



**Hidden Lake Management LLC,
St. Louis, MO
Section 232 Program**



To: Roger Lewis, Director, Office of Residential Care Facilities, HP
//signed//
From: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
Subject: The Operator Generally Complied With Its Executed Regulatory Agreement and HUD Requirements But Did Not Properly Establish Its Management Agent and Management Agreement

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 Hidden Lake Care Center operator.

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

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

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



Audit Report Number: 2015-KC-1004

Date: June 30, 2015

The Operator Generally Complied With Its Executed Regulatory Agreement and HUD Requirements But Did Not Properly Establish Its Management Agent and Management Agreement

Highlights

What We Audited and Why

We selected the Hidden Lake Care Center for review based on a news article entitled “Poorly Rated Nursing Homes Got HUD Guaranteed Mortgages Anyway,” published by the Center for Public Integrity. The article stated that 240 facilities in 38 States and Washington, DC, received U.S. Department of Housing and Urban Development (HUD)-backed mortgages worth nearly \$2 billion a month after receiving a low, one-star rating from the Federal Government, and Hidden Lake Care Center was one of the nursing homes identified. The audit objective was to determine whether the Hidden Lake Care Center operator complied with its executed regulatory agreement and HUD requirements.

What We Found

The Hidden Lake Care Center operator generally complied with its executed regulatory agreement and HUD requirements. The operator made its lease payments, met HUD’s liability insurance requirements, had no unresolved State or Federal inspection deficiencies, and maintained the project in good condition. However, it did not properly establish its management agent and management agreement. It did not receive prior approval from HUD for its management agent and agreement as required. Also, the management agreements did not contain a required provision. The management agent and management agreement deficiency occurred because the operator was not aware of HUD’s guidance regarding management agents and management agreements.

What We Recommend

We recommend that HUD (1) require the operator to place the required provision in the management agreement and submit the required management agent and management agreement documentation to HUD for approval and (2) ensure that the operator receives training on management agents and management agreements.

Table of Contents

Background and Objective.....	3
Results of Audit	5
Finding: The Operator Generally Complied With Its Executed Regulatory Agreement and HUD Requirements But Did Not Properly Establish Its Management Agent and Management Agreement	5
Scope and Methodology	7
Internal Controls.....	8
Appendix	9
A. Auditee Comments.....	9

Background and Objective

Hidden Lake Care Center is a healthcare project consisting of a 112-bed skilled nursing facility, 48-bed residential care facility, and 48 independent living units located in Raytown, MO. In August 2012, the U.S. Department of Housing and Urban Development (HUD) insured the Hidden Lake Care Center's mortgage in the amount of more than \$10.3 million under Section 232 of the National Housing Act. Section 232 is a Federal Housing Administration-insured loan product that covers housing for the frail elderly and those in need of supportive services. Residential healthcare facilities, such as nursing homes, assisted living facilities, and board and care facilities, are examples of this type of housing. Section 232 may be used to finance the purchase, refinance, new construction, or substantial rehabilitation of a project. Hidden Lake Care Center's owner is a limited liability company (LLC) in Ohio. Hidden Lake Management, LLC, based in St. Louis, MO, is the Hidden Lake Care Center operator.

Before our audit, we found Hidden Lake Care Center received a low, one-star rating on the Medicare.gov nursing home compare website. This rating was based on health inspections, staffing, and various quality measures. Although we selected Hidden Lake Care Center due to this rating, we later learned the one-star rating didn't indicate it was a substandard property.

On August 1, 2012, the owner entered into a lease agreement with the operator to lease Hidden Lake Care Center. On that date, the operator entered into a nursing home regulatory agreement with HUD. On September 1, 2012, the operator entered into a management agreement with another LLC (management agent) to manage Hidden Lake Care Center. In July 2014, the operator replaced the original management agreement when it entered into a home office agreement, along with other nursing home licensees, with the same management agent. Many duties were the same between the two agreements, including instituting standards and procedures for admitting patients and collecting payments from patients or third parties; the evaluation of the performance of all departments; advising or assisting in designing public relations programs; and providing accounting, billing, and collection services.

According to the final rule for the Section 232 Healthcare Facility Insurance Program – Strengthening Accountability and Regulatory Revisions, dated September 7, 2012, HUD must approve the management agent and management agreement before a management agent is retained. However, this guidance was not effective before the first management agreement was executed on September 1, 2012. Also, 24 CFR (Code of Federal Regulations) 232.1011 states that the management agent, each initial management agreement with that agent, and any amendments to management agent agreements deemed material must be acceptable to HUD and approved in writing. However, this regulation was not published until 2013.

The Section 232 Handbook, Section II, Production, paragraph 8.3, states that a management agent must be approved by the Office of Residential Care Facilities before participation and the management agreement must be approved by HUD before execution. In addition, the Section 232 Handbook, Part III, Asset Management, paragraph 8.3, states that the typical duties of

management agents may include but not be limited to such things as personnel administration, resident admissions, marketing, billing, collections, accounting services, etc. The Section 232 Handbook was issued in May 2014 and became effective in September 2014.

Our objective was to determine whether the Hidden Lake Care Center operator complied with its executed regulatory agreement and HUD requirements.

Results of Audit

Finding: The Operator Generally Complied With Its Executed Regulatory Agreement and HUD Requirements But Did Not Properly Establish Its Management Agent and Management Agreement

The Hidden Lake Care Center operator generally complied with its executed regulatory agreement and HUD requirements. The operator made its lease payments, met HUD's liability insurance requirements, had no unresolved State or Federal inspection deficiencies, and maintained the project in good condition. However, it did not properly establish its management agent and management agreement. The management agent and management agreement deficiency occurred because the operator was not aware of HUD's guidance regarding management agents and management agreements.

The Operator Generally Complied With Its Regulatory Agreement and HUD Requirements

For our audit period, the operator made its monthly payments to the owner as required in the regulatory and lease agreements. The Section 232 Handbook, Section II, Production, chapter 14, appendix 14.1, requires an operator to meet HUD's requirements for professional liability insurance. The operator met the required limits of \$1 million per occurrence, a \$3 million aggregate limit, and no deductible limits in the annual policies. Also, the project's health surveys and fire inspection reports did not include unresolved State or Federal inspection deficiencies that would put the project's licensing or funding at risk.

According to the regulatory agreement, the operator should maintain the project in good repair and condition. In addition, the operator should not remodel, reconstruct, or demolish any part of the project. The project has seven separate buildings, with two buildings devoted to skilled care, one devoted to residential care, and four devoted to independent living. We inspected the seven buildings and determined that the buildings and the surrounding areas were well maintained. Also, there was no remodeling or reconstruction in progress or recently completed.

The Operator Did Not Properly Establish Its Management Agent and Agreement

The operator did not receive prior approval from HUD for its management agent and agreement as required in 24 CFR 232.1011 and the Section 232 Handbook. The Integrated Real Estate Management System did not list a management agent for the project. Also, the Office of Healthcare Programs staff was unaware that the operator had a management agent.

According to the regulatory agreement's lean rider, the operator must not enter into a management agreement involving the project unless it contains a provision that in the event of default under the operator or the owner regulatory agreement, the management agreement will be

subject to termination without penalty upon written request of the commissioner (HUD). However, the management agreements did not contain this provision.

The Operator Was Not Aware of HUD's Guidance Regarding Management Agents and Management Agreements

During our audit, the operator indicated that it was not aware of HUD's guidance regarding management agents and management agreements. In addition, the operator indicated it had received no training on management agents and management agreements.

Recommendations

We recommend that the Director of the Office of Residential Care Facilities

- 1A. Require the operator to place the required provision in the management agreement and submit the required management agent and management agreement documentation to HUD for approval.
- 1B. Ensure that the operator receives training on management agents and management agreements.

Scope and Methodology

Our review generally covered the period September 1, 2012, through January 31, 2015. We conducted fieldwork from March through April 2015 at the Hidden Lake Care Center operator's offices located at 6 City Place Drive, Saint Louis, MO.

To accomplish our objective, we

- Interviewed the HUD Office of Healthcare Programs staff;
- Interviewed Hidden Lake Care Center's owner, operator, and management agent staff;
- Reviewed the Code of Federal Regulations and HUD handbooks;
- Reviewed the regulatory agreements for Hidden Lake Care Center's operator and owner;
- Analyzed Hidden Lake Care Center's operating, lease, management agent, and home office agreements;
- Identified key sections in Hidden Lake Care Center's management and home office agreements between the operator and the management agent and compared the management agent's services in the two agreements;
- Reviewed the Hidden Lake Care Center operator's monthly rental payments and the associated documentation for our audit period;
- Reviewed Hidden Lake Care Center's health survey and fire inspection reports, professional liability insurance documents, accounting records, bank statements, rental payment invoices, management agent fees, and financial statements;
- Reviewed Integrated Real Estate Management System data; and
- Visited Hidden Lake Care Center to verify whether the property was maintained in good repair and condition.

We used Hidden Lake Care Center's accounting records to determine whether they complied with the executed regulatory agreement and HUD requirements. Those accounting records included details of the auditee's lease payments, comprised of monthly rent, property taxes, liability insurance, and reserves for replacement. We reviewed all of the operator lease payments from September 2012 through January 2015. We determined that the records were sufficiently reliable for use as our primary support in meeting our objective. Also, we obtained data from the Integrated Real Estate Management System. We relied on the data from this system for background information only.

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

Internal Controls

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

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

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

Relevant Internal Controls

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

- Controls over compliance with the regulatory agreement and Section 232 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.

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 regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the Hidden Lake Care Center operator's internal control.

Separate Communication of Minor Deficiencies

We reported minor deficiencies to the auditee in a separate management memorandum.

Appendix

Appendix A

Auditee Comments

The auditee elected not to provide written comments.