

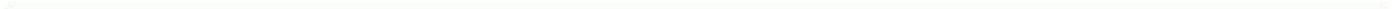


Mental Health Systems, Inc., San Diego, CA

Continuum of Care and Supportive Housing Program Grants

**Office of Audit, Region 9
Los Angeles, CA**

**Audit Report Number: 2017-LA-1003
June 2, 2017**





To: William Vasquez, Director, Los Angeles Office of Community Planning and Development, 9DD

Laurence Wuerstle, Acting Director, San Francisco Office of Community Planning and Development, 9ADS

//SIGNED//

From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: Mental Health Systems, Inc., San Diego, CA, Did Not Allocate Payroll Costs in Accordance With 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 Mental Health Systems, Inc.

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 213-534-2471.



Audit Report Number: 2017-LA-1003

Date: June 2, 2017

Mental Health Systems, Inc., San Diego, CA, Did Not Allocate Payroll Costs in Accordance With Requirements

Highlights

What We Audited and Why

We audited Mental Health Systems, Inc.'s (MHS) Supportive Housing Program and Continuum of Care direct grants from the U.S. Department of Housing and Urban Development (HUD). We audited MHS as the result of requests from HUD, prompted by a media report and the County of San Diego's review of MHS in response to whistleblower accusations of improprieties. The accusations centered on MHS drawing government funds in advance and channeling funds to related entities. The County identified issues with MHS' use of its funding; therefore, HUD had concerns about HUD funds. Our audit objective was to determine whether MHS administered its HUD funding in accordance with grant and program requirements.

What We Found

MHS did not allocate its payroll costs to Continuum of Care and Supportive Housing Program grants in accordance with program requirements. Specifically, MHS did not have sufficient methodology for the allocation of time charged by employees to its HUD grants. As a result, HUD had no assurance that \$142,181 spent on salaries and benefits was appropriately charged to the grants.

We found no evidence that the whistleblower accusations of improprieties applied to the HUD grants reviewed.

What We Recommend

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development coordinate with the Acting Director of HUD's San Francisco Office of Community Planning and Development to require MHS to (1) develop and implement a written methodology for employees' time allocation to its HUD grant programs in accordance with program requirements, (2) provide training on program requirements to employees working on HUD grants, and (3) support \$142,181 spent on payroll allocated to HUD grants or repay the program from non-Federal funds.

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Background and Objective

The Continuum of Care program was authorized under the McKinney-Vento Homeless Assistance Act, as amended by the Homeless Emergency Assistance and Rapid Transition to Housing Act of 2009.¹ The Continuum of Care program (1) promotes communitywide commitment to the goal of ending homelessness; (2) provides funding for efforts by nonprofit providers and State and local governments to quickly rehouse homeless individuals and families while minimizing the trauma and dislocation caused to homeless individuals, families, and communities by homelessness; (3) promotes access to and effective use of mainstream programs by homeless individuals and families; and (4) optimizes self-sufficiency among individuals and families experiencing homelessness.

Mental Health Systems, Inc. (MHS), is a nonprofit organization founded in 1978 to provide innovative and cost-effective mental health and drug and alcohol recovery services. MHS operates more than 85 community-based programs throughout California for people who either cannot afford privately paid services or for whom appropriate services are not otherwise available. Its outpatient, residential, and home-based programs serve children, adolescents, and transition-age youth; adults and older adults; the homeless; veterans and military families; and adult offenders under Federal, State, and county jurisdictions.

Between January 2014 and August 2016, MHS had a total of seven HUD grants totaling more than \$1.2 million.

Contract number	Project	Grant type	Start date	Contract value
CA0843L9T141301	Fresno Housing Plus II	Continuum of Care	7/1/2014	\$183,327
CA0843L9T141402	Fresno Housing Plus II	Continuum of Care	7/1/2015	188,554
CA0843L9T141503	Fresno Housing Plus II	Continuum of Care	7/1/2016	191,272
CA0706L9D011205	Next Step Transitional Housing	Continuum of Care	10/1/2013*	74,195
CA0706L9D011407	Next Step Transitional Housing	Continuum of Care	10/1/2015	73,760
CA0708L9D011508	Safe Haven - Housing	Continuum of Care	4/1/2016	282,511

¹ The Act streamlined HUD's homeless grant programs by consolidating the Supportive Housing Program, Shelter Plus Care, and Single Room Occupancy grant programs into the Continuum of Care program. Unless otherwise noted in this audit report, the term "program" refers to both the Supportive Housing Program and the Continuum of Care program.

CA0975B9T141000	Fresno Housing Plus III	Supportive Housing Program	12/1/2015	279,307
Total				1,272,926

*This grant's start date is October 1, 2013; however, the first drawdown was not until February 2014.

Our audit objective was to determine whether MHS administered its HUD funding in accordance with grant and program requirements.

Results of Audit

Finding 1: Mental Health Systems, Inc., Did Not Allocate Payroll Costs in Accordance With Requirements

MHS did not allocate payroll costs to its Continuum of Care and Supportive Housing Program in accordance with program requirements. We attributed this condition to MHS' not having a written methodology for how employees were to allocate their hours for the HUD programs in accordance with 2 CFR (Code of Federal Regulations) 200.403 and 200.430 requirements. We also attributed this condition to employees' not fully understanding the program requirements. As a result, HUD had no assurance that \$142,181 spent on salaries and benefits was appropriately charged to the HUD grants.

MHS Lacked Support for Its Payroll Allocation Methodology

MHS did not have a sufficient basis for its allocation of employee salaries for its Supportive Housing Program and Continuum of Care grants. Program regulations under 2 CFR 200.403 and 200.430 require reports reflecting the distribution of activity of each employee to be maintained for all staff members whose compensation is charged directly to awards and state that charging based on budgeted rates is not appropriate (appendix C). However, three of the four grant programs (Fresno Housing Plus II, Next Step Transitional Housing, and Safe Haven – Housing) had a systematic problem of charging direct employees time based on allocation percentages instead of based on actual hours worked on the HUD grants. These project employees charged a percentage of their time to more than one project, ranging from 5 percent to 50 percent, and worked on HUD projects and other non-HUD-funded (Federal, State, and county) programs. The employee positions in question included

- administrative support staff,
- case manager,
- coordinator,
- division manager,
- office manager,
- program manager,
- registered nurse,
- specialist, and
- supervisor

MHS did not maintain support to show the allocation percentages were reasonable. The amounts allocated to the 3 projects between 2014 and 2016 totaled \$142,181.

Questioned payroll costs

Contract number	Project	Grant type	Start date	Contract value	Questioned payroll
CA0843L9T141301	Fresno Housing Plus II	Continuum of Care	7/1/2014	\$183,327	\$44,007
CA0843L9T141402	Fresno Housing Plus II	Continuum of Care	7/1/2015	188,554	26,426
CA0843L9T141503	Fresno Housing Plus II	Continuum of Care	7/1/2016	191,272	3,271
CA0706L9D011205	Next Step Transitional Housing	Continuum of Care	10/1/2013	74,195	4,588
CA0706L9D011407	Next Step Transitional Housing	Continuum of Care	10/1/2015	73,760	1,540
CA0708L9D011508	Safe Haven - Housing	Continuum of Care	4/1/2016	282,511	62,349
CA0975B9T141000	Fresno Housing Plus III	Supportive Housing Program	12/1/2015	279,307	\$0
Total				1,272,926	142,181

The questioned amount excludes employees who worked exclusively on their Fresno Housing Plus II and III grants and, therefore, did not have to allocate time among funding sources.

MHS Had Inadequate Policies and Its Employees Were Unaware of Requirements

MHS' Portal Timecard User Guide policy and procedures gave its employees a choice to either use a percentage allocation method or an hours method. Most employees interviewed verified that they used a percentage allocation rather than using actual hours worked and the percentage came from program financial management. Employees received nothing in writing to support the percentages they charged to the HUD grants. MHS also had no written methodology stating how payroll allocation percentages were determined. According to MHS officials, the rates were established during internal discussions held during the grant application and award process and based on the amount of funding available under the grant.

In addition, most MHS employees stated that they were either not aware of or not familiar with Federal regulations at 2 CFR 200.403 and 200.430. MHS did not sufficiently inform its direct employees to charge actual time worked to the HUD programs.

Changes Were Being Made to Payroll Allocations

MHS acknowledged that the payroll allocation was a problem and had been working to change its policies and require employees to keep a detailed log of their time and activities. MHS was in the process of implementing a new system and once compatibility is confirmed, MHS can roll this new process out to its more than 700 employees.

Conclusion

MHS did not allocate payroll to its Supportive Housing Program and Continuum of Care grant in accordance with program requirements. This condition occurred because MHS did not have a sufficient written methodology for how employees were to track and charge their hours for the HUD programs. Also, MHS employees working on the HUD grants did not have a sufficient understanding of the program requirements. As a result, HUD had no assurance that \$142,181 spent on salaries and benefits was appropriately charged to the HUD grants.

Recommendations

We recommend that the Director of HUD's Los Angeles Office of Community Planning and Development coordinate with the Acting Director of HUD's San Francisco Office of Community Planning and Development and require MHS to

- 1A. Develop and implement a written methodology for employees' time allocations for its HUD grant programs in accordance with program requirements.
- 1B. Provide training on compensation for personal services grant program requirements to employees working on HUD grants.
- 1C. Support \$142,181 spent on payroll allocated to HUD grants or repay the program from non-Federal funds.

Scope and Methodology

We performed our onsite audit work at MHS' office located at 9465 Farnham Street, San Diego, CA, from September 2016 through February 2017. Our review generally covered the period January 2014 through August 2016.

To accomplish our objective, we performed the following:

- Reviewed Federal regulations at 2 CFR 200.403 and 200.430 and HUD's regulations at 24 CFR 578 and 583.
- Reviewed HUD's grant agreements with MHS and grant information found in HUD's Line of Credit Control System (LOCCS)².
- Reviewed MHS policies and procedures.
- Reviewed MHS accounting records and audited financial statements for fiscal years 2014 and 2015.
- Reviewed MHS organizational charts.
- Reviewed MHS source documentation and timesheets for Fresno Housing II, Fresno Housing III, Safe Haven, and Next Step projects.
- Interviewed appropriate MHS employees.

To test MHS' program expenses, we selected a nonstatistical sample. We obtained a list of draws made from LOCCS to determine the universe of draws for each project within our scope. Since there were four different projects, the method used to pull the survey sample draws (vouchers) was different for each project.

- Fresno Housing Plus II – We chose the last voucher paid as our sample draw for Fresno Housing Plus II because this was the first voucher and project reviewed.
- Fresno Housing Plus III – Only one voucher had been reimbursed at the time of our review so that was the only voucher available for our review.
- Next Step – We used Excel to randomly select one sample voucher to review.

² LOCCS is HUD's primary grant disbursement system, handling disbursement for most HUD programs.

- Safe Haven Housing – There were only three draws so we chose the voucher with the highest dollar amount to review.

We performed further testing of vouchers based on the payroll allocation issues identified during the initial survey sample. Fresno Housing Plus II had 18 vouchers and Next Step had 16 vouchers paid within our scope. We used Excel to randomly select five vouchers for each of the two grants. Since we already reviewed 1 of the 3 Safe Haven Housing vouchers, we reviewed the remaining two vouchers, making the review of this project's vouchers 100 percent. Since we did not use a statistical sample, we did not project the results; however, we determined the problem with payroll allocations to be a systematic one based on samples reviewed, staff interviews, and MHS' lack of policies and procedure. As a result, for the Fresno Housing Plus II, Next Step, and Safe Haven Housing projects, we questioned the payroll allocations across all grants reviewed based on actual amounts reflected in MHS' general ledgers. No additional vouchers were reviewed for Fresno Housing Plus III since the payroll allocation was not an issue for this grant. We were able to determine that the information contained in MHS' general ledger matched with bank statements and LOCCS; therefore, we judged MHS' data to be sufficiently reliable for audit purposes.

We reviewed all the expenditures from the sample draws and only identified issues with the payroll allocations. We did not see any payments made to the related entities or indications of draws in advance based on the general ledgers and other accounting records reviewed. As a result, there was no indication the whistle-blower complaint issues were applicable to the HUD grants

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:

- Effectiveness and efficiency of program operations – Implementation of policies and procedures to ensure that program funds are used for eligible purposes.
- Reliability of financial information – Implementation of policies and procedures to reasonably ensure that relevant and reliable information is obtained to adequately support program expenditures.
- Compliance with applicable laws and regulations – Implementation of policies and procedures to ensure compliance with applicable HUD rules and requirements.

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:

- MHS lacked adequate policies and procedures for payroll allocation to ensure that program funds were used in accordance with Federal regulations (finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1C	\$142,181
Totals	142,181

- 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 legal interpretation or clarification of departmental policies and procedures.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1



May 16, 2017

Tanya E. Schulze
Regional Inspector General for Audit
Office of Audit (Region 9)
300 N. Los Angeles Street, Suite 4070
Los Angeles, CA 90012

Re: Auditee Formal Response Comments

Dear Ms. Schulze,

Mental Health Systems (MHS), a 501© (3) non-profit organization founded in 1978, was created to provide innovative and cost-effective case management, mental health, alcohol and other drug treatment, and recovery services delivered in the least restrictive and most appropriate settings. MHS has expanded to 75 broad-ranging programs, offering services to residents in 6 California counties and employing nearly 750 dedicated individuals. The agency utilizes a variety of comprehensive and integrated services to develop culturally appropriate, client-centered, and strengths-based service plans that meet the specific needs of unique individuals and their families. Several MHS programs offer a combination of mental health, alcohol and drug, case management, and community support services to clients with special needs including the seriously mentally ill, dually diagnosed, transitioning youth, homeless mentally ill, homeless veterans, and individuals involved in the criminal justice system, who reside in residential, transitional, Safe Haven, and permanent supportive housing programs.

MHS extends its appreciation to the U.S. Office of Inspector General (OIG) for offering their expertise and guidance with assisting the agency in a manner consistent with Department of Housing and Urban Development (HUD) expectations for the Continuum of Care and Supportive Housing Program Grants.

Please accept the below response to the U.S. Department of Housing and Urban Development, Office of Inspector General's results of the Audit of Mental Health Systems dated May 1, 2017. Our response is centered on Finding # 1, page # 5 and the recommendations on page # 7 of the audit.

Recommendation 1A:
Develop and implement a written methodology for employees' time allocation to its HUD grant programs in accordance with program requirements.

MHS Response:
MHS has already developed and, in February 2017, implemented a revised policy for employee time allocation to its HUD grant programs. The new policy requires HUD grant program staff to record the date, start time, end time, grant number, and description of all time spent on eligible HUD activities. Over the past year, MHS has worked closely with the San Francisco HUD office

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Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1



to ensure that this methodology satisfies the criteria outlined in 2 CFR§200 regarding adequate documentation of salaries and wages, and MHS is committed to the continued utilization of this methodology for Time & Activity allocation for all Continuum of Care and Supportive Housing Program Grants employees going forward.

Recommendation 1B:

Provide training on compensation for personal services grant program requirements to employees working on HUD grants.

MHS Response:

MHS provided training in February 2017 on program requirements – specifically regarding new Time & Activity reporting requirements. MHS plans to schedule additional formal trainings on a regular and as-needed basis to ensure the accurate recording and allocation of eligible time expensed to its HUD grant programs.

Comment 2

Recommendation 1C:

Support \$142,181 spent on payroll allocated to HUD grants or repay the program from non-Federal funds.

MHS Response:

MHS can support the \$142,181 in payroll expenses allocated to the HUD grants in question through the following documentation that was required by MHS at the time:

1. Employee timecards that were created by the employees themselves, and subsequently approved by supervisors before being charged to HUD grant programs
2. 1,000+ pages of detailed client progress notes, which MHS can provide upon request

Comment 3

Comment 4

While MHS' current policy (see Response 1A) – that is, the requirement of staff to record detailed timestamps and descriptions for all HUD services – was not implemented until February 2017, the San Francisco HUD office has already agreed to reimburse MHS for all payroll expenses charged to its programs *prior* to that date. In April 2017, HUD released outstanding payments with full knowledge of the above, and with the expectation of MHS' continued execution of its current Time & Activity reporting policy. Thus, it is MHS' position that the repayment clause of Recommendation 1C is not applicable.

Comment 5

Respectfully submitted,

James C. Callaghan, Jr.
CEO & President
Mental Health Systems

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OIG Evaluation of Auditee Comments

- Comment 1 As discussed in the finding, the OIG was aware that new policy changes were in progress but we have not been provided the new policy or evidence of its implementation. The sufficiency of this information will need to be reviewed and validated by HUD as part of the audit resolution process.
- Comment 2 While we acknowledge MHS appears committed to proactively addressing the finding issues, it did not provide the training documentation to the OIG. HUD can verify the sufficiency of the training in audit resolution.
- Comment 3 The OIG did review timesheets for the employees in question. As discussed in the finding, there was insufficient support resulting in the \$142,181 in questioned costs.
- Comment 4 The OIG was not provided the documentation of detailed client notes during the course of the audit. The documentation can be provided to HUD during audit resolution, and HUD will assess if this information is sufficient to resolve the \$142,181 in question.
- Comment 5 HUD's release of funds does not resolve the questioned costs under recommendation 1C. However, MHS will have an opportunity to address the recommendation with HUD in audit resolution.

Appendix C

Criteria

2 CFR Part 200, Uniform administrative requirements, cost principles, and audit requirements for Federal awards

2 CFR 200.403 Factors affecting allowability of costs.

Except where otherwise authorized by statute, costs must meet the following general criteria in order to be allowable under Federal awards:

(g) Be adequately documented. See also §200.300 Statutory and national policy requirements through §200.309 Period of performance of this part.

2 CFR 200.430 Compensation—personal services.

(i) *Standards for Documentation of Personnel Expenses*

(1) Charges to Federal awards for salaries and wages must be based on records that accurately reflect the work performed. These records must:

- (i) Be supported by a system of internal control which provides reasonable assurance that the charges are accurate, allowable, and properly allocated;
- (ii) Be incorporated into the official records of the non-Federal entity;
- (iii) Reasonably reflect the total activity for which the employee is compensated by the non-Federal entity, not exceeding 100% of compensated activities (for IHE [Institutions of higher education], this per the IHE's definition of IBS [institutional base salary]);
- (iv) Encompass both federally assisted and all other activities compensated by the non-Federal entity on an integrated basis, but may include the use of subsidiary records as defined in the non-Federal entity's written policy;
- (v) Comply with the established accounting policies and practices of the non-Federal entity (See paragraph (h) (1) (ii) above for treatment of incidental work for IHEs.); and
- (vi) [Reserved]
- (vii) Support the distribution of the employee's salary or wages among specific activities or cost objectives if the employee works on more than one Federal award; a Federal award and non-Federal award; an indirect cost activity and a direct cost activity; two or more indirect activities which are allocated using different allocation bases; or an unallowable activity and a direct or indirect cost activity.
- (viii) Budget estimates (i.e., estimates determined before the services are performed) alone do not qualify as support for charges to Federal awards, but may be used for interim accounting purposes, provided that:
 - (A) The system for establishing the estimates produces reasonable approximations of the activity actually performed;
 - (B) Significant changes in the corresponding work activity (as defined by the non-Federal entity's written policies) are identified and entered into the records in a timely manner. Short term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term; and

(C) The non-Federal entity's system of internal controls includes processes to review after-the-fact interim charges made to a Federal awards based on budget estimates. All necessary adjustment must be made such that the final amount charged to the Federal award is accurate, allowable, and properly allocated.