Issue Date	January 20, 2012
Audit Report Number	2012-KC-1001

TO: Brenda L. Waters, Director, Kansas City Multifamily Housing Hub, 7AHMLAS
Craig Clemmensen, Departmental Enforcement Center, CACB

//**signed**//

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

SUBJECT: John Calvin Manor Violated Its Regulatory and Loan Agreements With HUD and Inappropriately Made Salary Payments to Its Board President

HIGHLIGHTS

What We Audited and Why

We audited John Calvin Manor of Lee's Summit, MO, in response to a request from the U.S. Department of Housing and Urban Development's (HUD) Office of Multifamily Housing in Kansas City, KS. Our audit objective was to determine whether the property violated its regulatory and loan agreement with HUD.

What We Found

The property violated its regulatory and loan agreements with HUD by improperly spending restricted funds, defaulting on its mortgage payment, and failing to submit financial statements to HUD. In addition, it inappropriately made salary payments to its board president.

What We Recommend

We recommend that HUD should develop a plan with the property to reestablish and fully fund its reserve for replacement account, debt reserve account, and tenant security deposit account and become current on its mortgage obligation. We also recommend that HUD work with the property to seek reimbursement from the former board president for the ineligible compensation he received and take appropriate administrative actions against the former board president up to and including debarment.

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

Auditee's Response

We provided the draft report to the property on January 3, 2012 and requested a response by January 17, 2012. The property provided written comments on January 13, 2012. The property agreed with our findings and recommendations.

The complete text of the auditee's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

John Calvin Manor, a Missouri nonprofit corporation governed by a board of directors, was formed in 1965. The property is a 100-unit assisted living facility located in Lee's Summit, MO. The U.S. Department of Housing and Urban Development (HUD) funded the construction of the property under Section 202 of the Housing Act of 1959 in the amount of $1 million. The board entered into a 50-year mortgage agreement with HUD in October of 1967.

The Section 202 program helps expand the supply of affordable housing with supportive services for the elderly. It provides very low-income elderly individuals with options that allow them to live independently but in an environment that provides support activities such as cleaning, cooking, and transportation. In addition, the property is authorized to receive Section 8 rental subsidies for 84 of its 100 units. It received $79,788 in Section 8 funding from September 2008 to September 2011.

The property employed an onsite manager to oversee day-to-day operations. The board is ultimately responsible for ensuring that the property is operated in accordance with its regulatory agreement and applicable HUD handbooks. However, the board may contract with a management agent to provide oversight and supervision of day-to-day operations and long-term planning.

The property was owner managed until August 1, 2010. The board then used the services of a management consultant for the 8-month period ending March 31, 2011. On April 1, 2011, the board hired a full-time HUD approved management agent to oversee the property until March 31, 2012.

Our audit objective was to determine whether the property violated its regulatory and loan agreement with HUD.

RESULTS OF AUDIT

Finding 1: The Property Violated Its Regulatory and Loan Agreements with HUD

The property violated its regulatory and loan agreements with HUD by improperly spending restricted funds, defaulting on its mortgage payment, and failing to submit financial statements to HUD. This condition occurred because the property lacked controls over its financial operations and its board did not provide adequate oversight of the property. As a result, the property could not meet its operating needs or fund necessary long-term capital improvements to ensure safe and affordable housing for its elderly residents.

Funds From Restricted Accounts Were Improperly Spent

The property improperly spent funds from three separate restricted accounts: the reserve for replacement account, the debt reserve account, and the tenant security deposit account.

<u>Reserve for Replacement Account</u>

Between April 2008 and November 2010, the property transferred the more than $240,000 balance in its reserve for replacement account to unrestricted accounts without the required HUD approval. HUD Handbook 4350.1, REV-1, paragraph 4-2, requires that the property receive approval before expending funds from its reserve for replacement account.

The reserve balance would have been more than $278,000 if the property had not transferred the funds out of the account and if it had deposited the required monthly payments. The loan agreement requires the property to deposit funds each month into its reserve for replacement account. The required deposit amount was $1,032 between July 2008 and October 2009. In November of 2009, HUD increased the required monthly deposit amount to $1,064. The property had not maintained a reserve for replacement account since November 2010.

<u>Debt Reserve Account</u>

Between July 2009 and October 2010, the property spent more than $69,000 from its debt reserve accounts on expenses not approved by HUD. HUD Handbook 4350.1, REV-1, paragraph 27-3, states that debt reserve funds are to be used exclusively for payments of principal and interest on the mortgage note or to meet escrows. The funds were used to cover operating expenses of the property.

The property closed its debt reserve account in October 2010. The loan agreement between the property and HUD requires a debt reserve balance of more than $41,000. The property is required to fund the account with revenues in excess of 90 days of expenses at the end of each fiscal year.

Security Deposit Account

From April through September 2010, the property transferred more than $26,000 from its tenant security deposit account to operating accounts to cover operating expenses. HUD Handbook 4370.2, REV-1, paragraph 2-9, states that funds in the security deposit account must not be commingled with other funds. The tenant security deposit account was underfunded by more than $21,000 as of June 30, 2011.

The Property Defaulted on Its Mortgage Payment

As of September 1, 2011, the property was 6 months in arrears on its mortgage payments, totaling $23,821. The loan agreement requires the property to make monthly mortgage payments to HUD in the amount of $3,403.

The Property Failed To Submit Audited Financial Statements to HUD

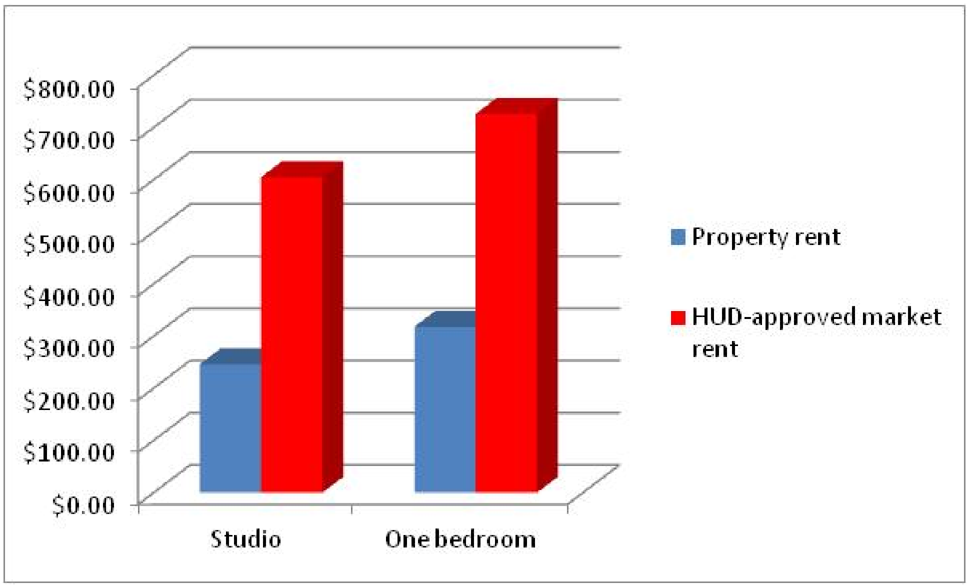
The property last submitted audited financial statements to HUD in June 2008. The regulatory agreement requires the property to submit financial statements prepared by an independent auditor no later than 90 days after year end. In addition, HUD Handbook 4370.2, REV-1, paragraph 3-1, states that the owners are responsible for submitting audited financial statements to HUD.

The Property Lacked Controls Over Its Financial Operations

The property did not have written policies and procedures or financial controls in place to ensure that it always collected income it was entitled to receive and denied HUD’s request for a depository agreement for its restricted accounts.

The property had no written policies and procedures for rent collection, procurement, disbursements, and maintenance. The board employed three different property managers from June 2009 to February 2011. None of the property managers had written policies or procedures to guide them in managing a HUD property.

The property did not have financial controls in place to ensure that it always collected income it was entitled to receive. From August 2009 to January 2011, the property requested its Section 8 voucher funds anywhere from 1 to 15 months late. It did not implement a proposed rent increase in 2009 and had not increased its rent since 1991. The property collected only $246 and $318 for its studio and one-bedroom units, respectively, although the HUD-approved market rents were $605 and $726. The following chart shows the differences between what the property collected for its studio and one-bedroom apartments and HUD's corresponding approved market rents.



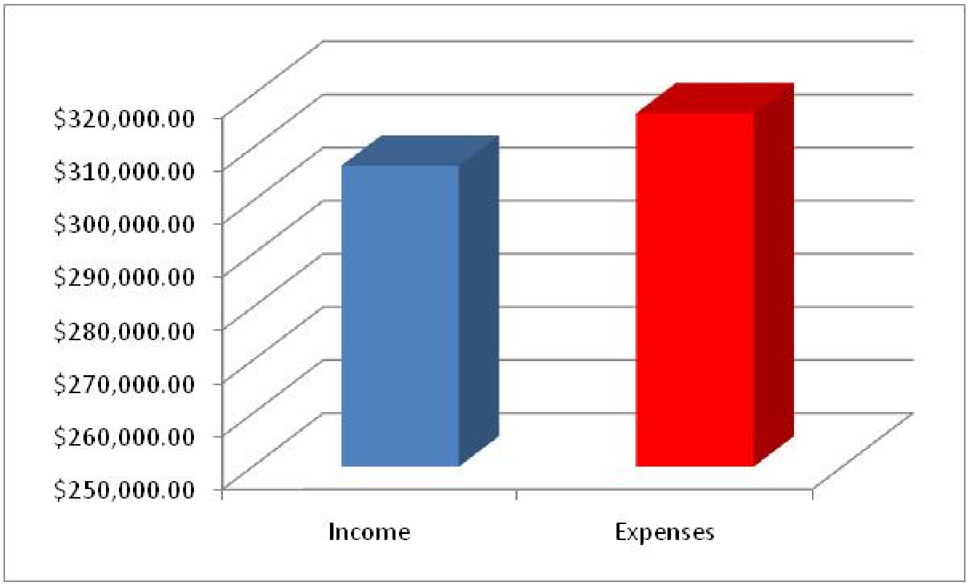
In 2003, HUD requested that the property sign a depository agreement for its restricted accounts. The property denied HUD's request. The depository agreement would have required financial institutions to receive approval from HUD before releasing restricted funds to the property and might have prevented the property from depleting its restricted accounts.

The Board Did Not Provide Adequate Oversight of Property Operations

The board did not actively oversee the activities and performance of property management. During our audit period, the board had only five of the required seven members, and none of the members had received formal HUD training. In addition, the articles of incorporation required the board to meet only once each fiscal year. The board met as a formality and did not review documents of financial position or make procurement decisions. Also, the former board president and the former property manager made procurement decisions without board knowledge or approval.

The Property Could Not Meet Its Operating Needs

As a result of the lack of board oversight, the property could not meet its operating needs or fund necessary long-term capital improvements to ensure safe and affordable housing for its residents. The property's revenue was not sufficient to meet basic operating expenses such as electricity, gas, water, and its mortgage. The following diagram represents the total income and the basic operating expenses for the 12-month period ending November 2010.



Conclusion

The property was unable to meet its current operating needs or fund necessary long term capital improvements because of a lack of board oversight. The property has been under control of its current HUD approved management agent since April 2011. HUD is currently working with the management agent to resolve the issues addressed in this report and should ensure that the management agent continues to manage the property until such time that the board can show that it has the capacity to manage the property.

Recommendations

We recommend that the Director, Kansas City Office of Multifamily Housing,

1A. Ensure that property management develops and implements controls over rent collection, maintenance operations, disbursements, and procurement.

1B. Ensure that board members and management receive adequate HUD training.

1C. Ensure that the property is managed by a HUD-approved management agent until the property's staff and board receive adequate training and develop adequate controls to successfully operate the property.

1D. Develop a plan with the property to reestablish and fully fund its reserve for replacement account. As of June 30, 2011, the underfunded amount totaled $278,165.

1E. Develop a plan with the property to reestablish and fully fund its debt reserve account to the required $41,093.

1F. Develop a plan with the property to fully fund its tenant security deposit account to its current required obligation. As of June 30, 2011, the account was underfunded by $21,196 .

1G. Develop a plan with the property to pay the $23,821 in arrears to become current in its mortgage obligation.

1H. Work with the property to execute a depository agreement for the restricted accounts.

Finding 2: The Property Inappropriately Made Salary Payments to Its Board President

The property inappropriately made salary payments to its board president. This condition occurred because the board did not provide adequate oversight of property operations. As a result, $8,500 was not available to help meet the property's operating needs at a time when it was in default.

The Property Inappropriately Made Salary Payments to Its Board President

The property inappropriately made $8,500 in salary payments to the board president from March to October 2010. The property's regulatory agreement and by-laws stated that no board member could receive compensation for services. The regulatory agreement also stated that the board could not amend the by-laws without HUD approval. The board president made a motion during a February 2010 board meeting to amend the property by-laws to allow for board member compensation. The amendment passed, and the board president started receiving compensation in March 2010. However, the board did not receive the required HUD approval to amend its by-laws to allow for board member compensation.

The Board Did Not Provide Adequate Oversight

The board did not provide adequate oversight of property operations. As stated in finding 1, the board conducted business with only five of the required seven board members. Only four board members, including the board president, attended the meeting in February 2010 when the board amended the property by-laws. In addition, the board received no training or guidance from HUD.

Funds Were Not Available To Help Meet the Property's Needs

As a result of the property's inappropriate salary payments to the board president, $8,500 was not available to help meet its operating needs at a time when it was in default. As stated in finding 1, the property was 6 months in arrears in its mortgage obligation. The $8,500 could have covered more than 2 months of mortgage payments to HUD.

Recommendations

We recommend that the Director, Kansas City Office of Multifamily Housing,

2A. Work with the property to seek reimbursement from the former board president for the $8,500 in ineligible compensation he received.

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

2B. Take appropriate administrative actions, up to and including debarment, against the property's former board president for his part in inappropriately collecting compensation as a board member.

SCOPE AND METHODOLOGY

Our review covered the period January 1, 2008, through March 31, 2011, and was expanded as necessary. We conducted our fieldwork from May through September 2011 at the property located at 310 Northwest Murray Road, Lee's Summit, MO.

To achieve our audit objective, we conducted interviews with

- HUD's multifamily management and staff located in St. Louis, MO, and Kansas City, KS;
- The property's previous and current board members and staff;
- The property's previous management consultant and the current management agent;
- Prior businesses that performed services for the property; and
- An independent accountant who prepared the property's 2007 and 2008 audited financial statements.

We also reviewed the following documents:

- Federal regulations and HUD requirements;
- Regulatory agreement, loan agreement, and note;
- The property's articles of incorporation and by-laws;
- Integrated Real Estate Management System and Tenant Rental Assistance Certification System data;
- Northridge Loan System payment history data;
- The property's audited financial statements and other accounting records;
- Contracts with the management consultant and the current management agent;
- The property's payroll and accounting records;
- The property's bank statements, checks, and other associated records obtained directly from financial institutions; and
- The board meeting minutes.

We tested whether the tenant security deposit information on hand was accurate. We validated the resident deposit ledger, and this ledger had a total of 90 tenants. We visited the property, selected five tenant files from the resident deposit ledger, and reviewed the lease agreement for each of the tenants. The lease agreement states what the required deposit is for each tenant. We matched the required deposit on the resident deposit ledger to the security deposit total on the lease agreement. We determined that the security deposit ledger was sufficiently reliable for the purposes of this audit.

In addition, we obtained data from the Integrated Real Estate Management System and Tenant Rental Assistance Certification System for background information.

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 procurement of goods and services.
- Controls over the property's financial operations.
- Controls regarding the oversight of the property.

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 items are significant deficiencies:

- The property lacked controls over its financial operations (finding 1).
- The board did not provide adequate oversight of the property (findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1D.	$278,165
1E.	$41,093
1F.	$21,196

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

JOHN CALVIN MANOR, INC

310 NW Murray Road

Lee's Summit

MO 64081

816-524-6888

January 13, 2012

To Inspector General Office,

The Board of Directors for John Calvin Manor would like to acknowledge that the entire Board has reviewed the findings of the Audit and agree with the recommendations.

The Board would like it to be on record that there are now 7 acting Board Members and the by-laws have changed to have quarterly meetings. Yarco has been hired as an approved HUD Management company and the Board is working with Yarco to receive HUD training. The Board is working toward improving the oversight of the property.

Sincerely,

Leslie Alford

John Calvin Manor Board President