Issue Date April 15, 2009
Audit Report Number 2009-SE-1002

TO: Roger E. Miller, Director, Office of Insured Healthcare Facilities, HI

Mona Fandel, Region X Regional Counsel, 0AC

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, 0AGA

SUBJECT: The John C. Cannon Retirement and Assisted Living Residence, Seattle, Washington, Violated Its Regulatory Agreement

HIGHLIGHTS

What We Audited and Why

We audited the John C. Cannon Retirement and Assisted Living Residence (project) at the request of the Region X Director of the Office of Multifamily Housing. The Director referred the project due to regulatory agreement violations. We wanted to determine whether the project owner used project funds in accordance with U.S. Department of Housing and Urban Development (HUD) requirements and properly maintained the property.

What We Found

The project's owner did not use project funds in accordance with HUD's regulatory agreement when it failed to get HUD approval for leases costing $189,000, used project funds to obtain unneeded equipment costing $10,700, and failed to keep adequate documentation to support expenditures costing $317,000. We found the property was properly maintained.

What We Recommend

We recommend that the Director, Office of Insured Health Care Facilities require the owner to repay the amount spent for the unapproved leases and unnecessary equipment. We also recommend that the Director, Office of Insured Health Care Facilities, require the project owner to provide documentation supporting expenses paid for with project funds. Further, we recommend the Regional Counsel pursue double damages remedies, civil money penalties, and/or administrative sanctions, as appropriate, against the former administrator and the board of directors.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a discussion draft report to the project owner on March 6, 2009, and held an exit conference with its board of directors on March 23, 2009. The project provided written comments on April 10, 2009. It generally agreed with our findings. The board reports they have searched for and found much of the missing supporting documentation.

The complete text of the auditee's response, along with our evaluation of that response, is in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

The John C. Cannon Retirement and Assisted Living Residence, a Washington State nonprofit corporation governed by a board of directors, is the owner of the John C. Cannon Retirement and Assisted Living Residence (project), a 120-unit assisted living senior apartment complex located in Seattle, Washington. In December 2000, the U.S. Department of Housing and Urban Development (HUD) insured an $11.5 million loan for the project under Section 232 of the National Housing Act, in consideration of which the project owner agreed to operate in accordance with a December 12, 2000, regulatory agreement. The project opened for business in January 2002.

Section 232 of the National Housing Act, as amended, includes insurance for mortgage loans to facilitate the construction and substantial rehabilitation of board and care homes. Facilities must accommodate 20 or more residents who require skilled nursing care and related medical services or those who, while not in need of nursing home care, are in need of minimum but continuous care provided by licensed or trained personnel. Eligible borrowers include investors, builders, developers, public entities (nursing homes), and private nonprofit corporations and associations.

When the project development began in 2000, the owner hired Global Health Management (Global Health) as the management agent. The president of Global Health served as the project administrator. Because Global Health lacked management agent experience, it hired a management subcontractor in June of 2000 to meet HUD's experience requirements. The management subcontractor resigned and in October 2001, Global Health replaced it with another management subcontractor. In June 2002, Global Health replaced this subcontractor with a third subcontractor a few weeks before HUD directed the project owner's board of directors to terminate Global Health for improper management.

However, the original project administrator and president of Global Health remained in his position until HUD directed the board to terminate his employment agreement in December of 2007. HUD advised us that the board immediately rehired the administrator to the position of fundraiser and provided him with office space at the project. During the administrator's tenure, the project missed mortgage payments beginning in May 2002, less than six months after opening. From 2003 to 2007, the project's occupancy rate averaged only 74 percent, and as a result of its insufficient rent revenue, the project's monthly mortgage payments went into arrears beginning in February 2005, with the reserve fund for replacement account significantly underfunded. In 2004 and 2006, Washington state inspectors issued stop placement orders that lasted about five weeks and four weeks, respectively.

In March 2008 at HUD's request, the management of the project was turned over to a professional management agency, Opportunities Industrialization Center. On June 24, 2008, the HUD Seattle multifamily hub requested that the Departmental Enforcement Center take enforcement action against the project owner for violations of its regulatory agreement. In September 2008, the loan servicer filed to record the assignment of the mortgage to HUD.

Our Objective

Our objective was to determine whether the project owner used project funds in accordance with the regulatory agreement and properly maintained the property.

RESULTS OF AUDIT

Finding 1: The Project Owner Violated Its Regulatory Agreement

The project's owner violated its regulatory agreement when it leased copiers costing $189,000 without HUD approval, bought unneeded facsimile equipment costing $10,700, and failed to properly document other expenditures of $317,000. These violations occurred because (1) the owner and project administrator did not understand HUD's requirements and (2) the owner failed to obtain professional experienced management to operate the project, instead, entrusting the project's operations to an inexperienced project administrator. As a result, the mismanagement of the project's resources contributed to the default on its $11.5 million HUD-insured mortgage.

HUD did not approve equipment leases

The project did not obtain HUD approval when it entered into a five-year lease in 2005 for three copiers and another five-year lease in 2007 for four additional copiers. According to the regulatory agreement, HUD must approve any plan to lease equipment. The project's owner entered into the ineligible leases because the former project administrator did not believe HUD approval was required. As a result, $62,025 was not available for project operations and an additional $127,222 will not be available if the project makes the remaining payments.

Unneeded Equipment Purchased

In December 2006, the project bought facsimile equipment, even though the copiers leased in 2005 had facsimile capability. According to the regulatory agreement, only reasonably necessary expenditures are allowed. The project administrator purchased the facsimile equipment because he thought it was necessary to maintain state certification; however, the current management agent has maintained state certification since March 2008 without using the equipment. As a result, the project incurred almost $11,000 in debt for facsimile equipment that has not been installed or used.

Purchases Not Supported

The project lacked documentation to support expenditures including $160,415 for legal services (of which $140,893 had been paid and $19,522 had not been paid), $39,591 for accounting services (of which $10,785 had been paid and $28,806 had not been paid), and $8,955 for miscellaneous expenditures. This condition occurred because the project's management did not maintain its financial records in an auditable condition as required by the regulatory agreement. As a result, the project's owner could not provide assurance that these expenditures were reasonable, necessary, and benefitted the project.

Additionally, monthly payments of project funds totaling $107,817 were paid to an individual for marketing services. There was no documentation showing what marketing services were provided.

Conclusion

Title 12 of the United States Code (12 U.S.C. 1715z-4a) allows HUD to recover double the value of any assets or income used by a person or entity that owns or operates a nursing home in violation of the regulatory agreement. The project owner's board of directors is responsible to ensure that the project is operated in compliance with the regulatory agreement. The board did not ensure this compliance because it failed to obtain professional experienced management to operate the project, instead, entrusting the project's operations to an inexperienced project administrator. The following table summarizes the cost to the project due to the regulatory agreement violations.

Questioned cost category	Expense	Paid	Owed	Total
Ineligible	Copier lease	$ 62,025	$127,222	$189,247
Unnecessary	Facsimile		$ 10,729	$ 10,729
Unsupported	Legal	$140,893	$ 19,522	$160,415
Unsupported	Marketing	$107,817		$107,817
Unsupported	Accounting	$ 10,785	$ 28,806	$ 39,591
Unsupported	Miscellaneous	$ 8,955		$ 8,955
Total Ineligible, unnecessary, or unsupported costs				$516,754

This mismanagement contributed to the project's default on the $11.5 million HUD insured mortgage. At HUD's direction, the board hired a professional management agent in March 2008.

Recommendations

We recommend that the Director, Office of Insured Health Care Facilities,

1A. Prohibit the project from using project funds to pay $127,222 for the remaining terms of the copier leases and $10,729 for the unnecessary facsimile equipment.

1B. Require the project owner to provide documentation to support payments of $140,893 for legal services, $107,817 for marketing services, $10,785 for accounting services, and $8,955 for miscellaneous expenses or reimburse the unsupported amounts to the Federal Housing Administration insurance fund.

1C. Direct the project owner to provide documentation to support $28,806 in expenses incurred for accounting services and $19,522 for legal services or prohibit the use of project funds for these expenses.

1D. Reimburse the Federal Housing Administration insurance fund $62,025 for the ineligible lease payments.

We also recommend that the Regional Counsel,

1E Pursue double damages remedies against the former administrator and the board of directors for the ineligible and unnecessary expenditures and the applicable portion of the unsupported disbursements that were used in violation of the regulatory agreement.

1F Pursue civil money penalties and administrative sanctions, as appropriate, against the former administrator and board of directors for their part in the regulatory violations cited in this report.

SCOPE AND METHODOLOGY

We conducted our fieldwork at the project's office in Seattle, Washington, between October 2008 and January 2009. To achieve our objectives, we interviewed HUD and project staff, reviewed HUD and project records including the regulatory agreement, and inspected the project. Our review generally covered the period January 1, 2005, through July 31, 2008, and was expanded as appropriate.

Before 2007, the project did not keep the supporting documentation for its financial records in a reasonable condition for audit. Also, the project's financial records before 2005 were unavailable for review. Therefore, our review centered on 88 payments made in 2007. These payments included payments on a contract that did not have HUD approval and payments to the former project administrator and his family members. We also reviewed items noted in the referral from HUD to determine whether the payments were made for eligible purposes. We did not project the results of the samples.

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

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations,
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 objectives:

- Policies and procedures intended to ensure that project assets were used only for authorized purposes.

- Policies and procedures intended to ensure proper project maintenance.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe that the following item is a significant weakness:

- The board of directors did not have adequate internal controls to ensure that project assets were used only for eligible purposes.

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			$137,951
1B		$268,450	
1C		$ 48,328	
1D	$62,025		
Totals	$62,025	$316,778	$137,951

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 Office of Inspector General (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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

<u>Ref to OIG Evaluation</u> **<u>Auditee Comments</u>**

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April 13, 2009

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Los Angeles, CA 90017-3101

Attn: Joan Hobbs

Re: Response to Audit of John C. Cannon House Assisted Living Facility

Dear Ms Hobbs :

This letter is written at the request of the Board of Directors of the above referenced facility in response to your draft report dated March 6, 2008 received by the Board at its meeting with the auditors on March 23, 2008. At the Board's request, we are investigating the findings in the report and searching for missing information, much of which we have obtained, should support significant amounts of the expenditures found to be unsupported or unnecessary. Some information has been obtained which we believe reduces the amount of on unallowed expense, as well. Documentation in the form of receipts and other items will be kept at our offices pursuant to the recommendation of Mr. Ross Franklin by email today. We are still attempting to get all of the documentation for the accounting expenditures and expect to have this early next week. We believe we have obtained all of the billings for legal services and most of these billings appear to be related to legitimate project expenses with minor expenditures for corporate matters. Bills received date back to 2001 for Garvey Shubert and Barer and we also have significant billings from the Bullivant Houser firm.

We have been apprised that there are invoices for payments on marketing expenses through 2006 and perhaps sporadic invoices to 2008. We are going through files in the offices with the assistance of staff trying to locate these invoices and we believe, based on information received from the previous director and accounting staff that these invoices exist. We now know that the auditors are correct in the amount of monies expended for marketing and that there are not invoices for all of these payments. We did receive summary reports for work performed by marketing personnel to support some payments. Through next week we will continue looking for the invoices. Our office has been told much of the 2001 through 2006 years accounting information was boxed up on change of managers in 2008. I am attempting to verify this information exists.

The copiers for 2005 and 2007 do not appear to have been approved by HUD. There was a belief with respect to the 2005 copier lease that it was replacing a lease previously approved by HUD and therefore approval was not required according to prior employees. The copiers purchased in 20005 were apparently fraught with problems and therefore replaced with the 2007 copiers. The 2005 copiers have been paid off and the full lease balance was not paid. The sum of $23,000 was received from the new copier company to pay off the old copiers but apparently spent on project expenses. We understand from the current project administrator that a final payoff of the lease made e by agreement on July 23, 2008 for only $4,475.40 and the lease terminated by agreement, resulting in a credit against the lease amount for more than $10, 738.40. When the settlement was reached with company from which the copiers was leased the equipment was given to the facility to use as it sees fit. It is not being used and the Board intends to donate to another tax exempt organization. We have statements from Mr. Nuemann and documentation which will be made available for staff. .

The Rightfax purchase was purportedly to improve management of the residents' medication administration system after problems with the system. The system allows for physicians orders to be received and stored electronically on the multi-function copier machines (copy, fax, print, email and electronic file storage functions), which reportedly interfaces with the facility's computer network system. When a physician's orders is faxed for medications or treatment, the order is supposed to automatically stored electronically, emailed to several locations: a) the pharmacy, which fills the medication order and delivers the medication to the Facility; b) to the CNA Med-Technician who logs the order in the residents chart and in the Facility's Medication Record: c) to the Facility's nurses station where the meds are administered by the Nurses and Med-technicians; and d) to the Facility' Director of Nursing, who updates the residents' plan of care if needed. The auditors are accurately stated that it has not been used. We have received the last invoices from the project manager but understand that the amount stated is no longer owed in full. We are exploring with the previous director the facts surrounding this and we believe it was not used due to a decision by the most current project manager. We hope to have a written response regarding this and the problems with the 2005 equipment next week. It will be made available for the auditors if received.

The 2007 copy equipment lease was not approved by HUD. We do not believe approval was requested by the administrator. However we believe we have a source of payment for the buy-out of the lease that will not utilize project funds and the Board is directing the project administrator to request these funds.

April 13, 2009
Page 3

Comment 1

We do not know what miscellaneous expenses are in question and have requested this information from the auditors so we can investigate. We hope to get this information next week and will proceed to review it.

Comment 2

We respectfully request the Board be allowed to provide you with above referenced documents to support expenditures made by the agency. We further respectfully request on behalf of our client that no double damages be pursued. As indicated in the report the Board and staff have done a good job of maintaining the facility. They have taken steps to improve the management of records and the administration of the facility.

Very truly yours,

VANDEBERG JOHNSON & GANDARA, LLP

Constance L. Proctor

CLP:clp
Attachment
Enclosures

OIG Evaluation of Auditee Comments

Comment 1 The auditee requested information on the miscellaneous expenses we questioned, which we provided via email on April 13, 2009

Comment 2 The board requested to submit the additional supporting documentation to us for consideration. The Director, Office of Insured Healthcare Facilities, the action official, will review any supporting documentation during the audit resolution process.