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SUBJECT: Owners of Heartland Health Care Center of Bethany misspent or cannot account for the use of $18.7 million in project income.

HIGHLIGHTS

What We Audited and Why

We audited the Heartland Health Care Center of Bethany (Center), a nursing home that had a HUD insured mortgage. The Oklahoma City Multifamily staff voiced concerns because the owners did not submit annual audits, permitted the property to deteriorate into a substandard physical condition, defaulted on the mortgage, and filed for bankruptcy. In addition, HUD staff identified possible indications of equity skimming.

Our audit objective was to determine whether owners or other parties managing the Center complied with the project regulatory agreement and HUD requirements when disbursing project funds.

What We Found

Center officials did not disburse funds in accordance with their regulatory agreement. Specifically, Center officials used $2,310,160 for ineligible costs, such as loan repayments and late fees and could not support $4,508,688 in expenditures. Further, Center officials did not provide

documentation to support the use of revenue amounting to $11,909,900 for 3 years.

Center officials ignored requirements of the regulatory agreement and as a result they misspent funds. This ultimately resulted in mortgage default and closure of the Center.

What We Recommend

We recommend the Director of the Multifamily Program Center require Center officials to reimburse HUD $2,310,160 for the ineligible costs, provide support or reimburse HUD $4,508,688 for the unsupported expenditures, and provide support or reimburse HUD for the unsupported use of $11,909,900 in revenue.

We further recommend that the Director take appropriate administrative actions and pursue recovery of the funds from Center officials under the equity skimming statutes.

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

The Auditee chose not to comment in a timely manner regarding the findings contained in this report. We issued the draft to the Auditee on October 14, 2004, for comment and did not have a response as of the date of this report. Therefore, we issued the report without an Auditee response.

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BACKGROUND AND OBJECTIVES

HUD provides mortgage insurance for nursing homes, intermediate care, board and care, and assisted-living facilities. Section 232 of the National Housing Act authorizes the program.

In February 1997, HUD insured a $4.9 million mortgage on Heartland Health Care Center of Bethany (Center). Heartland of Bethany, Inc. owned the Center, a 235-bed nursing home in Bethany, Oklahoma. The parent company of the Center, RM&G, Inc.[1] leased the Center and managed its operations as an identity-of-interest management agent, which HUD approved.

The Center paid for services provided by six identity-of-interest companies. The identity-of-interest relationships included management agent officials with a financial interest in five companies. It also included the son of an owner with a financial interest in two companies besides being the registered agent of four companies.

The six companies provided various services.

1. Vision Health Care Finance, Inc. provided financial services (loans).
2. Selective Medical Staffing, Inc. provided temporary staff.
3. Vision Management, LLC, a consulting firm, provided management, accounting, and risk management services.
4. Vision Protection, LLC provided fire alarm services.
5. Pathways Rehab, LLC provided rehabilitation therapy services.
6. Pathways Respiratory Service, LLC supplied respiratory durable medical equipment.

During December 2002, the operating officer[2] turned over operations to Comprehensive Consultants, Inc., without HUD's approval. The owners defaulted on the loan on July 1, 2003. HUD foreclosed on August 20, 2004. The principal entities, Heartland of Bethany, Inc. and RM&G, Inc., filed for bankruptcy in September 2003. The mortgagee's claim totaled about $4.2 million and HUD has a solid $626,000 offer for the property.

The Center was no longer in business at the time of our audit. Therefore, we limited the objective of the audit to finding out whether owners or other parties managing the Center complied with the project regulatory agreement and HUD requirements when disbursing project funds.

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[1] RM&G is the first letter of the last names of the three principal owners of Heartland of Bethany, Inc.: Messrs. John V. Rich, Jr., Chairman of the Board; Donald Ray Moore, President; and Edwin Leslie Gage, Vice President.

[2] Mr. David Forgy was the Chief Executive Officer of RM&G, Inc.

RESULTS OF AUDIT

Finding 1: Center officials misspent $6.8 million.

Center officials used project funds for ineligible and unsupported payments. Specifically, Center officials used:

(1) $2,225,779 for loan repayments to an identity-of-interest company and
(2) $84,381 for ineligible costs such as late fees, duplicate payments, penalties, and payments for identity-of-interest nursing home expenditures.

Center officials did not provide supporting documentation for:

(1) $2,300,943 for wire transfers and checks written to identity-of-interest companies and nursing homes;
(2) $2,014,704 for invoices from identity-of-interest companies; and
(3) $193,041 for checks issued from the Center's Bank of Oklahoma account.

Center officials used funds for unreasonable or unnecessary costs and did not maintain their books and records in a reasonable condition for proper audit. Center officials ignored regulatory agreement requirements. As a result, Center officials misspent $6.8 million.

Center officials inappropriately repaid $2.2 million for identity-of-interest loans.

Center officials set up Vision Health Care Finance, an identity-of-interest[3] company[4]to make loans between the related nursing homes. A Center owner stated they could not keep track of the loans, between the nursing homes, until they created this company. The Center owner also stated the Center never made a profit; therefore, the Center never had surplus cash. Center officials did not have HUD's approval to repay the loans.

Vision Health Care Finance made the first loan on July 25, 2001. Center officials began making the loan repayments, by check and wire transfer, to Vision Health Care Finance on August 15, 2001. The payments continued through and ended on February 3, 2003. The final payment to Vision Health Care Finance, on February 3, 2003, was the

[3] Identity-of-interest is defined in HUD Handbook 4370.1 Rev 2 as an entity or person having business relationships with the project owner or any officer, director, or partner of the mortgagor. For purposes of this definition the term "person" includes any individual, partnership, corporation, or other business entity. Any ownership, control, or interest held or possessed by a person's spouse, parent, child, grandchild, brother, or sister is attributed to that person.

[4] Center officials did not disclose to HUD that Vision Health Care Finance was a related company.

remainder amount in the Center's operating bank account.[5] The total amount the Center repaid Vision Health Care Finance was $2,225,779.

Center officials did not follow HUD requirements when they made loan repayments to the identity-of-interest company. HUD Handbook 4370.2 Rev-1 states the Center may not repay owner loans unless in a surplus cash position. The handbook also states if the Center repays the loans, from a non-surplus cash position, the owner is subject to criminal and civil monetary penalties.[6] These criminal and civil monetary penalties include the equity skimming statutes. The Center was not in a surplus cash position; therefore, violated HUD requirements and is subject to the equity skimming statutes.

Center officials paid $84,381 for various ineligible costs.

Center officials used project funds for ineligible expenses including paying for owner expenses, 1-900 calls, expenses of other related nursing homes, personal cell phone charges, late fees, insufficient fund charges, rotary club membership dues for an employee, flowers for doctors, a parking ticket, duplicate payments, donations, and penalties and interest. According to the Center's regulatory agreement, the Center may only pay reasonable and necessary operating costs. The above expenses are not reasonable necessary operating costs therefore are ineligible.

The Center paid the ineligible expenses with checks with exception of the insufficient fund charges. The Center made payments for ineligible expenses as early as January 1998.[7] These payments continued through December 2002.

Of the ineligible costs, the Center incurred $29,962 in insufficient fund charges from June 2000 through December 2002. The banks automatically deducted the insufficient fund charges. Officials used the remaining $54,419 to pay for owner expenses, 1-900 calls, personal cell phone bills, and rotary club membership dues, expenses of other related nursing homes, duplicate invoices, late fees, flowers for doctors, a parking ticket, and penalties and interest. As a result of the Center not following their regulatory agreement, they misspent a total of $84,381 for various ineligible costs.

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[5] First National Bank Account Number 49482.

[6] Criminal equity skimming statute is 12 USC §1715z-19; Civil equity skimming statute is 12 USC §1715z-4a.

[7] Because Center officials could not provide accounting records for 1997, 1999, and 2003, we could not determine if the Center paid ineligible charges during these years.

Center officials paid $2.3 million for wire transfers and checks written without explanation.

Despite regulatory requirements, Center officials distributed project funds to 9 identity-of-interest companies,[8] 22 related nursing homes,[9] and 3 unknown bank accounts.[10] Center officials could not justify $2,300,943 in payments. Center officials made the distributions by check and wire transfers[11] when the property had no surplus cash and without HUD approval.

Center officials started distributions to the 9 related companies in January 2001,[12] the 22 related nursing homes in June 2001, and the 3 unknown bank accounts in December 2002. These distributions continued through December 2002 when Center officials transferred operations to Comprehensive Consultants, Inc.

Without explanation or supporting documentation, Center officials paid $1,603,548 with checks and wire transfers to nine related companies. The payments included: (1) checks to four related vendor companies that totaled $865,298 more than the invoices they submitted; (2) unsupported wire transfers of $576,250 to six related vendor companies; and (3) unsupported wire transfers and checks totaling $162,000 to RM&G, Inc.

The Center disbursed $657,395 to 22 related nursing homes without supporting documentation to show the purpose of the payments. The Center did not obtain HUD approval to transfer funds to the identity-of-interest nursing homes.

Center officials wired a total of $40,000 to three bank accounts. Officials could not identify the owners of the accounts or explain the transfers of project funds. Due to time constraints we did not attempt to determine the ownership of these accounts.

Center officials ignored and did not follow their regulatory agreement when making distributions, which specifies that only reasonable expenses and necessary repairs may be paid out of project funds. The regulatory agreement defines distribution: "A distribution is any withdrawal or taking of cash or any assets of the project… other than for the payment of reasonable expenses necessary to the operation and maintenance of the project." As a result, the Center misspent $2,300,943.

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[8] Selective Medical Staffing, Vision Management, Vision Protection, Pathways Rehab, Pathways Respiratory, RM&G, Vision Maintenance, Republic Relations, and a Vending Account.

[9] Atoka Colonial, Beggs, Cedar Creek, Cottonwood, Crescent, Cyril, Duncan, Edmond, Healdton, Hennessey, Heritage Manor, Hillcrest, Marlow, McAlester, Medford, Perry, Quartz Mountain, Ringling, Rosewood, Silvercrest, Thomas, and Wilson.

[10] Bank account numbers 49834, 55620, and 55631.

[11] Includes telephone and Internet transfers.

[12] RM&G, Inc. received the first distribution.

Center officials did not provide supporting documentation for $2 million paid from identity-of-interest invoices.

Five identity-of-interest companies[13] submitted invoices to the Center without supporting documentation. Center officials paid these invoices without obtaining documentation to support the charges. Center officials should have obtained the documentation to show services were, in fact, provided and at a reasonable cost.[14] Also, Center officials did not follow their regulatory agreement in maintaining complete records in reasonable condition for proper audit. As a result, Center officials misspent $2,014,704 paying the five companies.

Selective Medical Staffing, a related staffing agency, submitted $577,897 in invoices from February 2001 through October 2002. The invoices did not have any supporting documentation, such as timesheets with a supervisor's signature, attached to them. In addition, the invoices did not identify who worked. They only had the certification[15] of who worked. The invoices also did not indicate a service date to show when the employee worked. Selective Medical Staffing submitted vague invoices and the Center paid them anyway.

The Center did not have supporting documentation for $604,451 in payments to Vision Management. Vision Management submitted $623,995 in invoices from August 2000 through November 2002. The Center only had supporting documentation for $19,544. A Center owner, and owner of Vision Management, described Vision Management as a consulting firm. The $604,451 supposedly consisted of $541,054 for management, accounting, and risk management fees and $63,397 for life insurance and various items Vision Management purchased for the Center. Center officials could not provide justification for the $541,054 in fees nor any supporting documentation for the $63,397.

The Center did not have supporting documentation for $3,683 in Vision Protection invoices. Vision Protection was an identity-of-interest fire alarm company. The Center had a total of $15,029 in Vision Protection invoices from August 2001 through August 2002 but support for only $11,346 of the invoices.

Pathways Rehab was an identity-of-interest respiratory therapy services company. The Center did not provide supporting documentation for $971,112 in Pathways Rehab invoices. However, the Center had only paid $811,964 of the unsupported invoices.

The final related company was Pathways Respiratory, a respiratory durable medical equipment supplier. The Center paid $16,709 for invoices with no support. They paid these invoices without a description of the goods purchased.

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[13] Selective Medical Staffing, Vision Management, Vision Protection, Pathways Rehab, and Pathways Respiratory.

[14] Project Owner's and Management Agent's Certification, paragraph's 3(d), 4(a), and 4(f).

[15] Such as LPN, etc.

In total, the Center paid $2,014,704 for unsupported invoices from five related companies. The Center's regulatory agreement specifically states that records shall be maintained in reasonable condition for proper audit. Also, the Center's Project Owner's and Management Agent's Certification states the Center should have obtained documentation to support that the goods and services obtained were provided and at a reasonable cost. The Center failed to abide by these requirements.

Center officials did not provide an explanation for $193,041 in checks.

The Center's December 2002 Bank of Oklahoma bank statement identified $193,041 in cleared checks. However, the Center did not provide documentation to identify the purpose or the payee of the checks. As a result, the $193,041 is unsupported and misspent.

Conclusion

In conclusion, the Center misspent $6.8 million for ineligible and unsupported expenditures. Center officials did not follow their regulatory agreement requirements, which resulted in misspending project funds and mortgage default.

Recommendations

We recommend the Director of the Multifamily Program Center:

1A. Require the Center to repay $2,310,160 for ineligible expenditures.

1B. Require the Center to either repay or provide supporting documentation for $4,508,688 in unsupported expenditures.

1C. Pursue and/or support the initiation of a civil action under Title 12, United States Code, Section 1715z-4a, against the principals of the owner and management agent, if they are not responsive to HUD's requirements to repay or support ineligible or unsupported expenditures as contained in recommendations 1A, 1B, and 2A of this report.

1D. Initiate administrative sanctions against the principals of the owner and management agent involved in Center operations.

Finding 2: Center officials did not support the use of $11.9 million in project funds.

Center officials received $11,912,333 in project revenue from Medicare and Medicaid from February 1997 through December 1999.[16] However, officials could not provide any documentation to support how they used the project revenue. Center officials failed to keep their records to prove they used project revenue for authorized purposes. Therefore, the use of the revenue is questionable.

The Center earned $3,356,740 in revenue from February 5, 1997, through December 31, 1997. Center officials could not provide any documentation to support the use of funds. However, Center officials did provide 7 months of the management agent's general bank account statements. The management agent commingled funds from the Center and its other related nursing homes in this bank account and could not provide adequate records to identify the funds. Therefore, we could not determine how the agent used the Center's funds.

From January 1, 1998, through December 31,1998, the Center received $4,750,366 in revenues. The only documentation the Center provided was a set of 1998 financial documentation.[17] Center officials did not provide invoices to show how they spent the revenue. However, with the limited documentation provided, we identified $2,433 in ineligible costs that we included in Finding 1. The remaining $4,747,933 is unsupported costs.

For calendar year 1999, the Center received $3,805,227 in project revenues. The Center did not provide any support for the use of these funds.

The Center's regulatory agreement states that the records shall be maintained in reasonable condition for proper audit at all times. The civil equity skimming statute[18] states if the Center cannot establish that the use of project funds were made for a reasonable operating expense or necessary repair of the project, double the value may be recovered.

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[16] We cannot say with certainty this amount includes all revenue received. The Center did not provide sufficient documentation to determine the actual amount of revenue received. Therefore, we relied on Medicaid and Medicare sources to determine the amount of revenue.

[17] This included a balance sheet, statement of operations, detail trial balance, corporate invoice transfer, corporate check transfer, month-end check register, month-end invoice register, and a month-end accounts payable aging schedule.

[18] 12 U.S.C. §1715z-4a.

Conclusion

The Center could not provide documentation for how it used $11,909,900 in project revenues. Regulatory requirements directed Center officials to maintain complete records. They failed to do this. In addition, if the Center cannot prove the use of project funds, HUD may recover double the value.

Recommendations

We recommend the Director of the Multifamily Program Center:

2A. Require the Center to repay or support the $11,909,900 in project revenues earned.

2B. Pursue and/or support the initiation of a civil action under Title 12, United States Code, Section 1715z-4a, against the principals of the owner and management agent, if they are not responsive to HUD's requirements to repay or support ineligible or unsupported expenditures as contained in recommendations 1A, 1B, and 2A of this report.

2C. Initiate administrative sanctions against the principals of the owner and management agent involved in Center operations.

SCOPE AND METHODOLOGY

Our audit objective was to determine whether owners or other parties managing the Center complied with the project regulatory agreement and HUD requirements when disbursing project funds. To accomplish the objective, we:

- Interviewed HUD officials, Center officials, Center's receiver, Medicare representatives, Oklahoma State Department of Health representatives, and Oklahoma Health Care Authority representatives;
- Reviewed relevant HUD regulations and guidelines;
- Examined records provided by Center officials; and
- Reviewed the Center's accounting records provided.

Medicare and Oklahoma Health Care Authority representatives provided revenue information stating the Center received approximately $29.9 million from February 1997 through the early part of 2004.[19] However, the Center did not provide sufficient documentation to show how Center officials spent the project revenue. Therefore, we could not determine if the Center spent all revenue according to HUD requirements. Although we served a subpoena to obtain all accounting records, the Center provided only the following:

- 1997 – 7 months of the management agent's general bank account statements;
- 1998 – 1 full calendar year set of financial reports;[20]
- 1999 – Nothing;
- 2000 – 1 full calendar year set of financial reports, bank statements from February through December, and invoices;
- 2001 – 6 months of financial reports, bank statements for the year, and invoices;
- 2002 – Bank statements for the year and invoices; and
- 2003 – Bank statements for 2 months, which showed the bank accounts closed.

We were not able to review the vast majority of the 2003 information. Center officials transferred Center operations to a third party, Comprehensive Consultants, Inc. (CCI). HUD did not approve this transfer of operations. CCI maintained the operating records during 2003. However, we were not able to obtain the operating records because the Department of Health and Human Services subpoenaed these records through a grand jury.

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[19] The Oklahoma Health Care Authority representative stated the Center has a year to file Medicaid claims. Therefore, payments after the facility closed are legitimate.

[20] This included a month-end check register, month-end invoice register, and a month-end accounts payable aging schedule.

We conducted our fieldwork between February and August 2004 in Oklahoma City, Oklahoma. Our audit period generally covered the period from February 5, 1997, through December 2003, when the Center closed.

We conducted the audit in accordance with generally accepted governmental auditing standards.

INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We did not review internal controls because the Center closed in December 2003.

APPENDICES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Ineligible [1]	Unsupported [2]
1A	$2,310,160	
1B		$ 4,508,688
2A		11,909,900
Totals	$2,310,160	$16,418,588

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 polices 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 audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

CRITERIA

Regulatory Agreement

Paragraph 6(b)
Owners shall not without the prior written approval of the Secretary:
Assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs.

Paragraph 9(c)
The mortgaged property, equipment, buildings, plans, offices, apparatus, devices, books, contracts, records, documents, and other papers relating thereto shall at all times be maintained in reasonable condition for proper audit and subject to examination and inspection at any reasonable time by the Secretary or his duly authorized agents.

Paragraph 13(g)
A distribution is any withdrawal or taking of cash or any assets of the project… other than for the payment of reasonable expenses necessary to the operation and maintenance of the project.

Project Owner's and Management Agent Certification

Paragraph 3(d)
We (Agent) agree to refrain from purchasing goods or services from entities that have identity-of-interest with us unless the costs are as low as or lower than arms-length open-market purchases.

Paragraph 4(a)
The Agent agrees to assure that all expenses of the project are reasonable and necessary.

Paragraph 4(f)
The Agent agrees to maintain copies of such documentation and make such documentation available for your inspection during normal business hours.

HUD Handbook 4370.1 Rev 2, *Reviewing Annual and Monthly Financial Reports, Glossary*

Identity of Interest
This term applies to an entity or person having business relationships with the project owner or any officer, director, or partner of the mortgagor where the costs of products or services might not be determined through arms-length negotiation. Such a relationship should be construed to exist when the owner and the product or service provider are not the same person but (1) the project owner; or (2) any officer or director of the project owner or (3) any person who directly or indirectly controls 10 percent or more of project owner's voting rights or directly or indirectly owns 10 percent or more of the project owner; is also (1) an officer or director of the management agent; or (2) a person who directly or indirectly controls 1.0 percent or more of the vendor. For purposes of this definition the term "person" includes any individual, partnership, corporation, or other business entity. Any ownership, control or interest held or possessed by a person's spouse, parent, child, grandchild, brother or sister is attributed to that person.

HUD Handbook 4370.2 Rev. 1*, Financial Operations and Accounting Procedures for Insured Multifamily Projects*

2-11. REPAYMENT OF OWNER ADVANCES

A. Advances made for reasonable and necessary operating expenses may be paid from surplus cash at the end of the annual or semi-annual period. Such repayment is not considered an owner distribution. It is considered a repayment of advances. Repayment of owner advances when the project is in a non-surplus cash position will subject the owner to criminal and civil monetary penalties. (See Appendix 1, Criminal Statutes.)

Equity Skimming Statutes

12 USC 1715-4a
The double damages remedy (12 U.S.C.A. Sec 1715z-4a, 1997) is a civil remedy for unauthorized use of multifamily housing project assets and income. It applies to any person who uses assets or income in violation of the regulatory agreement or regulation. Use of assets or income in violation of the regulatory agreement or any form of regulatory control as may be imposed by the Secretary shall include any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project and has not been maintained in accordance with the requirements of the Secretary and in reasonable condition for proper audit.

In any judgment favorable to the United States entered under this section, the Attorney General may recover double the value of the assets and income of the project that the

court determines to have been used in violation of the regulatory agreement or any applicable regulation, plus all costs relating to the action, including but not limited to reasonable attorney and auditing fees.

12 USC 1715z-19

The equity skimming penalty (12 U.S.C.A. Sec 1715z-19, 1997) is a statute that provides criminal penalties: fines of not more than $500,000 and imprisonment of no more than 5 years. It applies to an owner, agent, or manager of a multifamily property who willfully uses rents, assets, or income for purposes other than to meet reasonable and necessary expenses during a period when the mortgage note is in default or the property is in a non-surplus cash position.