Saltillo Assisted Living, Saltillo, MS

Assisted Living Facility Insured Under the Section 232 Program

Office of Audit, Region 4
Atlanta, GA

Audit Report Number: 2016-AT-1009
August 2, 2016

To:	Roger Lewis, Director, Office of Residential Care Facilities, 0HP
	Dane Narode, Associate General Counsel for Enforcement, CACC
	Craig T. Clemmensen, Director, Departmental Enforcement Center, CACB
	//signed//
From:	Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA
Subject:	The Members and Operator Did Not Comply With the Executed Regulatory Agreement and HUD's Requirements for Saltillo Assisted Living, Saltillo, MS

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Saltillo Assisted Living, an assisted living facility insured under Section 232 of the National Housing Act.

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.

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The Members and Operator Did Not Comply With the Executed Regulatory Agreement and HUD's Requirements for Saltillo Assisted Living, Saltillo, MS

Highlights

What We Audited and Why

We audited Saltillo Assisted Living (project), an assisted living facility located in Saltillo, MS, based on a referral from the U.S. Department of Housing and Urban Development's (HUD) Departmental Enforcement Center and activities included in our 2015 annual audit plan. Our audit objective was to determine whether the members and operator of Saltillo Assisted Living complied with the executed regulatory agreement and HUD's requirements.

What We Found

The member, managing member, and operator did not comply with the executed regulatory agreement and HUD's requirements. Specifically, in managing and operating the project, the members or operator did not (1) follow the regulatory agreement by taking and using more than $246,000 in distributions and ineligible and unreasonable project expenses, (2) ensure that project expenses totaling more than $865,000 were properly supported, (3) submit audited financial statements as required, (4) maintain the project in good repair and condition, (5) obtain HUD's approval for leasing the project, and (6) maintain books and records in reasonable condition for proper audit. These conditions occurred because the members and operator did not implement adequate controls and lacked appropriate experience and the member was unavailable to ensure compliance with the regulatory agreement and HUD's requirements. As a result, the project lacked financial viability, HUD incurred a net loss of more than $1.5 million, and HUD lacked assurance that program requirements were met.

What We Recommend

We recommend that the Director of the Office of Residential Care Facilities require the members to reimburse HUD's FHA insurance fund for more than $246,000 in ineligible and unreasonable costs and provide support for or reimburse more than $865,000 in unsupported costs. We also recommend that HUD's Office of Program Enforcement pursue double damages against the responsible parties for the ineligible distributions, unreasonable, and unsupported disbursements that violated the project's regulatory agreement. Further, we recommend that the Director of HUD's Departmental Enforcement Center pursue civil money penalties, administrative action, and monetary sanctions against the responsible parties as applicable.

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Background and Objective

Saltillo Assisted Living (project) (formerly known as Dogwood Homeplace Assisted Living) is an assisted living facility located in Saltillo, MS, and was insured by the Federal Housing Administration (FHA) under Section 232 and 223(f) of the National Housing Act. The Section 232 program provides mortgage insurance for residential care facilities, such as nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. Section 223(f) FHA mortgage insurance is used to facilitate the purchase or refinance of multifamily rental housing. The project consists of three one-story buildings with a total of 53 units, and the most recent license issued within our scope of January 1, 2012, through December 31, 2015, was for 54 persons.

The member of the project ownership entity, Dogwood Homeplace Assisted Living, LLC, executed the regulatory agreement for the project on December 30, 2003. Based on information provided by HUD, Dogwood Homeplace Assisted Living, LLC,[1] was composed of a member with an 80 percent ownership interest in the project and a managing member with a 20 percent ownership interest in the project.[2] In addition, the project ownership entity leased the project operations to a related entity controlled by the managing member.

During our scope, there were three different operators, which included both members and the onsite management staff[3] that held a license with the State of Mississippi to operate the project as an assisted living facility. The table below lists the operators by their licensure dates.

Operators during the audit scope

Operator	License start date	License end date
Member	January 1, 2012	August 9, 2012
Managing member	August 10, 2012	September 17, 2015
Onsite management	September 18, 2015	December 31, 2015

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[1] Since the ownership entity is a limited liability company, we use the term "members" rather than "owners" in the report to describe the individuals associated with the ownership entity. The operating agreement for the limited liability company identifies the individual with the 20 percent ownership interest as the "manager"; therefore, we refer to this member as the "managing member" in the report. The individual with the 80 percent ownership interest is referred to as "member" in the report.
[2] The executed regulatory agreement defines the executor as a Mississippi limited liability company and all present and future members and managers of that company. Therefore, we determined that the regulatory agreement applied to both of the members.
[3] Although the members were also an operator, they are referred to as members throughout this report. Only the onsite management staff that was not part of the project ownership is referred to as an operator. The onsite management staff consisted of two nurses who had worked at the project since 2009 and 2011.

The project ownership entity did not make a mortgage payment for any period after August 2012. As a result, the project was assigned to HUD on August 27, 2013, and HUD paid claims totaling more than $2.3 million. The member was unavailable during this time as he was sentenced to 30 months in Federal prison for failure to pay Federal taxes in August 2013 as a result of an Internal Revenue Service (IRS) criminal investigation. Further, the project was foreclosed on and later sold on March 30, 2016, for $870,000. According to the HUD field office, due to the foreclosure sale of the project, it is no longer insured by HUD, and HUD's involvement in the project going forward will be limited to the terms of the foreclosure sale use agreement.[4] The violations identified in this report occurred while the project was insured by HUD, and the members and operator in place at that time were required to comply with the regulatory agreement and HUD requirements.

At the beginning of our audit, we discovered that the project had no liability or property insurance; therefore, on December 16, 2015, we issued interim memorandum 2016-AT-1801[5] to bring the matter to HUD's attention and recommended that HUD enforce its requirements for the members and operator to immediately obtain liability and property insurance on the project. HUD was unable to require the members to obtain liability and property insurance since the project was in the process of foreclosure. In addition, with the completion of the foreclosure sale, HUD is not in any chain of liability; therefore, the project is not bound by HUD's requirements to maintain liability and property insurance.

Our objective was to determine whether the members and operator of Saltillo Assisted Living complied with the executed regulatory agreement and HUD's requirements.

[4] The foreclosure sale use agreement, executed on May 5, 2016, between the purchaser and HUD, requires the purchaser to maintain the project as an assisted living facility; keep the project in decent, safe, and sanitary condition; allow the project to be inspected periodically; and follow other various provisions for the term of the agreement, which is 20 years.

[5] Some of the information and terms included in the interim memorandum are different from those in this audit report as the memorandum was issued during the audit.

Results of Audit

Finding: The Members and Operator of Saltillo Assisted Living Did Not Comply With the Executed Regulatory Agreement and HUD's Requirements

The members and operator of Saltillo Assisted Living did not comply with the executed regulatory agreement and HUD's requirements. Specifically, in managing and operating the project, the members or operator did not (1) follow the regulatory agreement by taking more than $181,000 in distributions from project funds, (2) ensure that project expenses totaling more than $930,000 were eligible and properly supported, (3) submit audited financial statements as required, (4) maintain the project in good repair and condition, (5) obtain HUD's approval for leasing the project, and (6) maintain books and records in reasonable condition for proper audit. These conditions occurred because the members and operator did not implement adequate controls and lacked experience with HUD programs or multifamily projects and the member was unavailable to ensure compliance with the regulatory agreement and HUD's requirements. As a result, the project lacked financial viability and was deprived of funds that could have been used to meet its debt service, HUD incurred a net loss of more than $1.5 million after payment of claims and the sale of the project, and HUD lacked assurance that the members and operator complied with the executed regulatory agreement and HUD's requirements.

Ineligible Distributions

Based on our review of all distributions totaling $1,000 or more, during the period January 2012 through December 2015, the members paid more than $181,000 in ineligible distributions to themselves while the project was in a non-surplus-cash position. Paragraph 6(e) of the regulatory agreement provides that owners must not make or receive and retain any distribution[6] of assets or any income of any kind of the project except surplus cash.[7] However, as of the latest financial statements submitted to HUD for the period ending December 31, 2009, the project was in a negative cash position of more than $566,000.

The majority of the ineligible distributions were cash withdrawals from the project's bank accounts that were not deposited into any of the other bank accounts of the project or used to pay for project expenses, based on the documentation available for review. Specifically, in the months in which the distributions occurred, the cash withdrawals ranged from $1,000 to $31,550 per month. Table 1 identifies the amount of ineligible distributions by the members by the type of distributions.

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[6] Paragraph 13(g) of the regulatory agreement defines "distribution" as any withdrawal or taking of cash or any assets of the project, including segregation of cash or assets for later withdrawal.

[7] Paragraph 13(f) of the regulatory agreement defines "surplus cash" as any cash remaining after the payment of the mortgage, payments to the reserve for replacement fund, and all other obligations of the project unless funds for payment have been set aside or deferred payment has been approved by the HUD Secretary.

Table 1: Ineligible distributions

Members	Cash withdrawals	Wire transfers	Check payments	Totals by members
Member	$50,170	$25,800	$5,800	$81,770
Managing member	95,200	0	4,050	99,250
Totals by distribution type	**145,370**	**25,800**	**9,850**	**181,020**

The managing member said he received distributions from the project funds as repayment of loans or advances he made to the project to maintain project operations while he was the operator. However, HUD does not permit[8] repayment of any advances unless the project is in a surplus-cash position. In addition, the managing member did not have any documentation to support or identify which cash withdrawal transactions were the repayments of the loans or advances. Therefore, we classified all withdrawals of project funds by the managing member as distributions.

Unsupported and Ineligible Project Expenses

The members and operator did not ensure or provide documentation to show that project expenses were used for reasonable and necessary purposes as required by the regulatory agreement[9] and HUD regulations.[10] We reviewed 215 disbursements totaling nearly $1.3 million from a universe of disbursements totaling more than $5.5 million for the period January 2012 through December 2015. Based on our review, 190 disbursements totaling more than $865,000 were unsupported, and 10 disbursements totaling more than $53,000 were ineligible. The unsupported disbursements were generally disbursements made to the operator and for goods and services purchased from project funds that were not supported by invoices showing that they were reasonable and necessary and used for the project. For example, the unsupported disbursements included legal expenses that appeared to be for the members' personal legal representation; however, without the supporting documentation, this determination could not be made. Therefore, we classified the expenses as unsupported. The ineligible disbursements generally related to rent payments made to the managing member that were not approved by HUD.

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[8] HUD Handbook 4370.2, REV-1, section 2-11, states that repayment of owner advances when the project is in a non-surplus-cash position will subject the owner to criminal and civil monetary penalties.

[9] Paragraph 6(b) of the regulatory agreement states that the owners cannot, without HUD's prior written approval, assign, transfer, dispose of, or encumber any personal property or pay out funds except for reasonable operating expenses and necessary repairs.

[10] Regulations at 24 Code of Federal Regulations (CFR) 232.1007 provide that goods and services purchased or acquired in connection with the project must be reasonable and necessary for the operation or maintenance of the project.

In addition, during the period January 2012 through December 2015, the project incurred more than $11,000 in 344 nonsufficient funds and overdraft charges from its financial institutions that were unreasonable or unnecessary for the operation of the project. We provided the schedules of unsupported and ineligible disbursements to the members and operator during our audit; however, they did not provide us supporting documentation for the disbursements.

Failure To Submit Financial Statements

Paragraph 9(e) of the regulatory agreement requires the owners to provide a complete annual financial report based upon an examination of books and records prepared in accordance with HUD's requirements. In addition, 24 CFR 232.1009 provides that operators must submit financial statements quarterly within 60 days of the date of the end of each fiscal quarter. However, the required financial statements had not been submitted to HUD by the members or operator for the past 5 consecutive years. The last audited annual financial statement that HUD received was for the fiscal year ending December 31, 2009. It identified the project at a negative cash position of more than $566,000. As a result of the members' and operator's failure to submit the required financial statements, HUD and the project lacked assurance of the project's financial viability and condition.

Failure To Maintain Project in Good Condition

Paragraph 7 of the regulatory agreement provides that the owners must maintain the mortgaged premises, accommodations, and grounds and equipment in good repair and condition. However, the members failed to maintain the project in good repair and condition. The project consists of three one-story buildings, with building 3 being closed through at least December 2015 due to damage from a water line break that occurred in late 2014 according to the operator. At the time the water line break occurred, the project did not carry property insurance as required; therefore, it could not file a claim to fix the damage to building 3.[11] The project was initially licensed for 63 persons, but since one of the buildings was in a state of disrepair, the most recent license within our scope was issued for only 54 persons, resulting in potential lost revenue for the project that could have been used toward the payment of its mortgage.

In addition, the project failed its most recent physical inspection conducted by HUD's Real Estate Assessment Center in October 2015 with a score of 53c.[12] Some of the items noted during our walk through of the project included dilapidated kitchens with old and damaged appliances, heavily stained carpets in some of the rooms and hallways, significant pot holes in the parking lot, and other minor deficiencies. The following pictures show examples of the physical condition noted during our walk through.

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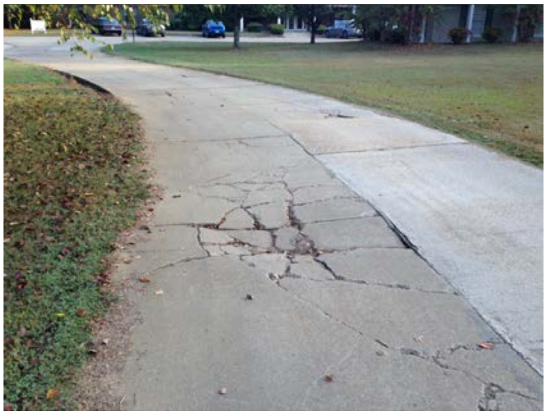
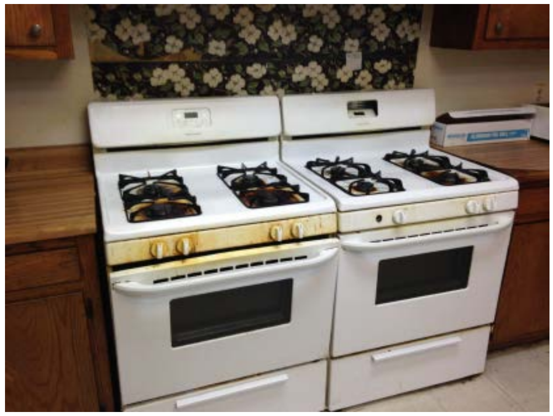
[11] See the Background and Objective section of this report for details.
[12] Scores can range from 0 to 100, and a passing score is 60 or above.



Pot holes in the parking lot.



Damaged kitchen stoves (broken oven controls, broken oven door, and missing stove knob)

At the time of project assignment to HUD in August 2013, the project's reserve for replacement[13] totaled nearly $83,000. According to the HUD field office, although the project may have needed some capital improvements, the reserve for replacement was not released due to the project's mortgage delinquencies and HUD's experience with the members' performance at the project. However, following the foreclosure sale of the project, HUD applied the entire $82,965 reserve for replacement balance as of April 20, 2016, toward the unpaid mortgage and other related charges of more than $2.8 million.

Unauthorized Leases for the Management and Operations of the Project

While the project can be leased with HUD's approval, the members and operator executed three unauthorized leases for the management and operation of the project during our scope. Paragraph 9(h) of the regulatory agreement provides that if the project is insured under Section 232, the owners must not lease all or part of the project except on terms approved by HUD. The leases were executed between the ownership entity and a related entity controlled by the managing member and between the ownership entity and the operator between 2012 and 2015. HUD informed us that none of the leases was approved due to discrepancies in the leases. Table 2 lists the number of leases executed.

Table 2: Unapproved project leases

Parties on lease	Date lease executed	Lease approved by HUD? (yes-no)
Ownership entity and a related entity controlled by managing member	April 17, 2012	No
Ownership entity and	January 15, 2013	No

[13] Paragraph 2(a) of the regulatory agreement provides disbursements from the reserve for replacement fund, whether for the replacement of structural elements and mechanical equipment of the project or any other purpose, may be made only after receiving consent in writing from HUD.

Parties on lease	Date lease executed	Lease approved by HUD? (yes-no)
operator		
Ownership entity and operator[14]	August 25, 2015	No

Inadequate Books and Records

The members did not maintain books and records in reasonable condition for proper audit. Paragraph 9(c) of the regulatory agreement states that the mortgaged property, equipment, buildings, plans, offices, apparatus, devices, books, contracts, records, documents, and other related papers must at all times be maintained in reasonable condition for proper audit. Documentation before the operator took over in January 2013 was generally not available. Although the members did not provide all subpoenaed documentation, both of the members provided a certification of compliance, indicating that they provided all available documentation to us. In addition, as stated above, the project's latest audited financial statements provided to HUD were for the period ending December 31, 2009.

Lack of Controls and Experience

The members and operator of Saltillo Assisted Living did not comply with the executed regulatory agreement and HUD's requirements because they lacked adequate controls and appropriate experience and the member could not be actively involved with the project. Specifically, the managing member stated that there were inadequate controls in place to address (1) loans involving project funds, (2) member distributions, (3) submission of financial statements to HUD, and (4) disbursements of project funds for reasonable and necessary expenses. More specifically, the managing member stated that to his knowledge, there were no reviews conducted of project disbursements to ensure that they were reasonable, necessary, and supported.

In addition, the managing member and operator lacked experience with HUD programs or multifamily projects. The operator lacked experience in managing the project's day-to-day operations. Principals acting as the project's operator were nurses employed by the project in 2009 and 2011, before taking over the day-to-day operations in 2013 and becoming the operator in 2015. The managing member said he had no experience with HUD programs or multifamily projects before his involvement with the project.

[14] The entities associated with the operator in the second and third leases are different but the individuals associated with each entity are the same. Based on information provided by the member, the second lease was not implemented due to ongoing litigation between the member and managing member.

While the member said he had prior experience with HUD programs, he said he was actively involved with the project only from January through April 2012 during our scope. In addition, the member was unavailable[15] beginning in August 2013, after which no further mortgage payments were made and during which time the mortgage defaulted and the project was assigned to HUD. Although the managing member was available during the time that the member was not, the managing member said that because the member was indicted and the project was losing money, he made the decision to not make any further mortgage payments on the project.

Conclusion

The members and operator did not comply with the executed regulatory agreement and HUD's requirements. The conditions identified occurred because the members and operator did not implement adequate controls and lacked appropriate experience with HUD programs or multifamily projects and the member could not be actively involved with the project to ensure compliance with the regulatory agreement and HUD's requirements. As a result, (1) the project lacked financial viability and was deprived of funds that could have been used to meet its debt service, (2) HUD incurred a net loss of more than $1.5 million after payment of claims and the sale of the project, and (3) HUD lacked assurance that the members and operator complied with the executed regulatory agreement and HUD's requirements.

Title 12, U.S.C. (United States Code), section 1715z-4a, provides that HUD may pursue legal action to recover any assets or income used by any person in violation of the regulatory agreement or any applicable regulation. The members and operator are responsible for providing documentation to establish that the use of project assets or income was for a reasonable operating expense or necessary repair of the property; otherwise, they may be subject to double damages.

In addition, the members failed to provide the annual financial statements as required; therefore, they may be subject to additional penalties. According to 12 U.S.C. 1735f-15(c)(1)(B)(x), a penalty may be imposed upon any liable party for failure to submit an annual financial report in accordance with the requirements.

Recommendations

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

1A. Require the members to reimburse HUD's FHA insurance fund $181,020 for the ineligible distributions to the members.

1B. Require the members to provide support or reimburse HUD's FHA insurance fund $865,142 for unsupported project disbursements.

1C. Require the members to reimburse HUD's FHA insurance fund $53,885 for the ineligible project disbursements.

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[15] See the Background and Objective section of this report for details on the member's unavailability.

1D. Require the members to reimburse HUD’s FHA insurance fund $11,587 for the unreasonable nonsufficient funds and overdraft charges.

We also recommend that HUD’s Office of Program Enforcement, in coordination with HUD’s Office of Residential Care Facilities

1E. Pursue double damages remedies against the responsible parties for the ineligible, unreasonable, and the applicable portion of the unsupported disbursements that was used in violation of the project’s regulatory agreement.

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

1F. Pursue civil money penalties and administrative sanctions against the responsible parties[16] for mismanagement of project funds and noncompliance with the regulatory agreement and HUD’s requirements.

[16] The project’s member was indefinitely debarred from participating in any HUD or Federal programs, effective May 29, 2014.

Scope and Methodology

We performed our audit work between October 2015 and May 2016 at the project located at 200 Knight Drive, Saltillo, MS, and at our office in Atlanta, GA. The audit generally covered the period January 1, 2012, through December 31, 2015, but we expanded the period as necessary.

To accomplish our audit objective, we

- Interviewed project personnel involved with the management of the project and HUD officials.
- Reviewed the executed regulatory agreement, leases of the project, the operating agreement, HUD handbooks, and other requirements relevant to Section 232-insured assisted living facilities.
- Reviewed 100 percent of distributions totaling $1,000 or more made to the members from January 1, 2012, through December 31, 2015, to determine the eligibility of the distributions. The sample and universe included 64 distributions totaling $229,420.
- Reviewed a nonstatistical sample of 215 disbursements totaling nearly $1.3 million from the project's bank records for the period January 1, 2012, through December 31, 2015, to determine eligibility from a universe of disbursements totaling more than $5.5 million, from which we excluded transfers and transactions selected in the other samples. When selecting the sample, we included some of the largest disbursements and disbursements that appeared unreasonable or unusual. For example, we selected several large disbursements of more than $10,000 and disbursements that were made to another project or related business entities that appeared to be unreasonable or unusual. The results of the disbursement review apply only to the sampled transactions and cannot be projected to the universe.
- Reviewed 100 percent of the nonsufficient funds and overdraft charges from the bank records for the period January 1, 2012, through December 31, 2015, to determine the total unreasonable or unnecessary bank fees charged to the project. The sample and the universe included 344 nonsufficient funds and overdraft charges totaling $11,587.
- Reviewed the project's mortgage payment history and reserve for replacement account balance.
- Toured the project to observe the general condition and layout of the project.

We relied in part on computer-processed data maintained for the project to achieve our audit objective. 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 adequately reliable for our purposes. We provided our review results to the members and operator 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:

- Effectiveness and efficiency of 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 provide reasonable assurance that program implementation is in accordance with laws, regulations, and provisions of contracts or grant agreements.
- Safeguarding of assets – Policies and procedures that management has implemented to reasonably prevent and promptly detect unauthorized acquisition, use, or disposition of assets and resources.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

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

- The members and operator did not implement adequate controls to ensure compliance with the regulatory agreement and HUD's requirements (finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/
1A	$181,020		
1B		$865,142	
1C	53,885		
1D			$11,587
Totals	**234,905**	**865,142**	**11,587**

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/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

Appendix B

Auditee Comments and OIG's Evaluation

We provided the report to project members and operator on June 20, 2016, and requested written comments by July 4, 2016, and extended this date to July 11, 2016, upon the member's request during the exit conference held on June 28, 2016. However, as of July 12, 2016, the project members and operator did not provide written or verbal comments to this report.