\$ 146	VA
River Ridge Apts.	15	\$ 2,077	\$ 138	VA
Belleville Meadows	128	\$ 17,500	\$ 137	VA
Mill Roads Apts.	4	\$ 532	\$ 133	VA
Fishing Bay Estates	15	\$ 1,975	\$ 132	VA
Accomack Senior Village	33	\$ 4,300	\$ 130	VA
Pine Street Village II	16	\$ 2,070	\$ 129	VA
Academy Hill Apts.	30	\$ 2,472	\$ 82	VA
Village Apts.	61	\$ 4,000	\$ 66	VA
Craigmont II Apts.	44	\$ 2,400	\$ 55	VA
Yorktown Square II	60	\$ 3,107	\$ 52	VA
Sentry Woods Apts.	30	\$ 1,557	\$ 52	VA
Colonial Beach Village	32	\$ 1,660	\$ 52	VA
Second Burton Woods	48	\$ 2,440	\$ 51	VA
Oakhill Apts.	40	\$ 2,000	\$ 50	VA
Burton Woods Apts.	60	\$ 2,992	\$ 50	VA
Surry Village	48	\$ 2,390	\$ 50	VA
Stevens Woods I	60	\$ 2,922	\$ 49	VA
Amherst Apts.	48	\$ 2,232	\$ 47	VA
Luray Village Apts.	-	\$ -	\$ -	VA

EXHIBIT E – RHS RESPONSE TO THE DRAFT REPORT



United States
Department of
Agriculture

Rural Development

Operations and
Management

Washington, DC
20250

NOV 21 2000


SUBJECT: Official Draft - Rural Housing Service,
Rural Rental Housing Program Insurance
Expenses
(04801-006-KC)

TO: James R. Ebbitt
Assistant Inspector General
for Audit
Office of Inspector General

Attached is a memorandum dated November 17, 2000, along with attachments, from Obediah G. Baker, Jr., Deputy Administrator, concerning recommendations 1, 2, 3, 4, 5, 6, 7, 8, and 9 in the above subject audit.

This response is being submitted for your consideration to reach management decision.

If you have any questions, please contact Rochelle Diamond of my staff on 692-0077.


SHERIE HINTON HENRY
Director
Financial Management Division
Attachment

Rural Development is an Equal Opportunity Lender. Complaints of
discrimination should be sent to: Secretary of Agriculture,
Washington, DC 20250





United States Department of Agriculture
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

November 17, 2000

TO: Sherie Hinton Henry
Director
Financial Management Division

FROM: *for* Obediah G. Baker, Jr. *Obediah*
Deputy Administrator
Multi-Family Housing

SUBJECT: Audit 04801-06-KC Rural Rental Housing Insurance Expenses

Attached is Multi-Family Housing's response to subject audit.

Please direct any questions or concerns to Melba Swarey at (202) 720-1613.

Attachment

Rural Development is an Equal Opportunity Lender
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, DC 20250



COMMENTS ON THE RECOMMENDATIONS OF OIG AUDIT 04801-006-KC
Rural Rental Housing Program Insurance Expenses

RECOMMENDATION NO. 1

Instruct personnel responsible for development and maintenance of the MFIS to ensure the system is able to provide managers data (such as insurance expenses), and State and regional comparison of line items. Instruct the States to assemble and analyze insurance cost data, as required, until adequate information is received from the MFIS to allow meaningful cost comparisons of individual expenses. Amend AN 3552 to require comparison of line items as needed (such as insurance expense).

AGENCY RESPONSE:

Efforts are underway to ensure MFIS is able to provide managers with cost data by use of a data warehouse. Implementation scheduled by September 30, 2001.

Amendment of AN 3552 is not necessary. MFIS provides both an analysis of the subtotal line items and comparison of individual line items. In addition, section 2930.117(c)(5) of 7 C.F.R. Part 1930 Subpart C requires State Offices to assemble, analyze and distribute statewide database of actual multifamily housing operation and maintenance costs for determination of cost reasonableness that reflects the variable characteristics of project operations. Internal reviews will place greater emphasis on enforcing the above requirements.

RECOMMENDATION NO. 2

Instruct the SO's to follow up to determine the reasons for unusually high or low insurance costs, to provide servicing instructions as necessary to management agents, and to correct the databases where errors exist. Require SO's to determine if high insurance charges can be supported by premium amounts and if the premium amounts are excessive when compared to other insurance companies.

AGENCY RESPONSE:

A memo instructing the cited SO to review the insurance costs will be issued and costs reviewed after the 2000 actuals are received. Section 1930.119(a)(5) of 7 C.F.R. Part 1930 Subpart C requires servicing officials to determine if the project is being operated according to the approved budget. Internal reviews will place greater emphasis on enforcing the above requirements. Anticipated date: April 30, 2001.

RECOMMENDATION NO. 3:

Instruct the servicing officials to 1) require the cited management company to verify that amounts paid for insurance policies match the premium stated on the face of the policy and to write checks to the insurance company, not the agent; 2) require the management company and Agency A to provide a full accounting for all insurance costs since 1994; 3) determine if Agency A should be barred from providing insurance to RRH projects; and 4) ensure the unallowable costs and any applicable interest are properly refunded to the projects.

AGENCY RESPONSE:

A memo instructing the servicing officials as cited in Recommendation No. 3 will be issued by January 31, 2001.

RECOMMENDATION NO. 4:

Instruct the Mississippi SO to require the cited management company to fully account for and recover the improper worker's compensation expenses charged to projects since 1994.

AGENCY RESPONSE:

A memo instructing the Mississippi SO to require the cited management company to fully account for and recover the improper worker's compensation expenses charged to projects since 1994 will be issued by March 30, 2001.

RECOMMENDATION NO. 5:

Instruct servicing officials to require management companies to properly classify expenses on form 1930-7 to ensure accurate reporting and to allow for meaningful comparison of costs. Perform checks to ensure management companies are not duplicating costs.

AGENCY RESPONSE:

An administrative notice will be issued prior to submission of 2002 budget cycle requiring management companies to properly classify expenses on form 1930-7. Section 1930.117(a)(4) of 7 C.F.R. Part 1930 Subpart C requires Agency officials to monitor the borrower's compliance with its regulations concerning real property tax, insurance,

bonding, security budgeting and reporting requirements. In addition, section 1930.116 of 7 C.F.R. Part 1930 Subpart C requires that project operations shall be conducted to meet the actual needs and necessary expenses of the property. Internal reviews will place greater emphasis on enforcing the above requirements. Anticipated date: June 30, 2001.

RECOMMENDATION NO. 6:

Instruct servicing officials to require the cited management companies to limit insurance charges to projects to only those that are actual and necessary and allowed under terms of the management agreement. Require Sun Belt to repay projects for the Errors and Omissions insurance. Require both Sun Belt and Southeastern to determine and repay projects the amounts paid for fidelity insurance.

AGENCY RESPONSE:

Review of the insurance charges by Sun Belt will be made after the audits are received by the cited projects. Anticipated date: April 30, 2001.

RECOMMENDATION NO. 7:

Instruct servicing officials to require a full accounting of finance charges and require Sun Belt to repay the projects for the unallowable finance charges. Instruct servicing officials to ensure the cited management company reduces expenditures or obtains consent before incurring finance charges.

AGENCY RESPONSE:

A memo to the cited servicing officials will be issued addressing a full accounting of finance charges by Sun Belt and repayment of any unallowable finance charges by January 31, 2001.

RECOMMENDATION NO. 8:

Have the SO instruct the cited management company on the maximum deductibles and ensure management companies are obtaining insurance policies with deductibles that meet regulations. Instruct the SO to require the management company to reimburse the project for the loss caused by the excessive deductible.

AGENCY RESPONSE:

A memo to the cited SO will be issued addressing the maximum deductibles by January 31, 2001.

RECOMMENDATION NO. 9:

Have the servicing officials obtain a complete description of the IOI relationship and determine if the IOI may continue to provide services to the projects.

AGENCY RESPONSE:

A memo to the cited servicing office will be issued addressing the IOI relationship by January 31, 2001.

ABBREVIATIONS

Agency A	
Sun Belt’s Insurance Agent.....	7
AN	
Administrative Notice.....	10
IOI	
Identity of Interest	1
MFH	
Multi-Family Housing.....	1
MFIS	
Multi-Family Information System.....	4
RHS	
Rural Housing Service	1
RRH	
Rural Rental Housing.....	1
SO	
State Office.....	1
Southeastern	
Southeastern Management Company, Inc.	1
Sun Belt	
Sun Belt Management Company.....	1