



Breakthrough Living Program, Topeka, KS

Section 202 Direct Loan Program



To: Kelly Haines, Director, Southwest Region Multifamily Housing Hub, 6AHML
Craig Clemmensen, Director, Departmental Enforcement Center, CACB

//signed//

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

Subject: Breakthrough Living Program Did Not Administer Its Program in Accordance With HUD Rules and Regulations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Breakthrough Living Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



Audit Report Number: 2015-KC-1001

Date: March 5, 2015

Breakthrough Living Program Did Not Administer Its Program in Accordance With HUD Rules and Regulations

Highlights

What We Audited and Why

We audited Breakthrough Living Program based on an audit memorandum referral received from the Director of the U.S. Department of Housing and Urban Development's (HUD) Southwest Region, Office of Multifamily Housing Programs. The referral cited several concerns, including the property's unilateral withdrawal of funds from the reserve for replacement account. Our audit objective was to determine whether Breakthrough Living (1) properly transferred funds from its reserve for replacement account, (2) properly charged its Section 8 tenants additional rental fees with the required approval, and (3) improperly paid overhead costs for its management agent.

What We Found

Breakthrough Living violated its regulatory agreement with HUD by improperly transferring funds from its reserve for replacement account and paying overhead expenses for its management agent. In addition, it improperly charged its Section 8 tenants \$69,000 in program fees.

What We Recommend

We recommend that HUD require Breakthrough Living to (1) repay the \$47,690 that it transferred from its reserve for replacement account, (2) repay \$5,642 that it used for its management agent's overhead expenses, (3) repay the \$69,577 that it improperly collected from its tenants, (4) ensure that its board hires a new HUD-approved independent management agent, and (5) ensure that its board receives adequate training regarding the financial operations of a HUD property.

We also recommend that HUD take appropriate administrative actions, up to and including debarment, against Breakthrough Living's former executive director for her part in repeatedly violating the property's regulatory agreement.

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Background and Objective

Breakthrough Living Program, Inc., a Kansas nonprofit corporation governed by a board of directors, was formed in 1984. It owns 15 Section 8-subsidized units located in Topeka, KS. Its mission is to empower individuals with mental illness to function more independently in their social living and working environments by providing the individuals with secure, decent, safe, and affordable housing. The U.S. Department of Housing and Urban Development (HUD) funded the construction of the units under Section 202 of the Housing Act of 1959. In July 1984, Breakthrough Living's board of directors entered into a regulatory agreement with HUD in the amount of \$508,000. The agreement provides for regulation by HUD of rental charges and operating methods.

The Section 202 program provides for Federal direct loans to private, nonprofit corporations and consumer cooperatives in the development of new or substantially rehabilitated housing and related facilities to serve the elderly and the handicapped. This program helps expand the supply of affordable housing with supportive services for the elderly or the handicapped. With the consolidation of the application requirements of the Section 202 and Section 8 programs in 24 CFR (Code of Federal Regulations) Part 885, projects which met the requirements of the Section 202 program are deemed to have met the requirements for housing assistance payments as provided in the U. S. Housing Act of 1937. Breakthrough Living is authorized to receive Section 8 rental subsidies for its 15 units. As of July 31, 2014, only 14 of the 15 units were occupied. It received \$299,791 in Section 8 funding from January 2012 to October 2014.

Breakthrough Living employed an identity-of-interest management agent, Breakthrough House, Inc., to oversee its day-to-day operations and long-term planning. The management agent's board of directors and executive director was the same as the Breakthrough Living board and executive director. Breakthrough Living's executive director provided oversight of the project's daily operations. The use of a designated management agent did not relieve the board of its responsibility to ensure that the program operated in accordance with its regulatory agreement and applicable HUD handbooks.

Our audit objective was to determine whether Breakthrough Living (1) properly transferred funds from its reserve for replacement account, (2) properly charged its Section 8 tenants additional rental fees with the required approval, and (3) improperly paid overhead costs for its management agent.

Results of Audit

Finding 1: Breakthrough Living Violated Its Regulatory Agreement with HUD

Breakthrough Living violated its regulatory agreement with HUD by improperly transferring funds from its reserve for replacement account and paying overhead expenses for its management agent. This condition occurred because the board did not provide adequate oversight over the activities and operations of the Breakthrough Living's management agent to ensure the regulatory agreement was followed. As a result, the appropriate level of funding was not always available in the reserve for replacement account and the operating account if needed to finance capital improvements and operating expenses.

Breakthrough Living Improperly Transferred Funds

Breakthrough Living's executive director transferred \$247,444 from its reserve for replacement account without the required HUD approval. HUD Handbook 4350.1, REV-1, section 4-2, requires Breakthrough Living to receive approval before disbursing funds from its reserve for replacement account.

Between January 2012 and July 2014, Breakthrough Living's executive director transferred \$44,959 from its reserve for replacement account to its operating account. It paid back \$24,254, and the unpaid balance was \$20,705 as of July 31, 2014. The executive director did not obtain the required HUD approval before disbursing funds from its reserve for replacement account. She also transferred \$202,485 from the account to its management agent's operating account, which is considered an unauthorized loan from project funds. The management agent paid back \$175,500, and the unpaid balance was \$26,985 as of July 31, 2014. Funding in the reserve for replacement account covers capital repairs such as roof replacements, kitchen upgrades, bathroom remodeling, and other extensive needs the project may need as it ages.

Overhead Expenses Paid for the Management Agent

Breakthrough Living improperly paid \$5,642 in overhead expenses for its management agent from the project's operating account. HUD Handbook 4381.5, section 6-38, does not permit overhead costs chargeable to a management agent to be paid from the property's operating account. The handbook states that overhead costs, including rent, phones, and office supplies, must be paid from the management fee.

During our audit period, Breakthrough Living paid overhead expenses, including office relocation costs as well as office rent, utilities, and equipment by paying a portion of its management agent's bills from the project's operating account. The table below provides details of the office overhead type and expense amount for which Breakthrough Living paid overhead costs for its management agent from January 1, 2012, through July 31, 2014.

Office overhead type	Expense amount
Relocation	\$91
Rent	4,178
Utilities	1,365
Equipment	8
Totals	\$5,642

The Board Did Not Provide Oversight

Breakthrough Living’s board did not provide adequate oversight by not actively overseeing the activities and operations of the management agent that oversaw the operations of Breakthrough Living Program. Two members of the board told us they did not know much about the operations of Breakthrough Living and did not review the financial reports for the property. In addition, the management agent ignored repeated warning from HUD and the Departmental Enforcement Center that transferring money from the replacement account without HUD approval was a violation of the regulatory agreement. As of July 2014, the management agent continued to transfer funds from the reserve for replacement account after HUD denied the request to transfer funds.

Funding Was Not Always Available

As a result of the issues discussed above, the appropriate level of funding was not always available in the reserve for replacement account and the operating account to finance capital improvements and operating expenses. As of July 31, 2014, the required balance of \$83,679 in the reserve for replacement account was reduced by unauthorized loans of \$47,690. In addition, the required balance of \$6,979 in the operating account was reduced by ineligible expenses of \$5,642. Reducing the reserves in violation of the regulatory agreement could jeopardize the project’s ability to make necessary repairs when they occur.

Conclusion

The appropriate level of funding was not always available in the reserve for replacement account and the operating account because of inadequate board oversight to ensure the regulatory agreement was followed. In September 2014, the Breakthrough Living executive director resigned from her position, and the board was hiring a replacement. As of December 2014, the Breakthrough Living board was contracting with a new HUD-approved management agent to oversee the operations of the Breakthrough Living units.

Recommendations

We recommend that the Director of the Southwest Region, Office of Multifamily Housing Programs

- 1A. Require Breakthrough Living to repay from non-Federal sources the unpaid balance of \$47,690 that it transferred from its reserve for replacement account to its operating account and management agent.
- 1B. Require Breakthrough Living to repay from non-Federal sources the \$5,642 that it used to pay for its management agent's overhead expenses.
- 1C. Ensure that Breakthrough Living's board hires a new HUD-approved independent management agent.
- 1D. Ensure that Breakthrough Living's board receives adequate training regarding the financial operations of Breakthrough Living so it can ensure that its new management agent fully complies with the requirements.

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

- 1E. Take appropriate administrative actions, up to and including debarment, against Breakthrough Living's former executive director for her part in repeatedly violating the property's regulatory agreement.

Finding 2: Breakthrough Living Improperly Charged Its Section 8 Tenants \$69,000 in Program Fees

Breakthrough Living improperly charged its Section 8 tenants \$69,000 in program fees. This condition occurred because its board did not provide adequate oversight over the activities and operations of the Breakthrough Living management agent to ensure it followed the regulatory agreement. As a result, the tenants were not protected from the unreasonable fees.

Section 8 Tenants Were Charged Program Fees

Breakthrough Living improperly charged its Section 8 tenants \$69,000 in program fees without the required HUD approval. HUD Handbook 4350.3, paragraph 6-25(f), does not permit property owners to charge other fees to their Section 8 tenants without HUD approval.

During our audit period, we found 25 separate instances in which Breakthrough Living charged its Section 8 tenants program fees ranging from \$18 to \$300 per month. It charged 11 tenants \$300 per month, 13 tenants \$60 per month, and 1 tenant \$18 per month. Breakthrough Living stated that it used the program fees to help defray the costs of providing nontraditional services, such as water and trash, electric, gas, cable, Internet, snow removal, lawn mowing, in-home wellness visits, laundry, and membership to the Young Men's Christian Association (YMCA), to the tenants as part of the Supportive Housing Program. Breakthrough Living received \$69,000 in program fees from its Section 8 tenants between January 2012 and October 2014.

The Board Did Not Provide Adequate Oversight

Breakthrough Living's board did not provide adequate oversight over the activities and operations of the Breakthrough Living management agent to ensure it followed the requirements. Two members of the board told us they did not know much about the operations of Breakthrough Living and did not review the financial reports for the property. In 2009 and 2010, the management agent ignored repeated warnings from its Section 8 coordinator that charging program fees to the Breakthrough Living Section 8 tenants was a violation of HUD Handbook 4350.3 requirements.

Tenants Were Not Protected From Unreasonable Fees

As a result of the issues discussed above, the tenants were not protected from the unreasonable fees. The Section 8 tenants were charged program fees in addition to rent and they received services similar to those of the non-HUD-subsidized market rate renters. All other tenants who did not receive Section 8 housing assistance did not pay the program fees.

Conclusion

The tenants were not protected from the unreasonable fees because of inadequate board oversight and management's disregard of the requirements. As a result of our review, Breakthrough Living stopped charging program fees to its Section 8 tenants in October 2014. As of December 2014, its board was contracting with a new HUD-approved management agent to oversee the operations of the Breakthrough Living units.

Recommendations

We recommend that the Director of the Southwest Region, Office of Multifamily Housing Programs

- 2A. Require Breakthrough Living to repay the \$69,577 that it collected from its Section 8 tenants. For any tenant who left the Section 8 program and cannot be located, HUD should require Breakthrough Living to send his or her refund to the Kansas State treasurer so the treasurer can get the refund to the tenant or a family member.
- 2B. Ensure Breakthrough Living's board receives adequate training regarding the operations of Breakthrough Living to ensure its new management agent fully complies with the requirements.

Scope and Methodology

Our review generally covered the period January 1, 2012, through July 31, 2014; however, we expanded the scope to October 1, 2014, to address program fee charges noted during the audit. We conducted our fieldwork from August through December 2014 at the Breakthrough Living administrative offices located at 525 Topeka Boulevard, Topeka, KS.

To achieve our objective, we interviewed

- HUD's multifamily staff located in Kansas City, KS,
- Breakthrough Living's and its management agent's board members and staff,
- Breakthrough Living's Section 8 tenants, and
- Depository financial institution staff members who maintain Breakthrough Living bank accounts.

We also reviewed

- Federal regulations and HUD requirements;
- Breakthrough Living's regulatory agreement;
- Breakthrough Living's internal accounting procedures;
- Integrated Real Estate Management System and Tenant Recertification Assistance Certification System data;
- Breakthrough Living's audited financial statements and other accounting records;
- Breakthrough Living's payroll and accounting records;
- Breakthrough Living's bank statements, checks, and other associated records; and
- Management agent bank statements, checks, and other associated records subpoenaed from financial institutions.

We selected for review 100 percent of Breakthrough Living's monthly bank statements for the reserve for replacement account, tenant security deposit account, residual receipts account, and operating account for January 2012 through July 2014. We tested whether all withdrawals from these accounts were properly authorized and the balances in the accounts were accurate. Because we found instances in which funds were transferred to the management agent's operating account, we tested the management agent's operating account to determine whether the funds transferred into the account were properly spent.

We visited the 14 Breakthrough Living Section 8 tenants in the program as of July 31, 2014, and reviewed 100 percent of the 14 Section 8 tenant files and lease agreements. The lease agreement includes the monthly required total tenant payment and the housing assistance subsidy for each

tenant. We matched the required total tenant payment and housing assistance subsidy in the agreements to the form HUD-50059 (Owner's Certification of Compliance with HUD's Tenant Eligibility and Rent Procedures). We also verified that Breakthrough Living required its Section 8 tenants to pay program fees in addition to rent.

In addition, we obtained data from the Integrated Real Estate Management System and Tenant Rental Assistance Certification System. We relied on these systems for background information only and determined that Breakthrough Living received \$299,791 in Section 8 funding from January 2012 to October 2014.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Controls over the withdrawal of reserve for replacement funds.
- Controls over charging additional rental fees to Section 8 tenants.
- Controls over the payment of overhead expenses for Breakthrough Living's management agent.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following item is a significant deficiency:

- Breakthrough Living's board did not provide adequate oversight of the Breakthrough Living management agent to ensure it followed the regulatory agreement and HUD Handbook 4350.3 requirements (findings 1 and 2).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/
1A	\$47,690
1B	5,642
2A	69,577
Totals	\$122,209

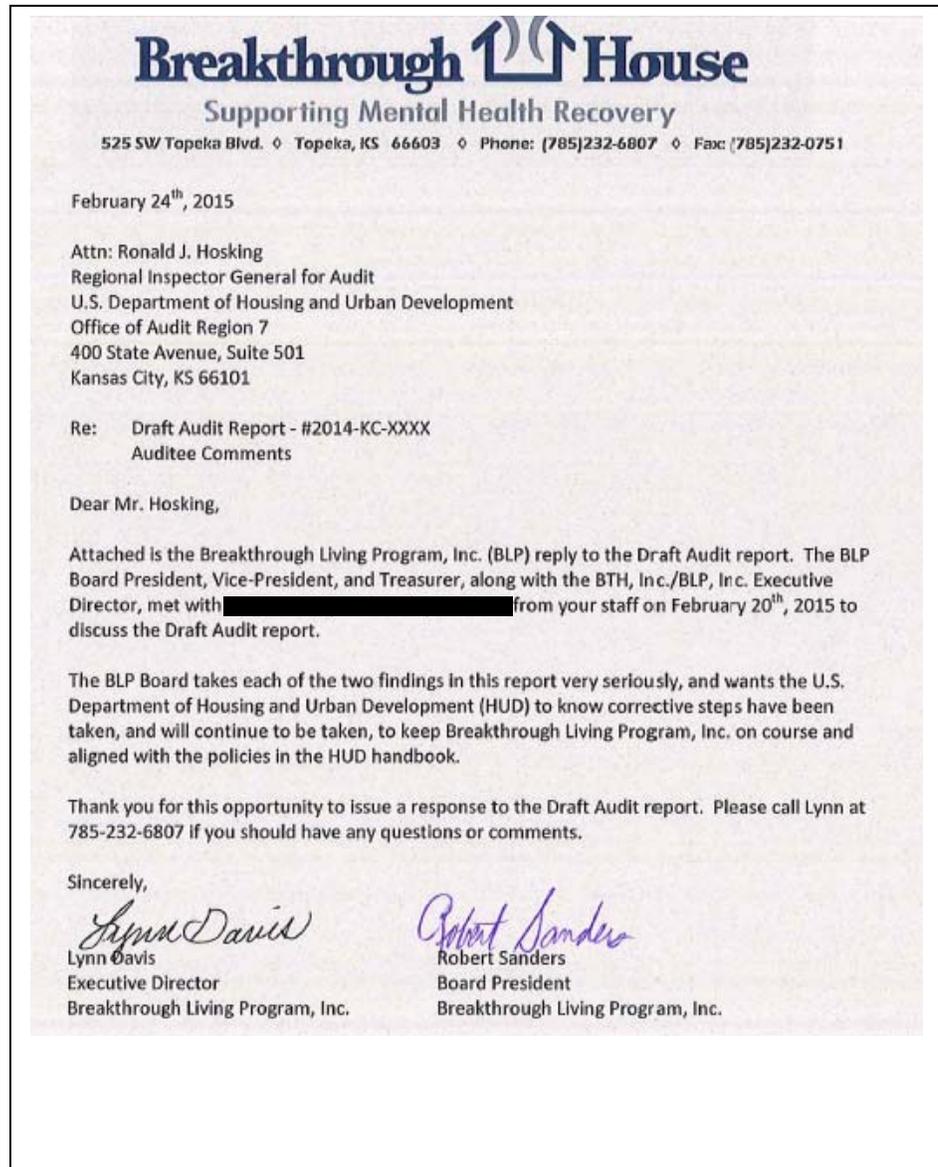
- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG
Evaluation

Auditee Comments



Comment 1

**Draft Audit Report – HUD-OIG
Reponse to Finding #1**



525 SW Topeka Blvd. ♦ Topeka, KS 66603

Finding 1: Breakthrough Living Violated Its Regulatory Agreement with HUD

The Breakthrough Living Program (BLP) Board acknowledges the following:

- Breakthrough Living’s former executive director improperly transferred funds from the BLP reserve for replacement account without the proper HUD authorization.
- Overhead expenses for BTH, Inc. are not an allowed project expense, and must be paid out of the management fee.
- The BLP board did not provide adequate oversight of BLP asset management.

Breakthrough Living Program, Inc. Auditee Comment to Finding 1:

The following are steps and actions that BLP, Inc. has taken to prevent any further occurrence of these violations:

- The Executive Director (HUD Asset Mgt.) that mishandled the BLP funds is no longer with BLP, Inc. or BTH, Inc. as of 10/2/2014.
- There is now open, regular and transparent communication between the BLP Board and the current Executive Director.
- The BLP Board of Directors began reviewing BLP financial reports in November 2014, and now regularly reviews these reports at least monthly.
- The Board Treasurer started reviewing all BLP bank account Reconciliations in November 2014.
- An agreement with a new HUD Asset Mgt. Agent was signed on 12/17/2014.
- The BLP Board of Directors will receive at least monthly reports from the new HUD Asset Mgt. Agent, and will not hesitate to request additional reports, as needed.
- The BLP Board Treasurer and Executive Director will have viewing privileges on all the BLP accounts overseen by the HUD Asset Mgt. Agent., and will view the activity of these accounts on a regular basis.
- The HUD Asset Mgt. Agent will be questioned to confirm the submission of any regular and occasional HUD reports needing submission, i.e. monthly and annual reports, 2530 updates.
- The 2530 has been updated, and a revision document will be submitted any time BLP Board members change in membership and/or position.
- In addition to Board oversight procedures, the bookkeeper will notify the Board Treasurer regarding any possible discrepancies noted.
- The BLP, Inc. Board is looking forward to attending the HUD financial operations management training to be recommended by HUD.
- The BLP, Inc. Board Manual will be updated, and it will include a section on Financial Operations of HUD properties, as well as a section outlining the type and frequency of training required to maintain board membership.

Comment 1

**Draft Audit Report – HUD-OIG
Reponse to Finding #2**

Breakthrough House
Supporting Mental Health Recovery
525 SW Topeka Blvd. ♦ Topeka, KS 66603

Finding 2: Breakthrough Living Improperly Charged Its Section 8 Tenants \$69,000 in Program Fees.

The Breakthrough Living Program (BLP) Board acknowledges the following:

- Breakthrough Living's Section 8 tenants were charged program fees.
- No document proving prior HUD permission could be found.
- The Board did not know Program fee authorization had not been obtained by HUD.

Breakthrough Living Program, Inc. Auditee Comment to Finding 2:

The following are steps and actions that BLP, Inc. has taken to prevent any further occurrence of these violations:

- The Program Fees were stopped in October 2014, which was as soon as this fee was found to be in violation of the HUD manual.
- An agreement for a new HUD-recommended Asset Mgt. Agent was signed on 12/17/2014.
- The BLP Board is ready to receive the HUD-recommended training in the HUD financial operations, so it can better oversee the actions of the new HUD Asset Manager.
- The BLP Board Treasurer and Executive Director will have viewing privileges on all the BLP accounts overseen by the new HUD Mgt. Agent. The BLP account activity will be viewed on a regular basis.
- The BLP board of directors will receive at least monthly reports from the HUD Asset Mgt. Agent, and will not hesitate to request additional reports, as needed.
- In addition to Board oversight procedures, the bookkeeper will notify the Board Treasurer regarding any possible discrepancies noted.
- The BLP Board of Directors has developed a Service Fee policy that addresses HUD and non-HUD tenants. This policy has been sent to HUD for approval.

OIG Evaluation of Auditee Comments

Comment 1 Breakthrough Living acknowledged the finding and provided steps it's taking to prevent further occurrence of the violations. HUD needs to coordinate with Breakthrough Living on the timeframe for implementing the recommendations and verify the recommendations are implemented.

Appendix C

Criteria

Breakthrough Living Program Regulatory Agreement

Paragraph 5 states that “disbursements from such fund, whether for the purpose of effecting replacement of structural elements, and mechanical equipment of the project or for any other purpose, may be made only after the consent in writing of HUD.”

Paragraph 11(c) states that “neither Mortgagor nor its agents shall make any payment for services, supplies, or materials unless such services are actually rendered for the project or such supplies or materials are delivered to the project and are reasonably necessary for its operation.”

Paragraph 11(j) states that “the mortgagor shall not collect from tenants or prospective tenants or occupants of the project any admission fee, founder’s fee, life care fee, or similar payment pursuant to any agreement, oral or written, whereby the mortgagor agrees to furnish accommodations or services in the project to persons making such payments.”

HUD Handbook 4350.1, REV-1

HUD Handbook 4350.1, REV-1, section 4-1, provides for the establishment of a reserve fund for replacements for most projects with HUD-insured, formerly coinsured, and HUD-held mortgages, including Section 202 direct loan projects. Section 4-2 states that “disbursements from such fund, whether for the purpose of effecting replacement of structural elements and mechanical equipment of the project, for the cure of mortgage defaults, or for any other purpose, may be made only after receiving the consent in writing of the Commissioner. In the case of Section 202, 162, 801, or 811 projects, where HUD serves as the mortgagee [lender], the project owner escrows the funds but may not withdraw them from the Reserve for Replacements Account without the Asset Management Branch Chief’s written permission.”

HUD Handbook 4350.3

HUD Handbook 4350.3 does not permit property owners to charge other fees to their Section 8 tenants without HUD’s or the contract administrator’s approval. Paragraph 6-25(f) states that “owners may require tenants to pay other charges; (1) if HUD or the contract administrator has approved the charges.”

HUD Handbook 4381.5

HUD Handbook 4381.5, section 6-38, provides basic guidance on management costs charged to the project’s operating account. It does not permit overhead costs chargeable to a management agent to be paid from the project’s operating account. Section 6-2 requires that overhead costs, including rent, phones, and office supplies, be paid for from the management fee.