Schwenckfeld Manor, Lansdale, PA

HUD-Insured Section 202 Multifamily Rental Housing for Seniors and Persons With Disabilities

Office of Audit, Region 3
Philadelphia, PA

Audit Report Number: 2017-PH-1006
September 25, 2017

To: Brenda J. Brown, Director, Asset Management Division, Baltimore Asset Management Division, Baltimore Satellite Office, Multifamily Northeast Region, 3BHMLAP

Craig T. Clemmensen, Director, Departmental Enforcement Center, CACB

//signed//

From: David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia Region, 3AGA

Subject: The Owner of Schwenckfeld Manor, Lansdale, PA, Did Not Always Manage Its HUD-Insured Property in Accordance With Applicable HUD Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the HUD-insured Schwenckfeld Manor multifamily project.

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 website. 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 215-430-6734.

Audit Report Number: 2017-PH-1006
Date: September 25, 2017

The Owner of Schwenckfeld Manor, Lansdale, PA, Did Not Always Manage Its HUD-Insured Property in Accordance With Applicable HUD Requirements

Highlights

What We Audited and Why

We audited Schwenckfeld Manor because it was a high-risk multifamily project on our multifamily risk assessment for projects within our region and we had never audited it. Our audit objectives were to determine whether the project owner (1) disbursed project funds for costs that were reasonable, necessary, and supported for the operation and maintenance of the project; and (2) properly disclosed identity-of-interest relationships.

What We Found

The owner of Schwenckfeld Manor (1) may not have disbursed project funds for costs that were supported as reasonable and necessary for the operation and maintenance of the project, and (2) did not disclose its identity-of-interest relationships to the U.S. Department of Housing and Urban Development (HUD). Specifically, the owner (1) used project funds to pay up to nearly $2.1 million in costs that may have been for its parent company's benefit and the benefit of five other non-HUD housing entities the parent company owned, and (2) did not disclose to HUD its related parties as identity-of-interest entities on its management certification and paid nearly $403,000 in management fees to its parent company instead of the approved management agent for the project.

What We Recommend

We recommend that HUD require the owner to (1) provide documentation to show that payroll and other direct costs totaling nearly $2.1 million were reasonable and necessary expenses for the operation of the project or repay the project from nonproject funds for any amount that it cannot support; (2) develop and implement controls to ensure that the project complies with the regulatory agreement and applicable HUD requirements; (3) submit a project owner's and management agent's certification for identity-of-interest agents and other required documentation for review and approval; and (4) request retroactive approval of the fees paid to the identity-of-interest entity totaling nearly $403,000 and if HUD does not approve the management agent retroactively, repay that amount or the amount not approved by HUD.

We also recommend that the Director of HUD's Departmental Enforcement Center pursue civil money penalties and administrative sanctions, as appropriate, against the owner and its parent company and their principals for their part in the violations cited in this report.

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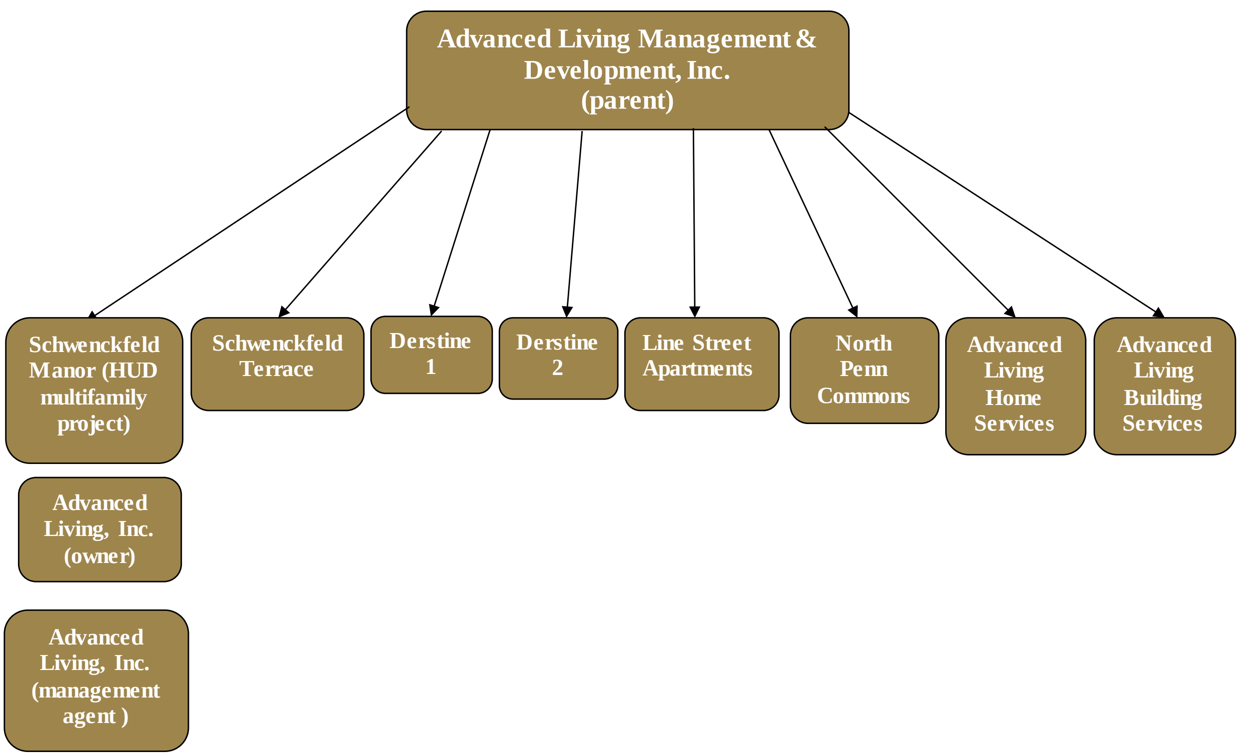
Background and Objectives

Schwenckfeld Manor opened in 1974 and receives project-based Section 8 assistance for 225 housing units available to seniors and persons with disabilities. The project is owned by Advanced Living, Inc. (owner). Advanced Living, Inc., was incorporated under the nonprofit corporation law of the Commonwealth of Pennsylvania on May 10, 1962. The project is owner managed because Advanced Living, Inc., is also the management agent for the project. Advanced Living Management and Development, Inc. (parent), is the parent company of the owner, five additional affordable housing entities,[1] a tenant services company and a building services company. The parent company was incorporated in 2007 and has been the controlling entity of the project's ownership entity since 2008. Schwenckfeld Manor is located at 1292 Allentown Road, Lansdale, PA. The offices of the parent company and one of its other housing projects are located on the same property as Schwenckfeld Manor. Below is the organizational structure of the parent and its identity-of-interest entities.



[1] Four of the five are for-profit affordable housing organizations: Schwenckfeld Terrace, Derstine 1, Derstine 2, and North Penn Commons. Line Street Apartments is a nonprofit affordable housing organization.

The project's mortgage was insured by the Federal Housing Administration (FHA) under Section 202[2] of the Housing Act of 1959. In February 2017, the owner refinanced the mortgage under Section 207, according to Section 223(f) of the National Housing Act.[3] The U.S. Department of Housing and Urban Development (HUD) regulates the loan through a regulatory agreement with the owner. The project received the following housing assistance from HUD over the last 3 years.

Year	HUD housing assistance payments
2016	$1,783,909
2015	1,779,832
2014	1,725,044
Total	**5,288,785**

Our audit objectives were to determine whether the project owner (1) disbursed project funds for costs that were reasonable, necessary, and supported for the operation and maintenance of the project; and (2) properly disclosed identity-of-interest relationships.

2 Until the creation of the Section 811 program in 1990, the Section 202 program provided funding to nonprofit organizations that developed and operated housing for seniors with very low incomes and people with disabilities.

3 Section 207-223(f) insures mortgage loans to facilitate the purchase or refinancing of existing multifamily rental housing. These projects may have been financed originally with conventional or FHA-insured mortgages.

Results of Audit

Finding 1: The Owner Could Not Support That It Always Used Project Funds for Costs That Were Reasonable and Necessary for the Operation of the Project

The owner may have used project funds for payroll costs[4] totaling more than $2 million in fiscal years 2014, 2015, and 2016 for services benefiting the project's identity-of-interest entities. Payroll costs for its parent company's chief operating officer, bookkeeper, receptionist, nurses, and other employees were passed through from the parent company and charged as project expenditures. Additionally, payroll costs for maintenance employees who worked at the properties of the identity-of-interest entities were charged to the project. The owner also used project funds for direct costs totaling more than $56,000 that it could not support as reasonable and necessary to operate the project. These conditions occurred because the owner lacked controls to ensure that it complied with its regulatory agreement and applicable HUD requirements. As a result, project funds totaling nearly $2.1 million may have been used for expenses that were not supported as reasonable and necessary for its operation and maintenance, creating a non-surplus-cash position and potentially putting project assets at risk.

The Owner Could Not Support That All Project Payroll Costs Were Reasonable and Necessary

The owner may have disbursed more than $2 million in fiscal years 2014, 2015, and 2016 for services benefiting the project's identity-of-interest entities. The parent company employed and paid the staff that provided services to it and its related entities. The parent company charged payroll costs to its related entities for reimbursement but did not charge them equitably. The parent company's chief financial officer prepared a spreadsheet each pay period to allocate the total payroll. Payroll costs for the parent company's chief operating officer, bookkeeper, receptionist, nurses, and maintenance employees had 100 percent of their time charged to the project. Through interviews, the chief operating officer, bookkeeper, and maintenance employees informed us that they performed work for all of the entities and that they did not use a timesheet to track their time. The chief financial officer told us that he did not allocate their payroll costs to the related entities and attributed charging the parent company's costs to the project to the prior chief financial officer. According to HUD Handbook 4381.5, REV-2, payroll costs for a management agent's supervisory employees (except those who oversee accounting and computer services) and employees who do not perform work for the benefit of the project are not allowed to be charged as project costs. Payroll costs for employees who perform work benefiting the project (front-line employees and central office accounting and computer

[4] For the purposes of this report, payroll costs refers to salary and fringe benefit costs.

supervisors) are to be allocated according to their time spent on the project.[5] Further, the Handbook requires costs of supervising and overseeing project operations to be paid from the project's management fees because they are not project costs.

Project expenditures included more than $3.1 million in payroll costs during our audit period. Of that amount, more than $392,000 was for the project's full-time, front-line clerks serving the residents. More than $1.4 million of that amount was for the parent company's chief operating officer, nurses, and maintenance supervisor, who are identified in the Handbook as supervisory and non-front-line employees. HUD and project officials stated that it was possible that some of these employees performed work benefiting the project, although documentation the officials provided was not sufficient to show that the work benefited the project. The remaining nearly $1.3 million went to payroll costs for maintenance workers and a bookkeeper, who performed work benefiting all of the entities. Therefore, those payroll costs should have been equitably allocated instead of being charged 100 percent to project funds. The table below provides details.

	Fiscal year 2016	Fiscal year 2015	Fiscal year 2014	Totals
Total payroll charged to Schwenckfeld Manor	$1,078,009	$977,370	$1,046,929	$ 3,102,308
Less payroll of the parent company's chief operating officer, nurses, and maintenance supervisor	537,984	421,209	472,199	1,431,392
Less payroll of Schwenckfeld Manor occupancy employees (full-time project staff)	127,276	135,906	129,247	392,429
Total front-line employee payroll costs to be allocated	**412,749**	**420,255**	**445,483**	**1,278,487**

We used the number of units methodology to allocate the nearly $1.3 million in payroll costs of front-line employees and estimated that 46 percent should have been charged to the other identity-of-interest entities owned by the parent company. The table below provides details.

[5] HUD Handbook 4381.5, REV-2, sections 6.38 and 6.39, state that reasonable expenses incurred for front-line management activities may be charged to the project operating account. Front-line activities include taking applications; screening, certifying, and recertifying residents; maintaining the project; and accounting for project income and expenses. If staff operating out of a single office perform front-line management functions for several properties, the costs must be prorated among the projects served in proportion to the actual use of services.

Rental properties owned by identity-of-interest entities[6]	Number of units	Percentage of total units
Schwenckfeld Manor (project)	225	54
Schwenckfeld Terrace	63	15
Derstine 1	59	14
Derstine 2	60	15
Line Street Apartments	6	2
Total	**413**	**100**
Total nonproject properties	**188**	**46**

Based on this methodology, payroll costs totaling more than $588,000 were unsupported. The table below provides details.

	Fiscal year 2016	Fiscal year 2015	Fiscal year 2014	Totals
Total front-line employee payroll costs to be allocated	**$412,749**	**$420,255**	**$445,483**	**$1,278,487**
Unsupported payroll for front-line employees (46 percent allocation based on number of units)	189,865	193,317	204,922	588,104

Project officials stated that because the project was the oldest property maintained, it required more staff time to operate, resulting in a larger share of allocated costs; however, they did not provide supporting documentation, such as employee timesheets recording time worked at each property.[7]

The project's regulatory agreement stated that all rents and other receipts of the project were required to be used only for reasonable expenses of the project. HUD Handbook 4370.2, REV-1, states that all disbursements from a project's regular operating account must be supported by approved invoices, bills, or other supporting documentation. The request for project funds should be used only to make mortgage payments, make required deposits to the reserve for replacements, and pay reasonable expenses necessary for the operation and maintenance of the project. Because the owner did not comply with these requirements, the project may have made unsupported disbursements totaling more than $2 million as shown in the table below.

[6] We did not include the parent company's fifth non-HUD property, North Penn Commons, in this calculation because it was not in service until after June 30, 2016, the end of our audit period.

[7] HUD Handbook 4381.5, REV-2, paragraph 6.38.b(4), states that weekly timesheets documenting hours spent and duties performed on front-line activities for each project and those spent on central office functions are an acceptable method of documentation.

	Fiscal year 2016	Fiscal year 2015	Fiscal year 2014	Totals
Unsupported payroll of the parent company's chief operating officer, nurses, and maintenance supervisor	$537,984	$421,209	$472,199	$1,431,392
Unsupported payroll for front-line employees (46 percent allocation based on number of units)	189,865	193,317	204,922	588,104
Total unsupported payroll costs	**727,849**	**614,526**	**677,121**	**2,019,496**

HUD Handbook 4381.5, REV-2, states that owner distributions are not permitted for projects with a nonprofit ownership entity. According to the project's audited financial statements for its fiscal years ending 2015 and 2016, the owner's equity was a deficit balance of $2.4 million and $2.7 million respectively. Further, the project had a surplus cash deficiency for both years of $114,742 and $114,212, respectively. The regulatory agreement stated that if the project had surplus cash, the surplus cash would be controlled by the Federal Housing Commissioner. The project would be in a more stable financial position if the parent company allocated payroll costs equitably.

The Owner Disbursed Project Funds for Other Costs That It Could Not Support as Reasonable and Necessary To Operate the Project

The owner disbursed nearly $43,000 in project funds to the parent company for expenses, such as employee entertainment, staff retreats, conferences, and memberships, which may have been required to be paid out of the management agent fee, and more than $13,000 in retainer fees to a law firm for legal services without documentation showing that the services provided were reasonable and necessary to operate the project. Officials of the parent company stated that many of these costs were allowable within the scope of the project. They also stated that the retainer fees were paid to obtain project-related legal advice from an attorney, but supporting documentation was not available. HUD Handbook 4370.2, REV-1, section 2-6, requires that only reasonable and necessary expenses be charged to the project, and HUD Handbook 4381.5, REV-2, section 6.38, gives examples of costs required to be paid from the management agent fee and those that may be charged directly to the project. The conditions described above occurred because the project lacked controls to ensure that it complied with its regulatory agreement and applicable HUD requirements. As a result, more than $56,000 disbursed for project expenses was unsupported.

Conclusion

The owner disbursed project funds for payroll costs totaling more than $2 million for services that may have benefited the project's identity-of-interest entities. The owner also charged direct costs totaling more than $56,000 to the project that it could not show were reasonable and necessary. These conditions occurred because the owner lacked controls to ensure that it complied with its regulatory agreement and applicable HUD requirements. As a result, the project spent nearly $2.1 million in unsupported costs for expenses that may not have been reasonable and necessary for its operation and maintenance, creating a non-surplus-cash position and potentially putting project assets at risk.

Recommendations

We recommend that the Director of HUD's Asset Management Division, Baltimore Satellite Office, Multifamily Northeast Region, direct the owner to

1A. Provide documentation to show that payroll costs totaling $2,019,496 and any payroll costs incurred outside our audit period, including fiscal year 2017, were reasonable and necessary expenses for the operation of the project or repay the project from nonproject funds for any amount that it cannot support.

1B. Provide documentation to show that other direct costs totaling $56,021 and any direct costs incurred outside our audit period, including fiscal year 2017, were reasonable and necessary expenses for the operation of the project or repay the project from nonproject funds for any amount that it cannot support.

1C Develop and implement controls to ensure that the project complies with the regulatory agreement and applicable HUD requirements.

We recommend that the Director of HUD's Asset Management Division, Baltimore Satellite Office, Multifamily Northeast Region

1D. Provide training and technical assistance to the owner and its management agent to ensure compliance with the terms of its regulatory agreement and applicable HUD requirements.

Finding 2: The Owner Did Not Disclose Identity-of-Interest Relationships

The project owner did not disclose its identity-of-interest relationships to HUD on its management certification as required. The owner also paid management fees totaling nearly $403,000 in fiscal years 2014, 2015, and 2016 to its parent company, an identity-of-interest entity, instead of the approved management agent for the project. These conditions occurred because the project lacked controls to ensure that it complied with applicable HUD requirements. As a result, the project's disbursement of nearly $403,000 in management fees was unsupported because, although the project received management services, the payment was made to an identity-of-interest entity instead of the approved management agent.

The Owner Incorrectly Reported It Had No Relationships With Identity-of-Interest Entities

The owner's president signed a project owner's certification for owner-managed multifamily housing projects and checked the box indicating that no identity-of-interest existed among the owner and any individuals or companies that regularly did business with the project. By checking that box, the owner certified that it had read and understood HUD's definition of identity of interest and that the statement accompanying the checked box was true. However, this certification was not correct. The owner entity was owned and controlled by a parent company which employed all of the staff and performed all of the accounting and bookkeeping for the project. That relationship was an identity-of-interest relationship and should have been disclosed to HUD.[8] Additionally, the president of the project's ownership entity was also the president of the parent company. The president also had a familial relationship with the chief operating officer of the parent company. These relationships were also identity-of-interest relationships that the owner should have disclosed to HUD.

HUD Management Agent Handbook 4381.5, REV-2, required the owner to submit the management certification and other information to HUD for review. HUD officials stated that the owner needed to submit the correct owner's management certification,[9] a management entity profile, and a management plan. Because the owner did not submit a correct, complete management certification, management entity profile, and management plan as required, HUD was not aware of the identity-of-interest relationships and related financial transactions, preventing it from properly conducting its oversight responsibilities. This condition occurred because the project lacked controls to ensure that it complied with its regulatory agreement and applicable HUD requirements. The president of the ownership entity stated that he was not aware that the identity-of-interest entities were not properly reported on the management agent certification. He further stated that he would work with HUD to file the correct management certification and any other forms and documents HUD required.

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8 The management certification contained a warning that there were fines and imprisonment for anyone who made false, fictitious, or fraudulent statements and who misused rents and proceeds in violation of HUD regulations applicable when the project was in a non-surplus-cash position.

9 Project owner's or management agent's certification for multifamily housing projects for identity-of-interest or independent management agents

The Owner Incorrectly Paid Management Fees

The project owner improperly paid management fees totaling nearly $403,000 for fiscal years 2014, 2015, and 2016 to the parent company instead of the approved management agent. HUD Management Agent Handbook 4381.5, REV-2, section 3.1, states that management fees may be paid only to the entity approved by HUD to manage the project. By signing the management certification, the owner agreed to submit a new management certification to HUD for approval before permitting an entity other than itself to manage the project or collect a fee. HUD officials stated that they had not received a new management certification and were not aware of the relationship to the parent company and its other identity-of-interest entities. This condition occurred because the project lacked controls to ensure that it complied with applicable HUD requirements. As a result, its disbursement of nearly $403,000 in management fees was unsupported because, although the project received management services, the payment was made to an identity-of-interest entity instead of the approved management agent.

Conclusion

The project owner did not disclose its identity-of-interest relationships to HUD on its management certification and management entity profile as required. The owner also paid management fees totaling nearly $403,000 in fiscal years 2014, 2015, and 2016 to an identity-of-interest entity instead of the approved management agent for the project. These conditions occurred because the owner lacked controls to ensure that it complied with its regulatory agreement and applicable HUD requirements. As a result, HUD was not aware of the identity-of-interest relationships, and it could not properly conduct its oversight responsibilities. The disbursement of nearly $403,000 for management fees was unsupported.

Recommendations

We recommend that the Director of HUD's Asset Management Division, Baltimore Satellite Office, Multifamily Northeast Region, direct the owner to

2A. Submit a project owner's or management agent's certification for identity-of-interest agents, a management entity profile, a management plan, and other required documentation for review and approval.

2B. Request retroactive approval of the fees paid to the identity-of-interest entity totaling $402,975 and any fees incurred outside our audit period, including fiscal year 2017, when submitting the project owner's or management agent's certification for identity-of-interest agents in response to recommendation 2A. If the request is not approved retroactively, the owner should repay the project from nonproject funds for the amount that was not approved.

We recommend that the Director of HUD's Asset Management Division, Baltimore Satellite Office, Multifamily Northeast Region

2C. Evaluate the owner's capability to effectively manage the project and consider whether independent professional management services are needed.

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

2D. Pursue civil money penalties and administrative sanctions, as appropriate, against the owner and its parent company and their principals for their part in the violations cited in this report.

Scope and Methodology

We performed our onsite audit work from March through August 2017 at the offices of the parent company located on the property at 1292 Allentown Road, Lansdale, PA. The audit covered the period July 1, 2013, through June 30, 2016, but was expanded when necessary.

To accomplish our objective, we reviewed

- HUD's files for the project, including the owner's management certification and regulatory agreement.

- HUD's program requirements at 24 CFR (Code of Federal Regulations) Parts 983 and 5; HUD Handbooks 4350.3, 4350.5, 4370.2, and 4381.5; housing assistance payment agreements; and other guidance.

- The project's audited financial statements for 2014, 2015, and 2016 and its parent company's consolidated audited financial statements, which included the project's owner entity, for 2015 and 2016 and its organizational charts.

- The project's computerized financial records.

- The project's cash disbursements journal, general ledger, and invoices and the parent company's journal entries, payroll registers, timesheets, invoices, and credit card bills.

- Return of Organization Exempt From Income Tax forms (Internal Revenue Service Form 990) for fiscal years ending June 30, 2014, and June 30, 2015, for the owner and for the fiscal year ending June 30, 2014, for the parent company.

- HUD's monitoring reports for the project.

We interviewed employees of the parent company and HUD staff. Neither the owner entity nor the project had any employees.

To achieve our audit objective, we relied in part on computer-processed data from the parent company's computer system.[10] We used the owner's general ledger and cash disbursements journal downloads to identify accounts and vendors we determined to be at high risk of being the types of costs that HUD Handbooks 4370.2, REV-1, and 4381.5, REV-2, required to be paid by a project's management agent or not eligible to be paid from project funds. Although we did not perform a detailed assessment of the reliability of the data, we did perform a minimal level of testing and found the data to be adequate for our purposes.

[10] The parent company maintained automated records for itself and all of its identity-of-interest entities.

To determine whether the owner managed the project in accordance with its regulatory agreement and applicable HUD requirements, we selected the three journal entries with the largest amounts for salary expense, totaling $118,073, from the project's general ledger office salary and maintenance salary expense accounts for fiscal years 2014 to 2016.[11] These amounts were the payroll reimbursement to the parent company, calculated by the parent company's chief financial officer. We identifed the employees whose salaries were charged to the project from the supporting payroll registers. We interviewed several of these employees, including the parent company's chief operating officer, bookkeeper, and maintenance supervisor and his staff, to understand the work they did.

From the project's 2016 general ledger accounts, we reviewed two accounts, "conventions and meetings" and "memberships and subscriptions," because they were at risk of including expenses that should be paid by the management agent rather than from project funds. We selected the three largest expenditures, totaling $5,768, from the accounts for review. The charges were for food and entertainment and expenses related to attendance at a professional conference. Employees of the parent company incurred these costs on the company's corporate credit card. It appeared that the costs were allocated; however, the documentation accompanying the disbursements did not show that the costs were reasonable and necessary for the operation of the project. We also reviewed the project's 2016 disbursements journal and selected an $846 payment for rental of a hot dog cart and propane and an $820 payment for a staff retreat. We selected these disbursements because they also appeared to be expenses that should be paid by the management agent. The project was charged 100 percent of the cost of the rental of the hot dog cart. The project was charged 50 percent of the cost related to the staff retreat. Again, the documentation accompanying the disbursements did not show that the costs were reasonable and necessary for the operation of the project. Because all $7,434 that we reviewed was not reasonable and necessary, rather than expand our review to smaller dollar amounts, we decided to question all $42,811 charged to the "conventions and meetings" and "memberships and subscriptions" accounts during the audit period as unsupported.

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 objectives.

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[11] The three journal entries represented salary for pay periods ending September 20, 2014, October 3, 2015, and June 11, 2016.

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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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 Deficiency

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

- The owner lacked controls to ensure that the project complied with its regulatory agreement and applicable HUD requirements (findings 1 and 2).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	$2,019,496
1B	56,021
2B	402,975
Totals	**2,478,492**

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

ADVANCED LIVING Communities

August 30, 2017

David E. Kasperowicz
Regional Inspector General For Audit
Philadelphia Region

Re: U.S. Department of Housing and Urban Development, Office of Inspector General's Review of the HUD-insured Schwenkfeld Manor Multifamily Project for Fiscal Years 2014, 2015 and 2016
Response to Final Results Audit Report

Dear Mr. Kasperowicz:

Please allow this letter to serve as the response of Advanced Living, Inc. ("Owner"), owner of the Schwenkfeld Manor Multifamily Project ("Project") to the findings of the Final Results Audit Report of the U.S. Department of Housing and Urban Development, Office of Inspector General's Review of the Project for Fiscal Years 2014, 2015 and 2016 ("Report").

Comment 1

We thank the auditors who performed the audit for their professionalism and respect for our ongoing operations while they were conducting the on-site, several months long audit. Owner acknowledges that it may not have always used best business practices with regard to effort reporting in managing the Project; however, they always strive to work in accordance with all applicable HUD requirements during the audit period (fiscal years 2014, 2015 and 2016). Before the audit occurred, Owner had already taken steps to improve policies and controls to ensure that the Project complies with the applicable regulatory agreement and HUD requirements. Of note, Owner's Chief Financial Officer during the audit period is no longer with Owner. Owner's current Chief Financial Officer is in the process of developing policies and procedures which should address some of the comments in the Report. While Owner recognizes that some of the findings are warranted, Owner respectfully disagrees with certain of the findings and proposed recommendations for at least the reasons set forth below, and looks forward to working with HUD to resolve the issues identified in the Report. For ease of reference, each finding and Owner's response thereto are provided in outline form herein below.

1292 Allentown Road, Lansdale, PA 19446
215-362-0227 • 215-362-8242 (fax) • www.advancedlivingcommunities.org

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Finding 1: The Owner could not support that it always used Project funds for costs that were reasonable and necessary for the operation of the Project because the Owner could not support that all Project payroll costs were reasonable and necessary.

Comment 2

Service Coordinators: Owner acknowledges that two (2) Service Coordinators who split their time on their timesheets between the Project and other duties were incorrectly charged 100% to the Project. The timesheets reflect that the payroll allocation should have been 77% to the Project instead of 100%. This correction was made during the second quarter of 2017. Of note, the Service Coordinators are Registered Nurses. However, all Service Coordinators are only doing work within the scope of the Service Coordinator position as defined by the applicable HUD regulations even though they are Registered Nurses. The Service Coordinators' time is accurately accounted for on their respective timesheets and supporting documentation, which Owner will provide to HUD Philadelphia in due course to reflect the Service Coordinators' time was properly allocated to the Project.

Comment 3

Management Staff: Owner acknowledges that effort allocation reporting for the three (3) management staff positions was not properly maintained. Owner respectfully submits that these three (3) positions qualify for front line reimbursement. Owner will collect and provide documentation to the Philadelphia HUD office regarding efforts and time spent on the Project for these positions.

Comment 4

Maintenance Staff: Owner acknowledges that its historical effort reporting of maintenance employees for the Project during the audit period, which was by way of paper work orders, is not a best practice. In June of 2016, prior to the Audit notification, Owner had already started implementing REALPAGE property management software to track effort reporting for all maintenance employees. Full implementation of the software fell outside of the audit period. Owner respectfully submits that proper controls are already in place to ensure accurate and efficient effort reporting of maintenance employees for the Project at this time.

Finding 1: The owner could not support that it always used project funds for costs that were reasonable and necessary for the operation of the project because Owner disbursed project funds for other costs that it could not support as reasonable and necessary to operate the Project

Comment 5

Legal Fees: Owner acknowledges that there was not a written agreement in place between the law firm that provided services related to the Project and the Owner. After the audit period, but prior to Owner being notified of audit, Owner hired a new law firm as general counsel under the terms of a written engagement letter contract. As a result, Owner respectfully submits that proper controls are now in place to address this matter. Owner will provide documentation to the HUD Philadelphia Office supporting the allocation of the costs in question to the Project.

Finding 2: The Owner did not disclose Identity-of-Interest Relationships.

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Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments
Comment 6	*Identity of Interest Entities/Management Fees*: Owner respectfully submits that Owner's annual tax returns and audited financial statements for the audit period properly and accurately disclose Identity-of-Interest Relationships. However, Owner acknowledges that the Management Entity Profile and the Management Certification document were not completed correctly and, as a result, did not properly disclose the Identity of Interest Relationships. Owner will submit up-to-date and corrected Management Entity Profile(s) and Management Certification document(s) to the HUD Philadelphia Office; and, to the extent required, request retroactive approval of the management fees paid to the Identity-of-Interest Entity.
Comment 7	Owner respectfully submits that the response outlined above; controls and procedures that have been implemented by Owner in the post-audit period; and, the additional documentation which Owner will provide in due course have adequately address the findings of the Report; and, that Owner is capable of effectively managing the Project. Owner further submits that, except as expressly set forth above, staff and employee costs were properly allocated to the Project. We look forward to partaking in any training HUD recommends to further ensure compliance with the applicable regulatory agreement and HUD requirements so that Owner can continue to provide high quality Section 202 multifamily rental housing for seniors and persons with disabilities.

Respectfully Submitted,

William P. Brown, President/ CEO
ALM&D

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OIG Evaluation of Auditee Comments

Comment 1 The owner acknowledged that it may not have always used best business practices with regard to documenting work activity to manage the project. The current chief financial officer is in the process of developing policies and procedures which should address some of the comments in the report. The owner will work with HUD to resolve the issues identified in the report. We acknowledge the owner's positive attitude toward the report. As part of the audit resolution process, the owner will work with HUD to resolve the recommendations.

Comment 2 The owner stated that service coordinator payroll was incorrectly charged 100 percent to the project until it changed the payroll allocation during the audit, in the second quarter of 2017. The owner stated that it will provide HUD with supporting documentation to show that the service coordinators only did work within the scope of work defined by HUD regulations and that their timesheets reflect time spent on the project. The chief financial officer changed the payroll allocation after we informed him of the problem in April 2017. As stated in the audit report, payroll costs for employees who perform work benefiting the project are to be allocated according to their time spent on the project. Timesheets documenting work hours and duties performed are acceptable methods of documentation. As part of the audit resolution process, HUD will review the documentation provided by the owner and determine whether it satisfies the recommendations.

Comment 3 The owner acknowledged that effort allocation reporting for three of the parent company's management staff was not properly maintained and documentation regarding their time spent on the project will be collected and provided to HUD because the owner believes they qualify for frontline staff reimbursement. As stated in the audit report, 100 percent of the payroll costs for the parent company's chief operating officer, bookkeeper, and receptionist were charged to the project. Sections 6.38 and 6.39 of HUD Handbook 4381.5, REV-2, state that reasonable expenses incurred for front-line management activities may be charged to the project operating account. Front-line activities include taking applications; screening, certifying, and recertifying residents; maintaining the project; and accounting for project income and expenses. The Handbook also states that payroll costs for a management agent's supervisory employees, except those who oversee accounting and computer services, are not allowed to be charged as project costs. Lastly, the Handbook requires costs of supervising and overseeing project operations to be paid from the project's management fees because they are not project costs. As part of the audit resolution process, the owner can provide documentation to HUD for consideration to address the recommendation.

Comment 4 The owner stated that its historical method of documenting work activity for maintenance employees was not a best practice and that in June 2016 it started implementing property management software to track their work activity reporting. However, full implementation of the software fell outside of the audit period. As stated in the audit report, the owner charged all of the maintenance employees' time to the project and did not equitably allocate their costs, using paper work orders or any other method, for work performed at the parent company's five other housing projects. We questioned a portion of the maintenance employees' payroll costs based on the total number of apartment units owned and operated by the parent company. Payroll costs for employees who perform work benefiting the project are to be allocated according to their time spent on the project and timesheets documenting hours spent and duties performed are an acceptable method of documentation. As part of the audit resolution process, the owner can provide documentation to HUD for consideration to address the recommendations.

Comment 5 The owner acknowledged that it lacked a written agreement to support the legal services that it incurred during the audit period. The owner stated that it hired a new law firm with a written engagement letter and that proper controls are now in place to address the finding. The owner will provide documentation to HUD supporting the allocation of the costs in question to the project. As part of the audit resolution process, the owner can provide documentation to HUD for consideration to address the recommendations.

Comment 6 The owner acknowledged that it did not correctly complete the management entity profile and management certification forms and as a result, did not properly disclose the identity-of-interest relationships to HUD. The owner stated that it will submit corrected forms to HUD and request retroactive approval of management fees paid to the project's parent company. The owner's planned actions meet the intent of our recommendations. As part of the audit resolution process, HUD will evaluate the documentation provided by the owner and determine whether it satisfies the recommendations.

Comment 7 The owner believed that its response, the controls and procedures it implemented after the audit period, and the documentation it will provide to HUD, adequately address the findings in the report. Additionally, the owner stated that it is capable of effectively managing the project and that payroll costs, except as noted in its response, were properly allocated to the project. As part of the audit resolution process, HUD will evaluate the documentation provided by the owner and corrective actions taken by the owner to determine that they satisfy the recommendations.