



Riverside Health and Rehabilitation Center, East Hartford, CT

Section 232 Program

**Office of Audit, Region 1
Boston, MA**

**Audit Report Number: 2018-BO-1001
November 13, 2017**



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

//Signed//

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

Subject: The Riverside Health and Rehabilitation Center, East Hartford, CT, Was Not Operated Under the Required Controlling Documents of the Section 232 Program

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of the Riverside Health and Rehabilitation 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 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 617-994-8345.



Audit Report Number: 2018-BO-1001

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The Riverside Health and Rehabilitation Center, East Hartford, CT, Was Not Operated Under the Required Controlling Documents of the Section 232 Program

Highlights

What We Audited and Why

We audited the Federal Housing Administration-insured nursing home, Riverside Health and Rehabilitation Center (the project), of East Hartford, CT, based on our risk assessment of nursing homes in the New England region. Additionally, the U.S. Department of Housing and Urban Development (HUD) identified the project as potentially troubled as of January 9, 2017, and four physical inspections performed by HUD's Real Estate Assessment Center, dating back to 2010, identified one or more deficiencies. Our audit objective was to determine whether the project was operated in accordance with its regulatory agreement and HUD requirements.

What We Found

Although the operator generally complied with the regulatory requirements tested, it did not operate in accordance with HUD requirements by not completing the required controlling documents. The uncompleted documents included the management agent agreement and management agent certification with a related management agent. The operator entered into a services agreement with the management agent, which did not have a fee structure that complied with HUD requirements. In addition, the operator did not have a HUD-compliant operating lease with the owner because the required operating lease addendum was not completed. These deficiencies occurred because the operator thought the services agreement it operated under was appropriate so it did not inform HUD that the project had a management agent, and the operator and owner were not aware that they needed to complete the operating lease addendum. As a result, the operator paid more than \$2.6 million in unsupported management fees in fiscal years 2015 and 2016. Also, without the required management agent documents or a HUD-compliant operating lease, HUD and the owner may not have had the authority to hold the operator accountable, and the operator may not have had the authority to hold the management agent accountable for improper business associated with the project.

What We Recommend

We recommend that HUD's Director of Asset Management and Lender Relations require the owner to (1) require the operator to complete the management agent documents with the management agent or seek reimbursement for the more than \$2.6 million in unsupported management fees paid in fiscal years 2015 and 2016 and (2) submit the operating lease for HUD review and complete the operating lease addendum in accordance with HUD requirements.

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Background and Objective

Section 232 of the National Housing Act authorizes the Federal Housing Administration (FHA) to insure mortgages made by private lenders to finance nursing homes and other eligible facilities. The Office of Residential Care Facilities (ORCF), 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) require HUD to regulate FHA-insured borrowers by means of a regulatory agreement, providing terms, conditions, and standards established by HUD.

The Riverside Health and Rehabilitation Center (the project), of East Hartford, CT, is a 345-bed for-profit nursing home facility that is owned by Riverside Health Care Realty LLC (the owner). The project is operated by a related company, Riverside Health Care Center, Inc. (the operator). The facility is licensed by the Connecticut Department of Health and participates in the Medicare and Medicaid programs. The mortgage was refinanced in 2011 under section 223(a)(7) of the National Housing Act of 1937 with a principal balance of more than \$17.8 million. As of December 31, 2016, the mortgage was current and had an unpaid principal balance of more than \$15.3 million.

On April 1, 2003, the operator entered into a services agreement with a related company, National Health Care Associates, Inc. (the management agent), to perform operational services for the project. Those services included budgeting; human resources, including assisting in the hiring and firing of management personnel; corporate compliance; management of maintenance and housekeeping; computer services; bookkeeping and accounting; purchasing; legal services; and marketing. The services agreement extended automatically each year. During our audit period, October 1, 2014, through September 30, 2016, the operator paid the management agent fees of more than \$2.6 million.

Our audit objective was to determine whether the project was operated in accordance with its regulatory agreement and HUD requirements.

Results of Audit

Finding 1: The Project Was Not Operated Under the Required Controlling Documents of the Section 232 Program

Although the operator generally complied with the regulatory requirements tested, it did not operate in accordance with HUD requirements by not completing the required controlling documents. The uncompleted documents included the management agent agreement and management agent certification with a related management agent. The operator entered into a services agreement with the management agent, which did not have a fee structure that complied with HUD requirements. In addition, the operator did not have a HUD-compliant operating lease with the owner because the required operating lease addendum was not completed. These deficiencies occurred because the operator thought the services agreement it operated under was appropriate so it did not inform HUD that the project had a management agent, and the operator and owner were not aware that they needed to complete the operating lease addendum. As a result, the operator paid more than \$2.6 million in unsupported management fees in fiscal years 2015 and 2016. Also, without the required management agent documents or HUD-compliant operating lease, HUD and the owner may not have had the authority to hold the operator accountable, and the operator may not have had the authority to hold the management agent accountable for improper business associated with the project.

Project Officials Generally Complied With the Regulatory Requirements Tested

We reviewed more than \$7.3 million of more than \$101.8 million in costs the project incurred during its 2015 and 2016 fiscal years and determined that the costs were generally reasonable, necessary, and supported. The mortgage was current, we found no improper distributions to the project owners, and the project and its systems appeared to be in good serviceable condition. However, we found two areas of noncompliance in which project officials did not operate in accordance with HUD requirements.

Management Agent Documents Were Not Completed

The operator and a related management agent did not complete the required management agent agreement and management agent certification. These documents ensure that a management agent is regulated in accordance with HUD requirements. Since April 1, 2003, the operator and the management agent had operated under a services agreement that extended automatically each year. The agreement detailed the operational services provided by the management agent for the project, including budgeting; human resources, including assisting in the hiring and firing of management personnel; corporate compliance; management and supervision of maintenance and housekeeping; bookkeeping and accounting; purchasing; legal services; and marketing. Based on the services provided over the last 14 years, we determined that the related company operated

as a management agent; therefore, a management agent agreement and management certification should be completed and approved by HUD.¹

Additionally, the services agreement fee structure did not comply with HUD requirements. HUD's Section 232 Handbook, Section 8.7, states that management agents may be compensated either based on a percentage of receipts or a negotiated flat rate on a recurring basis. The fee must be clearly designated in the management agreement and must be approved by ORCF. However, under the services agreement, the management agent's fee structure was based on a pro rata share of the total costs incurred for performing the services for all of its Connecticut healthcare facilities. Therefore, the fees paid did not comply with HUD requirements and were not approved by ORCF.

We informed ORCF that the project was not operating under the required management agent documents, and ORCF requested that project officials complete the required management agent agreement and management agent certification. ORCF stated that project officials did not respond to its request for the required documents or for an explanation as to why the management agent was not a management agent but, rather, a consultant. HUD's Section 232 Handbook, Section 8.5, states that if an entity, presented by the operator as a consultant, is found by HUD to have project commitment authorities or provide a wide scope of managerial services over an extended period, ORCF may deem the consultant to be a management agent and require that the entity be reviewed and approved as a management agent. We determined that the project had a management agent based on the type of services provided and the length of time those services were provided.

The Operating Lease Was Not HUD Compliant

The operator did not have a HUD-compliant operating lease with the owner because the required operating lease addendum was not completed. HUD's Section 232 Handbook, Section 8.2, requires that the operating lease between the borrower and ORCF-approved operator conform to HUD program obligations, which in part require the incorporation of an operating lease addendum, (form HUD-91116-ORCF). This measure ensures that the operator is held accountable for all business and healthcare services and the related cash flows from providing those services. The above condition occurred because the owner and operator were not aware that they needed to complete the operating lease addendum. As a result, HUD and the owner may not have had the authority to hold the operator accountable for improper business associated with the project.

Conclusion

The project was not operated in accordance with HUD requirements. These deficiencies occurred because the operator thought the services agreement it operated under was appropriate

¹ The Section 232 Handbook, HUD Handbook 4232-1 Chapter 8, defines a management agent as an entity that directs the day-to-day functions of a healthcare project as a contracted agent for the borrower or the operator. Management agents provide a wide scope of managerial services over an extended period.

so it did not inform HUD that the project had a management agent, and the operator and owner were not aware that they needed to complete the operating lease addendum. As a result, the operator paid more than \$2.6 million in unsupported management fees in fiscal years 2015 and 2016. Also, without the required management agent documents or HUD-compliant operating lease, HUD and the owner may not have had the authority to hold the operator accountable, and the operator may not have had the authority to hold the management agent accountable for improper business associated with the nursing home.

Recommendations

We recommend that HUD's Director of Asset Management and Lender Relations require the owner to

- 1A. Require the operator to notify HUD of future management agents prior to participation and to complete the required management agent documents with the current management agent or seek reimbursement for the \$2,666,082 in management fees paid in fiscal years 2015 and 2016.
- 1B. Submit the operating lease for HUD review and complete the operating lease addendum in accordance with HUD requirements.

Scope and Methodology

We performed our audit work from May through July 2017 at the project located at 745 Main Street, East Hartford, CT. Our audit generally covered the period October 1, 2014, through September 30, 2016, and was adjusted when necessary to meet our objective. To accomplish our objective, we performed the following:

- Reviewed the Code of Federal Regulations, HUD handbooks, and the project's policies and procedures.
- Reviewed key documents for the project, including the regulatory agreements, management agent agreements and certifications, and the operating lease.
- Interviewed key personnel to determine financial and operational controls.
- Reviewed independent public auditor reports to determine areas on which to focus our review.
- Reviewed HUD and U.S. Department of Health and Human Services monitoring reports to determine areas on which to focus our review.
- Reviewed the mortgage statement to determine whether the mortgage was current.
- Reviewed bank statements to identify unusual transactions.
- Reviewed the reserve for replacement account to determine whether deposits were made and expenditures were authorized by HUD.
- Reviewed owner distributions and determined whether the project was in a surplus-cash position.
- Identified related entities and reviewed contracts and invoices for cost reasonableness.
- Selected a sample of 20 disbursements totaling nearly \$7.4 million from a universe of 4,620 disbursements totaling more than \$101.8 million to determine whether the costs were necessary and reasonable. The sample was chosen based on large dollar disbursements, and disbursements that appeared unusual to the project. A sample was chosen rather than reviewing 100 percent of the universe because the universe was too large. We did not perform a statistical sample, so our results were not projected.

To achieve our objective, we relied in part on the project's computer-processed data. We used the data to select a sample to determine whether costs were reasonable and necessary. For our disbursement tests, we traced automated data to source documents. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes.

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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that the use of resources 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 Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The owner did not ensure that the operator completed the required management agent documents with the management agent, which would ensure that HUD and the owner had the authority to hold the operator accountable and the operator had the authority to hold the management agent accountable for improper business associated with the project

(finding 1).

- The owner did not complete a HUD-compliant operating lease with the operator, which would ensure that the owner had the authority to hold the operator accountable for improper business associated with the nursing home (finding 1).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A.	\$2,666,082
Totals	2,666,082


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

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments



National HealthCare
Associates Inc.

20 East Sunrise Highway
Valley Stream, NY 11581
516.705.4800

Via email: [REDACTED]

Ann Marie Henry
Regional Inspector General for Audit
Region 1 Boston
U.S. Department of Housing and Urban Development
Office of Inspector General
10 Causeway Street, Room 370
Boston MA 02222-1092

**Re: *Riverside Health and Rehabilitation Center
East Hartford, Connecticut
FHA Project No.: 017-43109
Supplemental Response to HUD OIG Draft Audit Report of October 12, 2017***

Dear Ms. Henry:

This letter is a follow-up to our exit conference, related to the findings in the Office of Inspector General Draft Audit Report, held on Tuesday October 24, 2017 and is intended to supplement [REDACTED] letter dated October 20, 2017 related to these findings.

With respect to Finding that Management Agent Documents Were Not Completed – as we discussed, we respectfully disagree with this finding. As we have previously indicated, we contend that the relationship between Operator and National does not meet the intent nor criteria requiring the establishment for “Management Agent Agreement” for the reasons previously stated in [REDACTED] letter, in addition to the following critical factors:

1. **National provides highly specialized services to Operator at cost.** As we discussed, National is able to provide the Project a highly efficient and cost-effective service platform where its expertise in all service fields can be shared with the Project in order to reduce overall overhead and expense, allowing the Operator to avoid employing directly such key personnel and incur the cost directly in order to do so as a stand-alone entity would be required, the costs of which would be entirely out of proportion with the respect to the services provided.

www.nathealthcare.com

Comment 1

Comment 1

**Ref to OIG
Evaluation**

Auditee Comments

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No doubt ORCF has seen time and again that stand-alone SNF operators simply cannot compete efficiently in the marketplace when they do not have the efficiencies of a system ("System") to generate economy of scale and scope savings/cost reductions associated with operationally required and in some cases, regulatorily mandated administrative and professional support services.

Comment 1

2. The highly specialized services provided by National to Operator are no different than that providing by competing For Profit and Not for Profit Health Systems and our structure mirrors the structure of those Systems which operate without management agreements or criticism from ORCF and/or HUD while adhering to Medicare and Medicaid standards related to the allocation of such costs.

Comment 1

3. While the relationship between Operator and National is transparent, memorialized in writing and bona fide in all respects, *it should not be overlooked that an identity of interest exists between Operator and National, in that [REDACTED] ■ [REDACTED] is the sole shareholder of National and is the major shareholder and President of Operator.* As a result, [REDACTED] management decisions concerning such functions as recruiting and retaining Operator staff, or negotiating and implementing vendor relationships, etc. are made in the best interest of the combined entities, but the distinction in capacity under which [REDACTED] manages (or delegates) is set forth in the Services Agreement.

Comment 2

With respect to the finding that the Operating Lease Was Not Compliant, we have since provided the auditor with a copy of the operating lease.

We appreciate the opportunity to provide a written response to the audit findings to further support our position and belief that Operator and National are fully compliant with all HUD Program Obligations, including those applicable to consulting and service agreements.

**Ref to OIG
Evaluation**

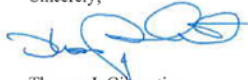
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We very much appreciate the professionalism exhibited by the auditor throughout the audit process, providing direct communication in addition to transparency as it relates to this review and are pleased that HUD OIG has found the Borrower and Operator compliant in all other respects.

Should you have any questions or comments, please feel free to call. We appreciate any and all re-consideration HUD OIG and/or ORCF will provide in view of the foregoing.

Sincerely,



Thomas J. Gilmartin
Chief Financial Officer

cc via email: Daniel Cosgrove, HUD OIG Boston
Todd M. Hebert, HUD OIG Hartford
Timothy P. Gruenes, HUD ORCF Minneapolis
Jennifer S. Buhlman, HUD ORCF Washington DC
Catherine Worley, HUD ORCF Seattle
Dale Becker, Walker & Dunlop, LLC
National Health Care Associates, Inc.
Karen Chadderton, Administrator

OIG Evaluation of Auditee Comments

- Comment 1 Project Officials disagreed with the finding that management agent documents were not completed as required. They stated that the relationship between Riverside Health Care Center, Inc. (Riverside) and National Health Care Associates, Inc. (National) does not meet the intent nor the criteria which requires the completion of the management agent documents. They stated that National provides highly specialized services to Riverside at a cost and the relationship between Riverside and National is transparent and set forth in the services agreement. We disagree that the relationship between Riverside and National does not meet the criteria which requires the completion of the management agent documents. National provided a wide scope of services that extended over a long period of time which are characteristics that distinguish a management agent in HUD's Section 232 Handbook. We also disagree with the fee structure that was established in the services agreement, and that it was transparent. National is compensated based on a percentage of their costs which is not one of the approved fee structures for management agents in HUD's Section 232 Handbook. Also invoices were not provided to show how the costs were calculated. Lastly, HUD ORCF has been in agreement throughout the audit that National acted as a management agent, and therefore must complete the required management agent documents.
- Comment 2 Project Officials disagreed with the finding that the operating lease was not compliant. As part of their response, they provided a copy of the operating lease addendum. We acknowledge receipt of the operating lease addendum and will rely on HUD to determine if this conforms to their requirements.