The Pine Grove Health Center, Pascoag, RI

Section 232 Program

Office of Audit, Region 1
Boston, MA

Audit Report Number: 2017-BO-1003
January 24, 2017

To: Timothy Gruenes,
Director, Asset Management and Lender Relations, HI

//**Signed//**

From: Ann Marie Henry
Regional Inspector General for Audit, 1AGA

Subject: Staffing Costs and Charges at Pine Grove Health Center, Pascoag, RI, Did Not Always Comply With Regulatory Requirements and Management Agreements

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 Pine Grove Health Center.

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 contact Ann Marie Henry, Regional Inspector General for Audit, at 617-994-8345.

Audit Report Number: 2017-BO-1003
Date: January 24, 2017

Staffing Costs and Charges at Pine Grove Health Center, Pascoag, RI, Did Not Always Comply With Regulatory Requirements and Management Agreements

Highlights

What We Audited and Why

We audited the Federal Housing Administration-insured Burrillville Nursing Home, Incorporated, doing business as Pine Grove Health Center, based on a U.S. Department of Housing and Urban Development (HUD), Office of Inspector General risk assessment. Additionally, HUD identified Pine Grove as a high financial risk and a potentially troubled facility, and Pine Grove's auditors reported substantial doubt regarding its ability to continue as a going concern due to recurring operating deficits, large receivables, accounts payable, current liabilities balances, and high bad debt expense. Our objective was to determine whether the owner managed Pine Grove's operations in compliance with HUD's regulatory requirements and other laws and regulations.

What We Found

Overall, Pine Grove's owner complied with the regulatory requirements tested, with the exception of the management services and compensation provisions of the management agreement. During 2014 and 2015, the owner paid onsite staffing costs of $322,314, and the management agent charged Pine Grove $139,027. We also estimated that the owner charged the project $353,420 prior to 2014 for employee services that should have been included as part of the management fee. This occurred because the owner used a management certification that conflicted with the approved management agreement and because the owner lacked controls over payments for services that, according to the management agreement, were part of the management fee.

What We Recommend

We recommend that the Director of HUD's Office of Residential Care Facilities require Pine Grove's owner to (1) require its management agent to repay $322,314 for ineligible salary and benefits paid for a clerk and bookkeeper, (2) remove $139,027 in payables to the management agent for ineligible employee services during 2014 and 2015, (3) support or remove an estimated $353,420 in payables to the management agent charged before 2014, and (4) develop and implement controls over payments to include ensuring that its management agreement clearly identifies services that are be provided and paid for by the management agent and to ensure that charges are not made for services that are part of the management fee.

Table of Contents

Background and Objective

Section 232 of the National Housing Act authorizes the Federal Housing Administration to insure mortgages made by private lenders to finance nursing homes and other eligible facilities. The Office of Residential Care Facilities, under the U.S. Department of Housing and Urban Development (HUD), Office of Healthcare Programs, manages the Section 232 program. Federal regulations at 24 CFR (Code of Federal Regulations) 200.105(a) state that as long as HUD is the insurer or holder of the mortgage, HUD will regulate the borrower by means of a regulatory agreement, providing terms, conditions, and standards established by HUD or by other prescribed means.

Burrillville Nursing Home, Incorporated, doing business as Pine Grove Health Center, operates a 71-bed nursing home facility located in Pascoag, RI. The facility is licensed by the Rhode Island Department of Health and participates in the Medicare and Medicaid programs. Pine Grove's mortgage is insured under Section 232 of the National Housing Act and was refinanced with a principal balance of more than $4.6 million on April 26, 2011. As of December 31, 2015, the mortgage payable was more than $4.4 million. Due to recurring losses, Pine Grove's independent auditors reported substantial doubt regarding its ability to continue as a going concern. Pine Grove entered into a management agreement on August 1, 2006, with Health Concepts Limited, its related management agent, to undertake the general day-to-day management of the facility, pay its accounts, collect its receivables, and provide all other management support needed for the operation of the facility. Although Health Concepts was contracted to provide management services, Pine Grove's owner remains responsible for compliance with HUD's requirements.

Our audit objective was to determine whether Pine Grove's owner managed Pine Grove's operations in compliance with HUD's regulatory agreement and other applicable laws and regulations. Specifically, we wanted to determine whether expenses were reasonable, necessary, and supported and whether the owner and management agent improperly advanced and distributed the project's funds.

Results of Audit

Finding 1: Staffing Costs and Charges at Pine Grove Health Center Did Not Always Comply With Regulatory Requirements and Management Agreements

Overall, Pine Grove's owner complied with the regulatory requirements tested. However, the owner used project funds for two onsite staff members to pay its accounts and collect its receivables, and charged project funds for employee services that were included and paid for as part of the agreement. This noncompliance occurred because the owner relied on a management certification that conflicted with its management agent agreement and did not have controls over payments for services that were part of the management fee. As a result, during the 2 years reviewed, Pine Grove incurred $322,314 in staffing costs that could have been used to reduce its deficit, pay bills, and reduce the risk of default. In addition, $139,027 was charged in accounts payable for ineligible employee services during our audit period, and we estimated that $353,420 was charged before our audit period for these ineligible employee services.

Overall, Pine Grove's Owner Complied With the Regulatory Requirements Tested

We reviewed more than $10.1 million of $13 million in costs that Pine Grove incurred during 2014 and 2015 and determined that the costs were generally reasonable, necessary, and supported. The mortgage was current, and we found no improper advances or distributions to the owners or issues with income. However, we found two areas of noncompliance.

Project Funds Should Not Have Been Used for Some Onsite Staff Costs

Pine Grove's owner used $322,314 in project funds during 2014 and 2015 for a bookkeeper and accounts payable clerk that should have been included as part of the management fee. This condition occurred because the owner used a management certification that identified Pine Grove as the payee for these onsite staffing costs. However, the management certification was not approved by HUD.

Therefore, Pine Grove's management agreement was the controlling document that established the services that the management agent was to provide and the fee for providing the services. The agreement required that for a 6 percent fee, the management agent would manage the general day-to-day activities of the facility, pay its accounts, collect its receivables, and provide all other management support needed for the operation of the facility. Therefore, the management agent should have used its management fee to pay for the onsite bookkeeper and accounts payable clerk, and Pine Grove's owner should not have used project funds to pay for these costs.

Some Services Should Not Have Been Charged to Pine Grove

The management agent billed Pine Grove $139,027 for bookkeeping, information technology, and other employee services during 2014 and 2015. We considered these charges ineligible because they were included in the management agreement and, therefore, were to be paid for as part of the management fee. This condition occurred because Pine Grove's owner did not have controls over payments for services that were part of the management fee.

In addition, we estimated the management agent charged $353,420 in similar ineligible employee services charges prior to 2014. The amounts remain in a payable to the management agent. We considered this payable unsupported until amounts charged that were not eligible have been removed from the payable.[1]

Conclusion

The owner used $322,314 in project funds to pay on-site staffing costs that per the management agreement should have been paid by the management agent. In addition, Pine Grove's owner lacked controls over payments for services that were part of the management fee and as a result, charged $139,027 in project funds during our audit period for ineligible employee services, and we estimated that $353,420 in additional ineligible charges were added to Pine Grove's payables before our audit period. These funds could have helped pay for eligible expenses of the project, and removing the payables would improve the project's financial position.

Recommendations

We recommend that the Director of HUD's Office of Residential Care Facilities require Pine Grove's owner to

1A. Obtain repayment of $322,314 from nonproject funds from the management agent for the ineligible bookkeeper and accounts payable clerk's salary and benefits, incurred during 2014 and 2015.

1B. Decrease the payable to the management agent by $139,027 for ineligible employee services billed during 2014 and 2015, thereby reducing future expenditures because project funds will not be used for these ineligible expenses when funds become available.

1C. Support or decrease the payables to its management agent for the amounts related to ineligible employee services charges before January 1, 2014, which we estimated to be $353,420.

1D. Develop and implement controls over payments to include; ensuring that its management agreement clearly identifies services that are be provided by the management agent and paid for as part of the management fee, and the project is not charged for services that are part of the management fee.

[1] For further details regarding the payable, see the scope and methodology section of this report.

Scope and Methodology

The audit focused on whether Pine Grove's operations complied with HUD's regulatory agreements and other applicable laws and regulations. We performed the audit fieldwork from January 2015 to May 2016, primarily at the Pine Grove Health Center, in Pascoag, RI. Our audit covered the period January 1, 2014, through December 31, 2015, and was extended when necessary to meet our audit objective.

To accomplish our audit objective, we

- Reviewed the Code of Federal Regulations, HUD handbooks, the regulatory and management agreements, and the management certification;
- Interviewed HUD and Office of Residential Care Facilities staff;
- Interviewed Pine Grove's owner, management agent, and management agent staff.
- Compared the provisions in Pine Grove's management agreement and certification and reviewed records to verify that payments to the management agent complied with the agreements;
- Analyzed Pine Grove's financial statements ending December 31, 2013 and 2014;[2]
- Reviewed policies and procedures to understand the auditee's controls over expenses and income;
- Selected and tested a sample of more than $10.1 million of the $13 million in costs during 2014 and 2015. We selected all credit card purchases to test based on their sensitivity and vulnerability to improper payments. We also selected payments to vendors that were paid more than $50,000 during 2014 and 2015. We selected this method because we were able to review more than 78 percent of purchases and costs within a reasonable amount of time. We did not use a statistical sample; thus, our results cannot be projected to the $13 million in purchases. However, our results are valid for the $10.1 million in purchases that we selected and tested;
- Tested the following areas for regulatory compliance: mortgage payments, owner distributions, loans, and owner advances. We did this by conducting interviews and reviewing independent audit reports, the general ledger, and bank statements;
- Reviewed Pine Grove's general ledger accounts for 2014 and 2015 to identify transactions that may have indicated errors, loss, or diversion of income;
- Used automated accounting data for our testing. For our expense tests, we traced from the automated data to source documents. For our income tests, we traced from the data in automated income reports to input generated in the Matrix, Patient Care, and Champ accounting systems to original documentation as necessary. Based on our limited review, we determined that the data reliability was sufficient for our purposes;
- Compared the average income per patient to a State average to determine whether there was an indication that Pine Grove's owner was underbilling or income was diverted.

[2] The report for December 31, 2015, was not available at the time of our review.

Based on our audit work, approximately 57 percent of the maintenance and administrative services programs' payable was ineligible. As of December 31, 2015, the balance of the payable was $863,652. We reviewed the $243,617 charged during 2014 and 2015. The balance of $620,035 charged before 2014 was not reviewed. Therefore, we estimated that $353,420 ($620,035 x 57 percent) was the unsupported amount.

We determined the amount of ineligible staffing costs for the bookkeeper and accounts payable clerk by reviewing the total salary paid to them during 2014 and 2015 as listed on their Paychex payroll register reports and adding 50 percent for employee benefits.

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

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.
- Compliance with applicable laws and regulations - Policies and procedures that management has implemented to reasonably ensure that the use of funds 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:

- Pine Grove did not have controls over payments for services that were part of the management fee (finding 1).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$322,314		
1B			$139,027
1C		$353,420	
Totals	**322,314**	**353,420**	**139,027**

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ 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.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. Regarding recommendation 1B, by removing the payable of $139,027, there will be a reduction in outlays of project funds should funds become available.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Health Concepts, Ltd.
NURSING, SUBACUTE, REHABILITATION, ALZHEIMER'S

RIVERVIEW HEALTHCARE COMMUNITY
VILLAGE HOUSE NURSING & REHABILITATION CENTER
ELMWOOD HEALTH CENTER
MORGAN HEALTH CENTER
WESTERLY HEALTH CENTER
BAYBERRY COMMONS
WEST SHORE HEALTH CENTER
SOUTH KINGSTOWN NURSING & REHABILITATION CENTER
PINE GROVE HEALTH CENTER
WOODPECKER HILL HEALTH CENTER
HERITAGE HILLS NURSING & REHABILITATION CENTER
EASTGATE NURSING & REHABILITATION CENTER

The Potter House, 359 Broad Street, Providence, Rhode Island 02907 • Phone: 401-751-3800 • Fax: 401-751-6350 • HealthConceptsLtd.com

January 6, 2017

Ann Marie Henry
Regional Inspector General for Audit
Region 1 Boston
US Department of Housing and Urban Development
Office of Inspector General
10 Causeway Street, Room370
Boston MA 02222-1092

VIA – Email
Re: Pine Grove Health Center
Draft Audit report number: 2017-BO-100X

Thank you for the time afforded us on December 8, 2016 to discuss the preliminary findings and for considering the following concerns on the results.

Finding 1 of the Audit report states that the owner relied on an "unapproved management certification" and that this resulted in "Project Funds being improperly used for onsite staff costs" and that "Services covered under the management agreement were improperly charged ... ie bookkeeping, information technology and other employee services". It concluded by stating that there is a "Significant deficiency in Internal Control"

I would like to discuss three points.

- The Management Agent's Certification filed with HUD
- The management agreement, its inception and evolution
- The services included in the management agreements 6% fee vs the additional charges billed by Health Concepts

MANAGEMENT AGENT'S CERTIFICATION

In 2007 Health Concept s submitted the Project Owner's/ Management Agent's Certification 9839-B to the local Providence HUD office along with the Management Entity profile 9832. Included with the 9839-B was a list of staffing at the facility level, which included the full charge bookkeeper who is responsible for accounts receivable and two clerical positions, one of whom does accounts payable. We received a call back from the Senior Project Manager stating that these forms were no longer required; that it was now done electronically via the HUD portal. We filed electronically and eventually received an email from the project manager stating that the APPS application for Health Concepts to be the Management Agent for Pine Grove had been approved.

Health Concepts manages a total of 12 facilities, currently 6 have HUD insured mortgages. In the past there were 2 others that had HUD insured mortgages that have now gone conventional. In total we have had eight HUD insured mortgages. At the time the Project Owner's/ Management Agent's

Auditee Comments

Ref to OIG Evaluation

Certification 9839-B for Pine Grove and the Management Entity profile 9832 were filed, we had been approved as the management agent for 7 other skilled nursing facilities following the exact same process and receiving approval of the 9839-B. One would expect the same outcome having followed the same procedures. The indication from the local HUD office was that the process had changed, not the resulting outcome. I understand that the 9839-B was not signed by HUD but I am also to understand that they do have it on file, hence leading one to believe they recognize its validity.

MANAGEMENT AGREEMENT EVOLUTION

By way of history of the management agreement, it was drafted to be in compliance with the State of Rhode Island Department of Human Services, Medicaid reimbursement program which stated that to be recognized by the Medicaid program, a home office needed three components, management, accounting and purchasing. In 1985 when the original management agreement was drafted, there were those three positions only. The management entity profile filed with HUD in 1998 included those three positions and stated that Health Concepts provides management and support services. Day to day operations was under the direct control of the Administrator.

The management agreement has evolved over the years. We answer to many authorities who continue to tweak the agreement to their specifications, including attorneys representing us before the Health Services Council when purchasing/managing new facilities (to assure the license stays in the name of the facility not the management company) and the HUD attorney at loan closings in the local HUD office. It was never the intent to change the structure of the management company or how the facility operates.

MANAGEMENT AGREEMENT 6% VS ADDITIONAL CHARGES

Over the past 30 years new positions were added to Health Concepts as the industry changed and regulatory requirements increased. We currently have 17 positions. Please see attached Organizational Chart. All facilities medical records became electronic, billing became electronic and facilities became wi-fi in part to accommodate DOH surveyors and the residents, resulting in the need for IT and Health Information, the hardware and software components. As opposed to every facility hiring their own IT person or hiring outside consultants, IT people were employed by Health Concepts and billed to the individual facilities based on actual hands on hours spent on the specific facility. As the financial needs grew and payor sources expanded bookkeeper coordinators were hired to train, assist and fill-in when there were absences in the facilities. Minimum data sets, (MDS's), a component of the electronic medical record, an interdisciplinary comprehensive assessment of the residents, was originally a tool used for patient care. In the late 1990's the MDS started to drive reimbursement and now also impacts our Five Star rating, a statistical rating based on quality measures. Potential errors in MDS's would result in incorrect billings and reduced ratings. Clinical reimbursement specialists were hired to audit the facilities MDS's . All these positions would have to be filled at the facility level if not provided and billed by Health Concepts , resulting in economies of scale.

It states in the audit report that the Management agreement required that for a 6 percent management fee, the agent would manage the day-to-day activities of the facility (in contradiction to the Management Entity Profile), pay its accounts, collect its receivables and provide all other management support needed for the operation of the facility. Please note this language was not in previous versions of the management agreement and was changed in 2006 by one of the many authorities noted above. It was never the intent to change the way the facilities or Health Concepts' positions were structured.)

Auditee Comments

Ref to OIG Evaluation

The management agreement also states in paragraph 7 that the facility shall reimburse manager for all proper, reasonable and reimbursable out-of pocket expenses incurred or paid by manager in connection with the performance of this agreement including but not limited to... items which OWNER would **normally purchase on its own**, but which are purchased by MANAGER on behalf of OWNER. Hence the additional charges over and above the 6% for specific hands on, task oriented hours at the facility.

Management is still included in the 6% Management Fee. The three original management positions noted above, along with seven additional management positions are included in the 6% management fee. Management sets policy and procedure and oversight. Hands on specific tasks are billed in addition to the management fee, as expenses that the facility would normally purchase on its own. This is true in all 12 homes, 6 HUD insured mortgages, six not in the HUD program.

We readily admit that the management agreement is vague ("items the facility would normally purchase on its own") in areas and contradictory in others. In retrospect, we agree we should have paid closer attention to the details of the changes made to the management agreement by the various authorities, as opposed to focusing on the imminent goals of either purchasing a new facility or refinancing a HUD mortgage to reduce the mortgage interest for the project.

Comment 1

We do not agree that project funds were improperly used for onsite staff costs nor that these costs were "not allowed by law". We notified HUD of what positions were held at the facility level and it was consistent with 7 previous HUD approvals and consistent with all 12 of our facilities.

Comment 2

We do not agree that the services noted above (bookkeeping, IT and other employee services) were ineligible as they were included in the 6% management fee. They were not management services. They were task oriented, hands on services provided at the facility that would otherwise have to have been hired at the facility level. These services were included under paragraph 7 of the management agreement.

Comment 3

We do not agree that there is a deficiency in internal control. All fees charged to the facility were reasonable and necessary for the operation of the facility.

Comment 4

Please also note that since Health Concepts began managing Pine Grove, August 2006, we have written off (removed from Pine Grove's expenses a total of $2,692,465 in management fees, an average of $286,000 per year. In addition the pass through expenses discussed above, that were billed to the facility have never been paid. Pine Grove has never paid Health Concepts for the management fee or any other items billed by Health Concepts.

Comment 5

Again, we agree that the management agreement needs to be rewritten to clarify the intent of the parties and the actual services provided and to not be in conflict with the Management Certification submitted to HUD, all while staying compliant with our various regulators.

We appreciate your consideration of the additional information included in this reply.

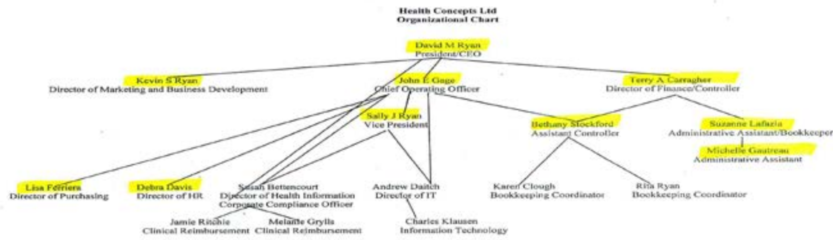
Respectfully

Terry A Carragher
Director of Finance
Health Concepts Ltd

Auditee Comments

Part of 6% Mgt Fee

Rest billed based on hours - specific tasks at or for facility -



12/2015

OIG Evaluation of Auditee Comments

The auditee for this assignment was the Pine Grove Health Center. Pine Grove has a management agreement with Health Concepts LTD, a related organization. While the audit report was directed to Pine Grove, Pine Grove chose to have Health Concepts formally respond to the report.

Comment 1 Health Concepts did not agree that project funds were improperly used for onsite staffing costs and did not agree that that onsite staffing costs were "not allowed by law". We did not question the legality of onsite staffing costs. However, the management agreement is a contract that required the management agent to pay Pine Grove's accounts and collect its receivables. Therefore, we questioned the eligibility of the bookkeeper's and accounts payable clerk's onsite staffing costs based on the contract; and we suggest that the owner work with HUD during audit resolution to determine what costs may be allowed.

Comment 2 Health Concepts did not agree that the bookkeeping, IT, and other employee services that we questioned were ineligible project costs because they were task oriented, hands on services provided for the project that would otherwise have to have been hired at the facility level. We maintain that bookkeeping and other services related to paying the projects accounts and collecting its receivables were already covered under the management agreement and thus, should not have been billed in addition to the six percent management fee. Regarding IT services, the auditee stated that the management agreement was vague and thus, IT services may be charged under provision seven of the agreement. Therefore, we suggest that the owner work with HUD during audit resolution to determine what costs may be allowed.

Comment 3 Health Concepts did not agree there was an internal control deficiency. However, they did agree that the Management Agreement was in conflict with the management certification for the on-site staff, and in conflict with the employee services that Health Concepts charged to Pine Grove. These deficiencies contributed to more than $322 thousand in additional onsite salary costs and more than $492 thousand[3] in noncompliant employee services charges. Therefore, we reported the lack of controls over payments for services that were part of the management fee as an internal control deficiency.

Comment 4 We agree that Health Concepts has written off management fees which has benefited the project. However, the onsite salary costs and employee services charges identified in this report remain as cash outflows and liabilities on the projects books and records.

---

[3] $492,447 = $139,027 + $353,420 as reported in finding 1.

Comment 5 Health Concepts agreed that the management agreement should be rewritten to clarify the intent of the parties, the actual services provided, and to not be in conflict with the Management Certification. In addition, this revised management agreement should be provided to HUD for its review and approval.