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Audit Report Number 2011-DE-1001
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TO: Brenda L. Waters, Director, Kansas City Multifamily Hub, 7AHML

FROM: //signed//  
Ronald J. Hosking, Regional Inspector General for Audit, Kansas City Region,  
7AGA

SUBJECT: Citizen Complaint Against BIONIC Real Estate Services, LLC, St. Joseph, MO,  
Regarding Its Management of a HUD Section 236-Insured Multifamily  
Property Cannot Be Supported

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited allegations made against BIONIC Real Estate Services, LLC (BIONIC), a U.S. Department of Housing and Urban Development (HUD)-approved management agent, in a citizen complaint received by our office. The allegations related to BIONIC's management of Powell Apartments, a HUD Section 236-insured multifamily property with partial project-based Section 8-subsidized units. The objective of our review was to determine whether there was evidence to support the allegations made against BIONIC regarding its management of Powell Apartments as stated in the citizen's complaint received by our office.

## What We Found

We did not find evidence to support the allegations made against BIONIC related to its management of Powell Apartments. In general, we did not find evidence to support that BIONIC

- Made intentional misstatements on its annual rental license renewal form,
- Was not current on its rental license fees,
- Conducted itself inappropriately in regard to a potential sale of the property,
- Paid itself more than the agreed-upon rate for management and bookkeeping fees,
- Paid related parties or other vendors ineligible or unallowable costs,
- Commingled funds with another HUD property,
- Misspent cash provided by the owner in March 2008 and March 2009,
- Violated HUD regulations when it hired a roofing contractor,
- Kept \$10,000 intended for a roofing contractor to cover insufficient funds within Powell Apartments' operating account,
- Made an insurance claim for the roof and received proceeds that were not redeposited into Powell Apartments' reserve for replacement account,
- Intentionally kept \$14,400 intended for a roofing contractor for final payment, and
- Reported incorrect balances for its tax and insurance escrow accounts in its April 2010 balance sheet.

## What We Recommend

This report contains no formal recommendations, and no further action is necessary.

## Auditee's Response

We provided the draft report to BIONIC on October 18, 2010, and BIONIC concurred with the report. BIONIC chose not to have an exit conference or provide formal written comments.

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## BACKGROUND AND OBJECTIVE

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BIONIC Real Estate Services, LLC (BIONIC), is a full-service property management company, serving profit and nonprofit owners and residents in conventional and affordable housing communities. The management company was founded in June 2005, in part to address and enhance quality and services to residents in affordable housing communities. BIONIC's offices are located in St. Joseph, MO. It manages one U.S. Department of Housing and Urban Development (HUD)-assisted property in Kansas and two properties in Missouri and serves as a consultant for another HUD-assisted property in Missouri.

Powell Apartments is a HUD multifamily Section 236-insured property with 22 units. Seven of the units are subsidized with Section 8 project-based vouchers. Powell Apartments is an elderly complex that consists of two apartment buildings containing 11 units each. The current owner of Powell Apartments is Eugene C. Capps (owner). The regulatory agreement under Section 236 of the National Housing Act provides instructions and requirements that the owner must abide by as long as the property is insured by HUD. A housing assistance payments contract renewal, effective February 1, 2008, 2009, and 2010, between HUD and the owner provides the annual rent rates for the seven Section 8-subsidized units at Powell Apartments. Powell Apartments is located in Kansas City, KS.

The Owner of Powell Apartments and BIONIC entered into a management agreement that was effective from September 1, 2005, through April 30, 2007, and automatically renewed for 2 years through April 30, 2009. In May 2009, the owner of Powell Apartments attempted to replace BIONIC with a management company that was not approved by HUD. BIONIC continued to manage the property until it provided HUD notice to terminate its relationship as Powell Apartments' management agent. The termination was effective May 31, 2010.

The review of BIONIC resulted from a citizen complaint to our office, which contained several individual allegations. The individual allegations included that BIONIC

- Made intentional misstatements on its annual rental license renewal form,
- Was not current on its rental license fees,
- Conducted itself inappropriately in regard to a potential sale of the property,
- Paid itself more than the agreed-upon rate for management and bookkeeping fees,
- Paid related parties or other vendors ineligible or unallowable costs,
- Commingled funds with another HUD property,
- Misspent cash provided by the owner in March 2008 and March 2009,
- Violated HUD regulations when it hired a roofing contractor,
- Kept \$10,000 intended for a roofing contractor to cover insufficient funds within Powell Apartments' operating account,
- Made an insurance claim and received proceeds for the roof that were not redeposited into Powell Apartments' reserve for replacement account,

- Intentionally kept \$14,400 intended for a roofing contractor for final payment, and
- Reported incorrect balances for its tax and insurance escrow accounts in its April 2010 balance sheet.

The objective of our review was to determine whether there was evidence to support the allegations made against BIONIC.

## RESULTS OF AUDIT

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We reviewed the allegations contained in a citizen's complaint against BIONIC regarding its management of Powell Apartments in Kansas City, KS. We found no evidence to substantiate the allegations. The significant allegations made in the complaint and the results of our review of those allegations are detailed below as follows:

- The complaint alleged that BIONIC intentionally misstated that it owned Powell Apartments on its annual rental license renewal form. We found no evidence to support this allegation. The renewal form was completed incorrectly, but the error likely resulted from an oversight and was, in any event, inconsequential. The renewal form is prefilled and sent to BIONIC every year. It requests that any changes be reported to the Licensing Division of Wyandotte County/Kansas City, KS. BIONIC's director told us that she overlooked the error. We checked with the Unified Government of Wyandotte County/Kansas City, KS, Licensing Division's program coordinator, who informed us that there was no harm in BIONIC's signing on behalf of the owner since the management agent was responsible for paying the fee on behalf of the owner. The program coordinator verified that the renewal form did not convey ownership and that BIONIC had since updated the form.
- The complaint alleged that BIONIC was not current on Powell Apartments' rental license fees. We found no evidence to support this allegation. We checked with the Unified Government of Wyandotte County/Kansas City, KS, Licensing Division's program coordinator, who informed us that Powell Apartments' rental license fees were current.
- The complaint questioned the circumstances surrounding a potential sale of the property in April 2008. We found no evidence showing inappropriate conduct by BIONIC. We reviewed all available documentation and interviewed the involved parties. In April 2008, BIONIC contacted the owner on behalf of a potential buyer. Around that time, the potential buyer created a legal entity, Powell Apartments, LP, to begin negotiations and acquire ownership of the property, and the owner provided a written authorization to HUD to release information to the potential buyer. During the ensuing weeks, there were limited conversations among the interested parties. On August 12, 2008, BIONIC wrote the owner to recommend that he engage an experienced attorney to help with the potential sale. We found no evidence of negotiations, conversations, or correspondence related to the potential sale after that date. As of September 30, 2010, the owner held title to the property.
- The complaint alleged that BIONIC paid itself more than the agreed-upon rate for management and bookkeeping fees. We found no evidence to support this allegation. We traced every payment made to BIONIC during our 2-year review period to supporting invoices and bank statements. Each invoice included a correct calculation of the fees on the invoice with supporting documentation attached. If the expense

was for something other than a management or bookkeeping fee, we determined that it was also eligible and supported.

- The complaint alleged that BIONIC made questionable payments to a related party. We found no evidence to support this allegation. We reviewed each payment made from Powell Apartments' operating account to the related party. The payments were for items such as a hot water heater and an air conditioning unit. Each of the four disbursements was supported with invoices and receipts. The disbursements were allowable.
- The complaint alleged that BIONIC commingled funds with another HUD property. We found no evidence to support this allegation. We reviewed bank statements for both Powell Apartments and the other property for two separate months. Each property had separate accounts as required for its own respective funds. The main account for each property was the operating account. There were no transfers between the different projects' accounts, and all disbursements were for the project that owned the account in which the transaction occurred.
- The complaint alleged that BIONIC misspent the owner's money because the owner wrote checks for more than \$28,000 in March 2009 and \$17,000 in March 2008 for alleged payable overruns. The complaint's main concern focused on funds paid to BIONIC. We found no evidence to support this allegation. Both payments were adequately supported by a payable aging detail report submitted to the owner by BIONIC. We verified that both checks were deposited into Powell Apartments' operating account and reduced the total amount of outstanding payables. We verified that the payables to BIONIC were properly supported by invoices and the portions of the fees paid were appropriate. We tested the other payables and verified that they were properly paid and supported by invoices.
- The complaint alleged that BIONIC may have violated HUD regulations when it entered into a roofing contract. We found no evidence to support this allegation. BIONIC notified HUD of the leaking roof at Powell Apartments, collected three bids, and submitted the bids to HUD for approval. HUD approved the three bids and told BIONIC to choose one. BIONIC chose the lowest bidder, at a contract price of \$24,400. HUD confirmed that BIONIC took the necessary and correct steps to procure the services of the roofing contractor.
- The complaint alleged that BIONIC used \$10,000 in reserve for replacement account funds to cover expenses in its operating account instead of paying the roofing contractor for the downpayment on the roof repairs as intended around October 2008. We found no evidence to support this allegation. We reviewed the accounting and bank records and found that BIONIC paid the roofing contractor \$10,000 at the end of September 2008 from the operating account and then received the \$10,000 from its reserve account in October 2008 to reimburse the operating account.

- The complaint questioned BIONIC's use of an insurance refund of \$10,431 that was noted in the balance sheet. We checked with Powell Apartments' insurance company and its independent accountant. The insurance company confirmed that no claims had been made for Powell Apartments by BIONIC. Powell Apartments' independent accountant confirmed that the \$10,431 was an adjusting entry to properly record payments for hazard insurance premiums made throughout the year.
- The complaint questioned whether BIONIC hired an additional roofing contractor for \$14,400 or intentionally withheld this final payment from the original roofing contractor. The original roofing contractor was the only contractor awarded the roofing contract for \$24,400 in late 2007. BIONIC paid the first payment of \$10,000 on September 29, 2008. The roofing contractor requested its final payment of \$14,400 on September 20, 2009. To approve the final payment, a HUD construction analyst had to inspect the roof. HUD's analyst performed the roof inspection around November 2009. Since he was not familiar with the product used, he asked the roofing contractor to provide HUD a manufacturer's warranty on the product before he would approve a release of the final payment. The roofing contractor did not provide a manufacturer's warranty to HUD, so HUD did not approve the release of money from Powell Apartments' reserve for replacement account.
- The complaint alleged that BIONIC reported incorrect balances for Powell Apartments' insurance and tax escrow account amounts in its April 2010 balance sheet. We analyzed the escrow activity and consulted with the independent public accountant and determined that the differences were due to timing differences. Powell Apartments posts the insurance and tax escrow expenses to its financial statements once a year at the completion of the audit. Since this year's audit was late due to an outstanding payable to the independent accountant, the balances were off but not incorrect. We verified that the tax and insurance escrow account balances, once posted, were equal and accurate.

## Recommendations

This report contains no recommendations, and no further action is necessary.



## SCOPE AND METHODOLOGY

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Our audit generally covered the period March 2008 through February 2010. We performed onsite work from March through June 2010 at Bionic's office located at 300 South 11th Street, St. Joseph, MO.

To achieve our audit objective, we conducted interviews with the

- Complainant;
- HUD management and staff located at the Kansas City multifamily hub;
- HUD OIG Office of Investigation in Kansas City;
- BIONIC's management, attorney, and staff;
- Onsite property manager for Powell Apartments;
- External parties and vendors related to Powell Apartments for specific allegation(s);
- Attorney representing the owner of Powell Apartments;
- Tenants of Powell Apartments; and
- Independent accountant who prepared Powell Apartments' 2008 and 2009 audited financial statements.

We reviewed the following documents

- Federal regulations and HUD requirements,
- Regulatory agreement and amendments and housing assistance payments contract and contract renewals between HUD and Powell Apartments,
- Management agreement between BIONIC and Powell Apartments,
- Initial citizen complaint and subsequent allegations,
- HUD and BIONIC records related to Powell Apartments,
- Powell Apartments' accounting records prepared and maintained by BIONIC,
- Powell Apartments' audited financial statements for both 2008 and 2009,
- Powell Apartments and BIONIC's history and ownership status,
- Specific Powell Apartments bank statements and cancelled check copies obtained directly from the financial institution, and
- HUD Real Estate Assessment Center information related to the most current physical inspection assessment and rating of Powell Apartments.

We did not rely on computer-processed data or select samples for our audit purposes. We traced or verified each allegation to supporting documentation to draw our conclusions.

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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Controls over segregation of duties of BIONIC employees.
- Controls over the record keeping for Powell Apartments' transactions.
- Controls over disbursements from Powell Apartments' accounts.

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.

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance of the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of BIONIC's internal controls.