St. Francis Hospital, Inc.
Columbus, GA

Section 242 Mortgage Insurance Program for Hospitals

Office of Audit, Region 4
Atlanta, GA

Audit Report Number: 2015-AT-1009
September 3, 2015

To:	Roger Miller, Deputy Assistant Secretary for Healthcare Programs, HP
	Dane Narode, Associate General Counsel for Enforcement, CACC
	Craig T. Clemmensen, Director, Departmental Enforcement Center, CACB
	//signed//
From:	Nikita Irons, Regional Inspector General for Audit, 4AGA
Subject:	St. Francis Hospital, Inc., Did Not Comply With the Executed Regulatory Agreement and Federal Regulations for the HUD Section 242 Program

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of St. Francis Hospital's Section 242 program.

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 404-331-3369.

Audit Report Number: 2015-AT-1009
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St. Francis Hospital, Inc. Did Not Comply With the Executed Regulatory Agreement and Federal Regulations for the HUD Section 242 Program

Highlights

What We Audited and Why

We audited St. Francis Hospital, Inc. because the U.S. Department of Housing and Urban Development (HUD), Office of Hospital Facilities, requested immediate assistance from HUD's Office of Inspector General (OIG) to review suspected violations of the hospital's regulatory agreement and rider (including covenants). Our objective was to determine whether the hospital complied with the executed regulatory agreement and HUD requirements for its Section 242 program. The review was also consistent with our mission to prevent and detect fraud in HUD programs under OIG's strategic plan.

What We Found

The hospital did not comply with the regulatory agreement and Federal regulations. Specifically, it submitted inaccurate financial information, improperly disbursed mortgage proceeds, incurred an unauthorized liability, and subjected mortgage funds to bank sweeps. This condition occurred because hospital management did not implement adequate controls and lacked internal controls and written policies and procedures to ensure that the HUD-insured mortgage was administered according to its executed regulatory agreement and HUD requirements for its Section 242 program. Additionally, members of the hospital's board of trustees, including its chairman, had potential conflicts of interest through employment with and serving on the board of the bank from which the hospital obtained a line of credit. As a result, $21.4 million in proceeds from the HUD-insured mortgage and HUD's collateralized properties were not disbursed properly and the multifamily insurance portfolio was subjected to increased risk. Also, HUD depended on inaccurate financial information to approve the $29.8 million mortgage increase.

What We Recommend

We recommend that HUD's Office of Healthcare Programs require the hospital to (1) repay $21.4 million in improperly disbursed mortgage funds, (2) resolve the apparent conflicts of interest between its board of trustees members and the bank, and (3) improve its internal controls and implement policies and procedures to provide accurate and complete reporting of financial information to ensure compliance with Federal regulations and HUD requirements. We also recommend that the Departmental Enforcement Center pursue administrative actions, as appropriate, against the responsible parties for the regulatory violations cited in this report. Additionally, we recommend that HUD's Office of General Counsel for Program Enforcement pursue civil remedies, if legally sufficient, against responsible parties.

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Background and Objective

Section 242 of the National Housing Act enables the affordable financing of hospital projects by reducing the cost of capital and significantly enhancing the credit of hospitals that qualify for mortgage insurance. The program improves access to quality health care, reduces the cost of hospital care, supports the U.S. Department of Housing and Urban Development's (HUD) community development mission, and contributes revenues to the General Insurance Fund.

The Office of Hospital Facilities is an office within HUD's Office of Healthcare Programs that handles the national operations of the Section 242 mortgage insurance program for hospitals. The Office of Hospital Facilities typically works to determine need and financial feasibility of large, complex hospital projects, while also monitoring the financial performance of hospitals in HUD's portfolio to prevent loan defaults and claims.

In June 2011, St. Francis Hospital, Inc., a nonprofit, community hospital based in Columbus, GA, applied for a Federal Housing Administration loan under Section 242 mortgage insurance to renovate and expand its hospital facility. The hospital's project involved renovating the existing buildings and building a new clinical services tower, medical office building, and central energy plant. HUD approved the mortgage insurance application in September 2011 and executed the assignment of commitment in November 2011 for $210 million.

On June 23, 2014, the hospital received an additional $29.8 million mortgage increase,[1] which HUD supported in the original project scope, for an obstetric project that the hospital started in 2013. According to the Office of Hospital Facilities, the final inspection report from HUD's Office of Architecture and Engineering showed that the project was completed on June 24, 2014. The HUD-insured mortgage had not received final endorsement during the audit.

On November 4, 2014, the hospital notified HUD of accounting irregularities and later publicly announced $30 million in financial misstatements involving overstated revenues and understated expenses. Based on this issue, in December 2014, the Office of Housing Facilities requested our assistance to review the hospital for possible violations of the regulatory agreement and Section 242 program requirements.

Our audit objective was to determine whether the hospital complied with its executed regulatory agreement and HUD requirements for its Section 242 program. Specifically, we wanted to determine whether (1) the hospital submitted accurate financial information to HUD to obtain the Section 242 mortgage increase and (2) used mortgage proceeds in compliance with the regulatory agreement and HUD requirements.

[1] The original mortgage amount, $210 million, plus the mortgage increase of $29.8 million resulted in a total mortgage of approximately $240 million for the hospital.

Results of Audit

Finding: St. Francis Hospital, Inc., Did Not Comply With Its Executed Regulatory Agreement and Federal Regulations for the HUD Section 242 Program

St. Francis Hospital, Inc., did not comply with the regulatory agreement and Federal regulations for the Section 242 program. Specifically, it submitted inaccurate financial information to HUD, improperly incurred a liability and disbursed mortgage proceeds to an affiliated party, executed an improper addendum for a line of credit, and subjected mortgage funds to bank sweeps. This condition occurred because hospital management did not implement adequate controls and lacked internal controls and written policies and procedures to ensure that the HUD-insured mortgage was administered according to its executed regulatory agreement and HUD requirements for the Section 242 program. Additionally, members of the hospital's board of trustees, including its chairman, had potential conflicts of interest through employment with and serving on the board of the bank from which the hospital obtained a line of credit. As a result, proceeds from the HUD-insured mortgage were not used for their intended purposes, and the multifamily insurance portfolio was subjected to increased risk due to $21.4 million in improper disbursements. Also, HUD depended on inaccurate financial information to approve the $29.8 million mortgage increase.

The Hospital Submitted Inaccurate Information to HUD

The hospital did not comply with its executed regulatory agreement and Federal regulations for the HUD Section 242 program when it submitted inaccurate information to HUD. The hospital misstated several financial statement accounts in 2012 and 2013, which concealed its true financial condition, when it applied for the $29.8 million mortgage increase in December 2013. In November 2014, the hospital notified HUD that it had identified accounting irregularities and restated the financials for 2012 through September 2014. For example, in 2013, the operating loss was understated by $9.6 million and restated at $9.9 million and patients' accounts receivable was overstated by $16.7 million and restated as $39.7 million. Because of the misstatements, the hospital replaced its chief financial officer. The former chief financial officer's signature on those misstated financials provided to HUD represented an improper certification.

The hospital's accounting officials stated that the hospital lacked internal controls and written financial policies and procedures. This allowed inaccurate financial information to be provided to executive management, board members, external auditors, and HUD. The amendment to the regulatory agreement and 24 CFR (Code of Federal Regulations) 242.58(d) state that the annual audited financial statements must identify any changes in accounting policies and their financial effect on the balance sheet and the income statement. HUD Handbook 4370.2, paragraph 2-3(B), requires that books and accounts be complete and accurate and the books of original entry be kept current at all times for HUD-insured projects.

HUD relied on the inaccurate financial information to approve the $29.8 million mortgage increase in June 2014. According to one HUD official from the Office of Hospital Facilities, HUD would not have approved the mortgage increase if HUD officials had known about the hospital's financial problems.

The Hospital Improperly Incurred a Liability and Disbursed Mortgage Proceeds

The hospital did not comply with its executed regulatory agreement and Federal regulations for the HUD Section 242 program when it improperly incurred a liability and disbursed mortgage proceeds to an affiliated party. It inappropriately incurred a $15 million liability from a line of credit loan that was executed under St. Francis Hospital Foundation, Inc., without HUD's knowledge or approval. On October 18, 2013, the Foundation executed the line of credit agreement for general medical and surgical care purposes. The Foundation is an affiliate of the hospital but it is not a party to the HUD-insured mortgage under the regulatory agreement. The hospital transferred the $15 million received from the line of credit to its operating account and posted the debt in its general ledger as due to the Foundation. Regulations at 24 CFR 242.63 state that the borrower must not enter into any long-term debt, short-term debt (including receivables or line of credit financing), equipment leases, or derivative-type transactions that do not comply with policies and procedures established by HUD.

In addition, the hospital inappropriately disbursed $11.8 million of the $29.8 million mortgage proceeds to the Foundation before the final endorsement of the HUD-insured mortgage without HUD authorization. Specifically, it improperly used $7.5 million of the mortgage proceeds to make a payment on the Foundation's $15 million line of credit and inappropriately transferred $4.3 million of the mortgage proceeds to the Foundation's investment account. Provisions of the regulatory agreement in section 23(d)(i) required HUD approval to distribute assets to excluded affiliates prior to final endorsement. According to HUD officials, the hospital did not inform them of the unauthorized $7.5 million payment to the Foundation's credit line until after the payment was made and after the hospital announced its financial misstatements in November 2014. Further, HUD officials stated they had no knowledge of the $4.3 million transfer. Therefore, the hospital violated its regulatory agreement when it improperly disbursed $11.8 million in mortgage proceeds.

The Hospital Executed an Improper Addendum for Its Line of Credit

The Hospital executed an addendum to the promissory note for its line of credit with Columbus Bank and Trust Company, a Division of Synovus Bank, which exceeded the limit set by the regulatory agreement. The hospital executed the addendum on March 11, 2014, and increased its line of credit from $8 million to $13 million, which exceeded its 15-day adjusted operating expenses, without HUD's approval. Based on the 2013 audited financial statements, the hospital's 15-day adjusted operating expenses was approximately $10.5 million. Regulations at 24 CFR 242.63 state that the borrower must not enter into any long-term debt, short-term debt (including receivables or line of credit financing), equipment leases, or derivative-type transactions that do not comply with policies and procedures established by HUD. According to the regulatory agreement (rider 1), section 29(B)(2), the short term line of credit may not exceed 15 days of adjusted operating expenses, as reflected on the most recent audited financial statements.

The Hospital Improperly Transferred Proceeds from HUD-insured Mortgage and HUD Collateral

The hospital transferred $10.5 million from proceeds of the mortgage increase and the sale of HUD's collateralized properties[2] to its operating account, which allowed Columbus Bank and Trust to sweep more than $9.6 million in hospital funds. The funds were swept from August 7 through November 10, 2014, to repay the hospital's $13 million line of credit. The bank generally swept the funds on the same day the hospital made the fund transfers (see table).

Date	Beginning balance: hospital operating account	Transfer from hospital investment account to hospital operating account	Transfer from hospital operating account to loan system (bank swept)	Ending balance: hospital operating account
08/07/2014	$ 88,569	$3,000,000	($2,417,100)	$ 85,242
09/04/2014	$155,468	$1,000,000	($ 928,400)	$142,449
10/02/2014	$ 35,039	$1,500,000	($1,774,600)	$190,756
10/03/2014	$190,756	$1,500,000	($ 909,600)	$102,324
10/30/2014	$ 77,369	$1,000,000	($ 911,100)	$295,407
11/06/2014	$239,843	$2,500,000		$64,885
11/10/2014	$183,916		($2,697,900)	$390,662
Totals		**$10,500,000**	**($9,638,700)**	

The hospital's daily balances from the operating bank statements showed that the hospital did not have adequate funds to sweep from its operating account without the transferred funds from the proceeds of the mortgage and sale of HUD's collateralized properties. The regulatory agreement, section 19, states that the hospital and St. Francis Hospital Affiliated Services, Inc. will not execute any agreement with provisions contradicting the provisions of the regulatory agreement. Thus, the execution of the sweep addendum violated this section and section 4, which does not allow the transfer of mortgaged property without HUD's approval. Therefore, $9.6 million was swept improperly and was not used according to the regulatory agreement.

The above conditions occurred because hospital management did not implement adequate controls to ensure that the HUD-insured mortgaged property was administered according to the executed regulatory agreement and HUD requirements for the Section 242 program. The hospital's accounting officials stated that the hospital lacked internal controls and written

[2] On October 17, 2014, the hospital received a wire transfer of $3,016,639.67 for the sale proceeds of HUD's collateralized properties on William Road in Columbus, GA.

policies and procedures. As a result, proceeds from the HUD-insured mortgage and HUD's collateralized properties were not properly disbursed, and the multifamily insurance portfolio was subjected to increased risk due to $21.4 million[3] in improper disbursements. Hence, HUD did not have an accurate picture of the hospital's financial position and its ability to pay the $240 million HUD-insured mortgage, which put HUD at risk of having to pay a potential mortgage insurance claim.

Hospital Board Members Had Potential Conflicts of Interest with an Affiliated Bank

Three members of the hospital's board of trustees, including the chairman, had potential conflicts of interest through employment with and serving on the boards of the Synovus Bank and Columbus Bank and Trust, from which the hospital obtained the revolving $13 million working capital line of credit. The hospital requested that HUD acknowledge and waive the potential conflicts of interest for two of the board members. However, HUD did not waive the conflicts. The hospital board's former finance committee chairman, who was replaced in March 2015, was employed by Synovus Financial Corporation as its executive vice president-chief risk officer; and the other hospital board member was also a board member of Synovus Financial Corporation. HUD officials also identified the hospital board chairman as an investor in Synovus Financial Corporation stock in 2012. Our review confirmed that he was also a board member of Synovus Financial Corporation from May 1999 to April 2012 and was on the board of directors at Columbus Bank and Trust from 2004 to 2008. He was appointed to the hospital board in 2004 and appointed chairman on January 1, 2014. The Internal Revenue Service conflict of interest guidance for tax-exempt organizations in the instructions for completing Form 1023 (the Application for Exemption under Section 501(c)(3)), provides that after disclosure of the financial interest and all material facts, board or committee members shall decide if a conflict of interest exists. It also defines an interested person as any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest through business or investment.

The hospital executed an unauthorized addendum to the promissory note with Columbus Bank and Trust and also transferred $10.5 million of the mortgage proceeds and sale of HUD's collateralized properties to its operating account, which subjected more than $9.6 million in hospital funds to sweeps by the bank. The conflict of interest may have influenced the hospital's execution of the addendum to the promissory note and decision to transfer the $10.5 million into the operating account.

Conclusion

The hospital (1) submitted inaccurate financial information (2) improperly incurred a liability and disbursed mortgage proceeds to an affiliated party, (3) executed an improper addendum for a line of credit, and (4) subjected mortgage funds to bank sweeps. These conditions occurred because hospital management did not implement adequate controls and lacked internal controls and written policies and procedures to ensure that the HUD-insured mortgaged property was administered according to its executed regulatory agreement and HUD requirements for the Section 242 program. The hospital also allowed members with potential conflicts of interest to

[3] The $21.4 million is composed of the $7.5 million used to pay the line of credit, $4.3 million transferred to the Foundation, and the $9.6 million subjected to bank sweeps.

serve on its board of trustees. As a result, proceeds from the HUD-insured mortgage were not used for their intended purposes, and the multifamily insurance portfolio was subjected to increased risk due to $21.4 million in improper disbursements. Also, HUD depended on the inaccurate financial information to approve the $29.8 million mortgage increase.

Recommendations

We recommend that HUD's Office of Healthcare Programs require the hospital to

1A. Repay to its investment account from non-project funds $11,800,000 of the mortgage increase that was not disbursed according to its executed regulatory agreement and HUD requirements for its Section 242 program.

1B. Repay to its investment account from non-project funds $9,638,700 of the mortgage increase and the sale of HUD's collateralized properties that was not disbursed according to its executed regulatory agreement and HUD requirements for its Section 242 program.

1C. Discontinue and avoid incurring current or future debts associated with the HUD Section 242 mortgage that do not comply with policies and procedures established by HUD.

1D. Resolve the apparent conflicts of interest between its board of trustees members and the bank to eliminate questionable connections.

1E. Improve its internal controls and implement policies and procedures to ensure compliance with its executed regulatory agreement, Federal regulations, and HUD requirements for (1) properly administering the HUD-insured mortgage proceeds and (2) providing accurate and complete reporting of financial information.

We also recommend that the Director of HUD's Departmental Enforcement Center

1F. Pursue administrative actions, as appropriate, against the responsible parties for the regulatory agreement violations cited in this report.

We further recommend that HUD's Associate General Counsel for Program Enforcement

1G. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against the hospital's former chief financial officer for incorrectly certifying to the accuracy of the financial information submitted to obtain the Section 242 program mortgage increase.

Scope and Methodology

We performed our review from January through June 2015 at St. Francis Hospital located at 2122 Manchester Expressway, Columbus, GA. Our review covered the period January 1, 2010, through December 31, 2014.

To accomplish our objectives, we

- Reviewed Federal regulations and HUD handbooks;
- Reviewed the executed regulatory agreement and rider (including covenants);
- Reviewed applicable hospital policies and procedures;
- Reviewed HUD correspondence and independent audit reports on the hospital;
- Reviewed hospital operating licenses, tax returns, and mortgage and financial records;
- Reviewed hospital board members' relationships with an affiliated bank;
- Interviewed HUD's Office of Healthcare Programs officials; and
- Interviewed current and former hospital officials and staff.

During the review period, in September 2011, the hospital obtained a $210 million loan under Section 242 mortgage insurance to renovate and expand its hospital facility. In June 2014, the hospital received a $29.8 million HUD-insured mortgage increase for an obstetric project that it started in 2013. We reviewed financial and bank records for the $29.8 million and found that the hospital inappropriately transferred $11.8 million of the mortgage proceeds in July and September 2014. From August through November 2014, the hospital made six fund transfers totaling $10.5 million from its investment account to its operating account, from which we determined that funds totaling more than $9.6 million were improperly swept.

We used the general ledger information from the hospital's financial system to determine how funds from the Foundation's line of credit and the mortgage increase proceeds were posted. However, we did not rely on the general ledger information for our conclusions or assess the reliability of the computer-processed data. The conclusions were based on additional reviews performed during the audit.

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:

- Reliability of financial data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

- 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 hospital did not have adequate controls over the reliability of financial reporting when it disclosed financial misstatements and improperly used $21.4 million in mortgage proceeds (see finding).

- The hospital did not implement adequate controls to ensure compliance with the executed regulatory agreement and requirements of the Section 242 program (see finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/
1A	$11,800,000
1B	$ 9,638,700
Totals	**$21,438,700**

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.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

St.Francis
We care for life.

July 28, 2015

Nikita N. Irons, CGAP, CFE
Regional Inspector General for Audit
75 Spring Street, SW, Room 330
Richard B Russell Federal Building
Atlanta, GA 30303

Dear Ms. Irons:

St. Francis Hospital, Inc. ("St. Francis") hereby respectfully responds to the draft audit report prepared by the Housing Urban Development Authority Office of Inspector General ("HUD-OIG") regarding St. Francis' compliance with its Regulatory Agreement for the funding obtained through the Section 242 Mortgage Insurance Program. As discussed during the exit conference on July 22, 2015, St. Francis believes several findings are inaccurate or incomplete. St. Francis hereby submits additional information and clarifications and respectfully requests that HUD-OIG consider and incorporate same into its draft report.

As HUD-OIG is aware, in November 2014, the Hospital promptly notified HUD of the Hospital's discovery of the misstatement of certain of its financial statements, thereby triggering HUD-OIG's review. The Hospital has fully cooperated with HUD-OIG and remains ready and willing to provide additional information to HUD-OIG as needed to provide a complete and accurate picture for its report.

Preamble.

Comment 1

In the Preamble under the Highlights Section and on page 4 of the draft report, St. Francis believes that any references of allegedly improper use of mortgage proceeds is not accurate. As set forth below, St. Francis' financial documents, the documentation of the draws, the final and the draft cost certification audit reports establish that all of the mortgage proceeds were properly used to remit payment for the approved project. Notably, the Hospital is not aware of any contractor, subcontractor or vendor asserting a claim for non-payment for the project funded through the 2014 mortgage increase. In addition, in the Highlights section and on page 4, the references to St. Francis Board Chairman's alleged conflict of interest are inaccurate. The Chairman of the Hospital's Board was not serving on the Synovus/CB&T ("Bank") board at the time the Hospital received the additional mortgage proceeds in 2014. In fact, the Chairman of the Hospital's Board participation on the Bank's board ended during 2012. Likewise, as discussed below, references to the additional Board member that served on the Bank board are inaccurate.

St. Francis Hospital • St. Francis Heart Hospital • St. Francis Women's Hospital • St. Francis Physicians Group • The Bradley Center

2122 Manchester Expressway • Post Office Box 7000 • Columbus, Georgia 31908-7000 • 706-596-4000 • www.wecareforlife.com

Comment 1

Comment 1

Comment 2

Comment 3

St. Francis Financial Information Submitted to HUD.

HUD-OIG's statement on page 4 of the draft report that "The Hospital Submitted Inaccurate Information to Obtain the Mortgage Increase" is inaccurate and incomplete. St. Francis acknowledges that its former chief financial officer, and individuals acting under his direction, took various actions that caused the financial statements of St. Francis to be misstated. Specifically, the reserves for contractual allowances were understated, and various expenses omitted and understated. St. Francis' Board of Trustees, however, had no knowledge of these misstatements when St. Francis submitted audited and interim financials to HUD. To the contrary, an independent accounting firm issued opinions as to the accuracy of St. Francis' financials in 2012 and 2013. The Board was entitled to rely on those audited financials. In the late summer of 2014, when a new chief financial officer was appointed, St. Francis began to learn of potential errors in its financials. Upon discovery of the misstated financials, the Board promptly notified HUD of same and took reasonable and necessary steps to correct the misstatements.

At no time did the Board, acting on behalf of St. Francis, submit inaccurate information to obtain the mortgage increase. The mortgage increase was submitted in good faith based upon financial documents that had been previously established as complete and accurate by an independent auditor. Therefore, the Hospital requests restating the title of this Sub-section on page 4 to read as follows: "The Hospital Financial Information was Inaccurate". To accurately reflect the facts, the Hospital also requests revising the second sentence of the first paragraph of this section on page 4 to read as follows: "The St. Francis' financial statement accounts in 2012 and 2013 were misstated and overstated the accounts receivables while understating the expenses" to properly reflect the facts.

St. Francis' Indebtedness and Use of Mortgage Proceeds.

On page 5 of the draft report, the title "The Hospital Improperly Incurred a Liability and Used Mortgage Proceeds" should be corrected, along with its accompanying narrative. Specifically, the St. Francis Hospital Foundation, Inc. ("Foundation"), which is an excluded affiliate under the Regulatory Agreement, obtained a Line of Credit with the Bank. The third sentence of the first paragraph of this section is incorrect because it was the Foundation and not the Hospital that obtained the line of credit. It is accurate that the Foundation in turn loaned the proceeds to St. Francis for the hospital's operations and to remit payment for the project costs. Specifically, St. Francis used the proceeds from the Foundation's line of credit to make payments to vendors for the project and to pay for the hospital's operational costs. Upon receipt of the HUD mortgage increase, St. Francis remitted partial payment on the Foundation loan in the amount of $7.5Million. However, the additional transfer on September 23, 2014 of $4.3Million to the Foundation's investment account was a transfer to an account that was subject to the Deposit Control Agreement with HUD and was not transferred improperly by St. Francis. This specific account was part of the collateral for the mortgage. Moreover, the $4.3Million was substantially transferred back to St. Francis for hospital operations. Please see the description of the transfers from the Foundation to the Hospital, attached hereto as Exhibit "A". This transfer of $4.3Million was placed in the one Foundation account that was collateral for the mortgage and therefore, did not violate the Regulatory Agreement. Notably, while the Hospital did not seek prior approval from HUD, St. Francis did not attempt to conceal the debt that the Foundation incurred. To the contrary, it was described in footnote 10 on page 23 of the 2013 audited financial statements, which were finalized in April 2014.

Comment 4

More important, any reference to improper use of mortgage proceeds is inaccurate. St. Francis has obtained two separate cost certification reports that audited the use of the mortgage proceeds. One report is final and the other report is in draft form. Both reports have independently confirmed that all of the mortgage proceeds were used for the project. The most recent cost certification audit was performed by Causey, Demgen & Moore, a HUD-approved vendor, and is currently in draft format awaiting conclusion of the financial audit. The cost certification concludes $252,257,798 was properly incurred for project related expenditures, while the total incurred HUD indebtedness is $239,887,300. This finding conforms to the final cost certification report that had been previously performed; again, confirming all mortgage proceeds were used for the project. Based upon its financial records and the two independent audits, St. Francis believes that all of the proceeds from HUD-insured indebtedness were used for expenditures properly charged to the project. A copy of the final and draft report is attached to this response as Exhibit "B" and is incorporated herein by reference. In addition, St. Francis is submitting the source financial data that provides conclusive evidence that the mortgage proceeds were used for the project. Accordingly, St. Francis requests the title of this section be modified to read "Hospital Improperly Incurred Additional Indebtedness" and remove any reference that the mortgage proceeds were not used for the project.

Hospital Use of Mortgage Proceeds and HUD Collateral.

Comment 5

On page 6 of the report, St. Francis requests reconsideration of the Section titled "The Hospital Improperly Transferred Mortgage Proceeds and HUD Collateral." The description and the illustrations contained in this section are incomplete and inaccurate. As part of its long-standing cash management systems, dating back to 2007, St. Francis used zero balance depository accounts linked to a master account, an overnight repurchase agreement for investment of excess funds, and a sweep agreement which originated prior to 2011, and linked to St. Francis' line of credit. When the master account fell below a minimum level, automated draws were made on the line of credit. Likewise, if there were excess funds available in the master account and there was an outstanding balance on the line of credit, the excess funds were swept to pay down the line of credit. From June 1, 2014 through November 13, 2014, St. Francis' draws and payments on its Line of Credit resulted in a net cash in-flow of $130,800. Effective November 13, 2014, the Bank froze the Line of Credit at $6,067,100. Please find attached hereto Exhibit "C", incorporated herein by reference, which details the cash log for St. Francis from June 2014 through December 2014. The following observations are made in reference to the attached cash log:

1. St. Francis' line of credit had a balance of $5.9 million on June 1, 2014 and ended the 2014 year at $6.1 million.

Comment 5

Comment 6

Comment 6

2. St. Francis was overdrawn by $20.5 million on June 1, 2014, and was holding checks of $16.6 million in order to maintain liquidity. By December 31, 2014 the total held checks were $1.9 million.
3. The mortgage increase loan proceeds of $28.3 million were deposited on June 23, 2014. St. Francis at the time had significant vendor debt related to the project as evidenced by its cash balance and held checks.
4. Line of credit draws were made on daily basis pursuant to the cash management procedures. These automated daily sweeps increased or decreased the line of credit based upon the balance of the operating account as reflected on the Bank's ledger. These procedures are set forth in the sweep addendum executed prior to the HUD-insured mortgage. For the six month period, total line deposits were $63.2 million and line of credit payments were $63.1 million.
5. St. Francis used its investment account to set aside cash for future obligations. The beginning and ending balance of the hospital investment account for the period (May 31, 2014 to December 31, 2104) was $131,300. The mortgage proceeds, net of the $7.5 million repayment on the Foundation loan previously used to fund the project in 2013, were transferred to the investment account and transferred back to St. Francis' operating account during the period July, 2014 to November, 2014. Such proceeds were appropriately used for the project.

Based upon St. Francis' cash log, cost certification audits, vendor payments and net changes to the line of credit, the financial analysis of the transfers of the mortgage proceeds outlined in the draft report is inaccurate. Again, as established by two separate and independent cost certification audits and the underlying source financial documentation, the mortgage proceeds were used for the project.

Hospital's Conflict of Interest Procedures.

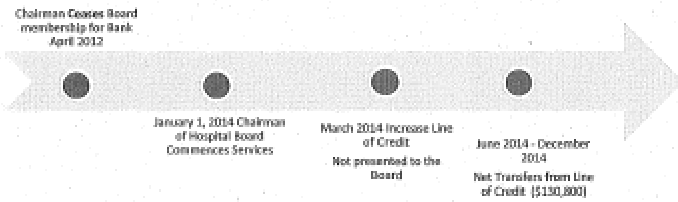
On page 7 of the draft report, the findings related to the St. Francis' Board conflicts of interest are incomplete and inaccurate. Based upon the HUD Handbook Chapter 6-2, two of the Board members referenced in the draft report did not have a conflict of interest. In fact, two of the Board members that held trustee positions for St. Francis and Bank were not in a position to provide any preferential treatment and did not obtain any personal gain. As to these issues, St. Francis submits the following:

First, St. Francis maintains a Conflict of Interest policy for its Board members and obtains financial disclosure statements from each Board member on an annual basis. Please find attached a copy of the Conflict of Interest policy and a Disclosure Form used by St. Francis, attached hereto as Exhibit "D" and incorporated herein by reference. St. Francis provides continuous education to its Board members and if there is a conflict of interest the Board member recuses herself or himself from voting on a matter. St. Francis' policies and procedures were established to comply with the Internal Revenue Service ("IRS") guidance for tax-exempt organizations and are designed to avoid any improper influence on business decisions.

Comment 7

Second, the draft report alleges that St. Francis' Board Chairman had a conflict of interest because he owned Synovus Corporation stock in 2012. Synovus is a large, publicly-traded company. Minority ownership in a public company does not create a conflict of interest as the Chairman was not in a position to benefit personally, directly or indirectly, from St. Francis increasing its unsecured line of credit with the bank. Moreover, at the time of the mortgage increase, the Chairman held a very minor equity interest in the Bank and was not in a position to influence the financial or credit decisions of the Bank.

Further, as outlined in the draft report, the only time when the Chairman of St. Francis was also on the Bank Board was several years prior to the mortgage increase in 2014 or any of the alleged transfers of payments to Bank in 2014. As a further illustration of the fact that there was not a violation of the conflict of interest standards, please see the table below:



Comment 8

Notwithstanding the fact that St. Francis' Chairman was not simultaneously on both organization's boards, when he was a Bank Board member, St. Francis' Board Chairman was never in a position to provide preferential treatment to St. Francis and did not make any decisions regarding credit or financing on behalf of the Bank. Therefore, any allegation that the Chairman of the Board had a conflict of interest that improperly influenced St. Francis to obtain an unsecured increase of $5Million from the bank or improperly transfer funds in 2014 is not supported by the undisputed evidence and should be deleted.

Comment 9

Likewise, the additional Board member that held simultaneous Board member status for St. Francis and the Bank did not have authority to make credit decisions on behalf of the Bank. Specifically, the individual St. Francis Board members were not in a position to obtain preferential treatment for St. Francis and did not receive any personal or private gain from the Bank's transactions with St. Francis. Likewise, the Chairman of the Board and the additional Board member did not have any influence over St. Francis' banking decisions and were not involved in negotiating terms from any financial institution. The St. Francis banking relationships were handled by the St. Francis executives. Therefore, the Board members do not have a conflict of interest as defined by the HUD Handbook Chapter 6-2.

In addition, the increase in the line of credit and the transfer of funds to the operating account were not presented to the St. Francis Board for review or approval. Rather, St. Francis executives facilitated those transactions. Accordingly, the Chairman of the Board and the

Comments 3 and 4

Comment 9

additional St. Francis governing Board member who also served on Bank's Board did not engage in activities that create a real or apparent conflict of interest as defined by the HUD Handbook. St. Francis also maintained policies and procedures to avoid any improper influence by any other Board member identified in the report.

In summary, because the Board Chairman's participation on the Bank Boards did not overlap with the two actions that have been identified by the draft report as violations of the Regulatory Agreement and because minority ownership in a public company does not create an individual personal benefit, St. Francis requests the removal of all references to the Board Chairman from the draft report. Likewise, St. Francis requests removal of the reference to the additional St. Francis Board member who had simultaneous membership in the Bank Board, because he did not have authority to provide preferential treatment for St. Francis, and did not attempt to achieve any personal or private gain. Simply put, HUD-OIG fails to point to any evidence that overlapping Board members caused any violation of the Regulatory Agreement.

Conclusion and Recommendations.

Because the cost certification audits, both the final and draft, and the underlying source financial documents establish that St. Francis expended all of the mortgage proceeds for the project, St. Francis requests the deletion of the recommendations in Sections 1A and 1B of the draft report. In support of this request, St. Francis respectfully requests OIG to consider the cost certification reports, source project draw information and the cash logs of St. Francis. Likewise, St. Francis requests the Conclusion section to be redrafted to remove any inference that the Hospital did not use the mortgage proceeds for the intended purpose. St. Francis further requests the removal of the references to a Conflict of Interest on behalf of the Board Chairman and the additional Board Member who is not employed by the Bank.

If you have any questions regarding the additional information, audit reports, policies or Exhibits to this response, please feel free to contact me or Greg Hembree, SVP/CFO. We appreciate your diligence and willingness to work with St. Francis to accurately reflect St. Francis' performance under the Regulatory Agreement.

Sincerely yours,

Kirk Wilson
Interim CEO

Enclosures (4)

CC: Greg Hembree, St. Francis Hospital
Michele Madison, Morris Manning & Martin
Robert Threlkeld, Morris Manning & Martin
Harris Winsberg, Troutman Sanders

OIG Evaluation of Auditee Comments

Comment 1 The hospital acknowledged that its former chief financial officer and individuals acting under his direction took various actions to cause its financial statements to be misstated. The hospital also commented that its board of trustees had no knowledge of the misstatements and was entitled to rely on those financials, which were audited by an independent accounting firm and reported as accurate. The hospital further commented that the board did not submit inaccurate information to obtain the mortgage increase. It also suggested changing the sub-section title and second sentence.

The accuracy of financial information is the responsibility of the board and hospital management through a system of checks and balances between themselves and external auditors. The finding discussed the lack of internal controls, policies, and procedures in this area that should have provided those checks and balances. Essentially, the board should have known about the misstatements and ensured corrections were made before the information was released. The board being unaware of the misstatements contributed to the condition; therefore, the board is ultimately responsible for the inaccurate financial information that was submitted to HUD. HUD relied on the financial information submitted to approve the $29.8 million mortgage increase. However, OIG considered the hospital's request, and revised the sub-section title to read "The Hospital Submitted Inaccurate Information to HUD."

Comment 2 The hospital concurred that it received the proceeds from the Foundation's line of credit as a loan, but specified that it was the Foundation and not the hospital that obtained the line of credit. The hospital stated that it used the proceeds from the Foundation's line of credit to make payments to vendors and hospital operational costs.

OIG agrees that it was the Foundation, and not the hospital, that executed the $15 million line of credit on October 18, 2013, and revised the sentence accordingly. OIG reviewed how the hospital disbursed the $28.2 million received from the mortgage increase and identified that $11.8 million of the mortgage proceeds were disbursed to the Foundation without HUD's prior authorization as required by the executed regulatory agreement. OIG did not review the proceeds from the Foundation's line of credit. Hospital's management denied our request for the Foundation's general ledger; therefore, we cannot determine whether funds from the Foundation's line of credit were used for eligible project and hospital operating costs.

Comment 3 The hospital disagreed that it improperly transferred the $4.3 million to the Foundation's investment account because the account was subject to the deposit control agreement with HUD.

The deposit control agreement referenced by the hospital was made with the lender and not HUD. In addition, although the account is subject to the deposit control agreement, the $4.3 million disbursement was still subject to the disbursement requirements stipulated in the executed regulatory agreement, which states that the mortgagor may distribute assets without prior HUD approval to excluded-affiliates and/or stockholders if the final endorsement of the HUD-insured note has occurred. Final endorsement had not occurred; therefore, the hospital was not in compliance with the executed regulatory agreement when it transferred $4.3 million to the Foundation's investment account without prior HUD approval.

Comment 4 The hospital disagreed with our reference to improper use of the mortgage proceeds in the report and believed that all mortgage proceeds were used for project expenditures. In addition, the hospital stated that it has obtained two cost certification reports, which confirmed that all of the mortgage proceeds were used for the project. It also provided copies of the cost certification reports.

OIG did not dispute the hospital's project expenditures; we maintain that the hospital did not disburse $11.8 million of the mortgage increase proceeds according to the executed regulatory agreement. HUD rejected the first cost certification report the hospital obtained and the second report was still in draft form when we held the exit conference on July 22, 2015. The attachments provided by the hospital are not included in appendix B, but are available upon request. However, we considered the hospital's request, and will replace references to the <u>use</u> of mortgage proceeds with <u>disbursed</u> or disbursement of mortgage proceeds.

Comment 5 The hospital disagreed with the description and illustrations, and the financial analysis of the transfers of the mortgage proceeds outlined in the draft report. The hospital explained that the fund transfers and sweeps were part of its cash management systems, dating back to 2007. The hospital believed that the analysis of the transfers was inaccurate based upon its cash log, certification audits, vendor payments and net changes to the line of credit.

OIG is aware of the line of credit draws and automated daily sweeps of the hospital's operating account from the bank as a part of the hospital's cash management systems. However, the hospital executed a line of credit that exceeded the regulatory agreement's limitation without HUD's approval. Further, the hospital financial officials authorized the transfers of the proceeds from the mortgage increase and the sale of HUD's collateralized properties from the hospital investment account to the hospital operating account, which were subjected to the automated sweeps by the bank to repay the line of credit loan that was not executed according to the regulatory agreement.

Comment 6 The hospital commented that it maintains a conflict of interest policy for its board members and obtains financial disclosure statements from each board member on an annual basis. The hospital also stated that it provides continuous education to its board members and if there is a conflict of interest the board member recuses herself or himself from voting on a matter. It further commented that its policies and procedures were established to comply with the Internal Revenue Service ("IRS") guidance for tax-exempt organizations and are designed to avoid any improper influence on business decisions.

The hospital had a conflict of interest policy and maintained the financial disclosure statements on file. The existence of the policy and maintaining the disclosure statements can help identify but does not alleviate conflicts of interest. In November 2014, HUD received written requests to waive potential conflicts of interest for two members of the hospital's board of trustees, including one who was the board's finance committee chairman at the time and employed by Synovus as an executive vice president and chief risk officer. Although HUD did not grant the waivers, the request letters identified that a potential conflict existed.

The IRS published a suggested conflict of interest policy in the instructions for completing Form 1023 (the Application for Exemption under Section 501(c)(3)). In part, it provides that after disclosure of the financial interest and all material facts, board or committee members shall decide if a conflict of interest exists. If the hospital's board followed these IRS procedures, the appropriate supporting information should be provided to HUD during the resolution of recommendation 1D of the report.

Comment 7 The hospital commented that the draft report alleges that St. Francis' board chairman had a conflict of interest because he owned Synovus Corporation stock in 2012. It added that minority ownership in a public company does not create a conflict of interest as the chairman was not in a position to benefit personally, directly or indirectly, from St. Francis increasing its unsecured line of credit with the bank. The hospital further commented that the only time when the chairman of St. Francis was also on the bank board was several years prior to the mortgage increase in 2014, or any of the alleged transfers of payments to the bank in 2014.

OIG maintains that the board chairman owned Synovus stock as recently as 2012 and no documentation has been provided to show the stock is no longer owned. The IRS conflict of interest guidance provides in part that an interested person is any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest through business or investment. Any supporting documentation the hospital has should be provided to HUD to clear the potential conflict of interest as discussed in recommendation 1D of the report. In addition, the transfers of mortgage proceeds and proceeds from sales were not alleged; we confirmed the improper transactions by reviewing the hospital's bank statements and financial records.

Comment 8 The hospital commented that (1) the chairman was not simultaneously on both organizations' boards when he was a bank board member, and (2) St. Francis' board chairman was never in a position to provide preferential treatment to St. Francis and did not make any decisions regarding credit or financing on behalf of the bank. The hospital further commented that any allegation that the chairman of the board had a conflict of interest that improperly influenced St. Francis to obtain an unsecured increase of $5 million from the bank or improperly transfer funds in 2014 is not supported by the undisputed evidence and should be deleted.

OIG maintains that the hospital's board chairman was in fact on both the hospital and Synovus boards simultaneously from 2004 to 2012. We confirmed that the chairman was appointed to the hospital's board in 2004 and served on Synovus' board from 1999 to 2012. Any supporting documentation the hospital has should be provided to HUD to resolve the potential conflict of interest as discussed in recommendation 1D of the report.

Comment 9 The hospital stated that the additional board member that held simultaneous board member status for St. Francis and the bank did not have authority to make credit decisions on behalf of the bank. It further stated that individual St. Francis board members were not in a position to obtain preferential treatment for St. Francis and did not receive any personal or private gain from the bank's transactions with St. Francis. The hospital also commented that the chairman and additional board member did not have any influence over St. Francis' banking decisions and were not involved in negotiating terms from any financial institution. It further commented that the St. Francis banking relationships were handled by St. Francis executives, so the board members do not have a conflict of interest as defined by the HUD Handbook Chapter 6-2.

The hospital's board has the ultimate oversight and governance responsibilities over its executives and their functions, including banking and financial operations. Therefore, the potential conflict of interest continued to exist with Synovus. The IRS guidance for tax-exempt organizations provides that a person has a financial interest if the person has, directly or indirectly, through business, investment, or family:

a. An ownership or investment interest in any entity with which the organization has a transaction or arrangement,
b. A compensation arrangement with the organization or with any entity or individual with which the organization has a transaction or arrangement, or
c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the organization is negotiating a transaction or arrangement.

Any supporting documentation the hospital has should be provided to HUD during the resolution of recommendation 1D of the report.