OFFICE OF AUDIT
REGION 4
ATLANTA, GA

Lighthouse Inn in Pompano Beach, FL

Assisted Living Facility Insured Under Section 232 Program

2013-AT-1007

SEPTEMBER 13, 2013

Issue Date: September 13, 2013

Audit Report Number: 2013-AT-1007

TO: Kelly M. Haines, Director, Office of Residential Care Facilities, HI
Craig Clemmensen, Director, Departmental Enforcement Center, CACB

Nikita N. Irons

FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Lighthouse Inn, Pompano Beach, FL, an Assisted Living Facility Insured Under Section 232, Violated Its Executed Regulatory Agreement

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Lighthouse Inn, 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 8L, 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.

Date of Issuance: September 13, 2013

Lighthouse Inn, Pompano Beach, FL, an Assisted Living Facility Insured Under Section 232, Violated Its Executed Regulatory Agreement

Highlights

Audit Report 2013-AT-1007

What We Audited and Why

We audited Lighthouse Inn, an assisted living facility located in Pompano Beach, FL. In April 2008, the U.S. Department of Housing and Urban Development (HUD) insured the $5.1 million mortgage on the property under Section 232 of the National Housing Act. In September 2010, the facility defaulted on the mortgage loan. Our overall audit objective was to determine whether the owner of Lighthouse Inn complied with the executed regulatory agreement and HUD requirements.

What We Recommend

We recommend that the Director of the Office of Residential Care Facilities require the owner of Lighthouse Inn reimburse HUD's Federal Housing Administration fund $146,983 in ineligible costs and $208,154 in unsupported costs if it cannot provide documentation to support that they are eligible and return the $10,950 in collected fees to tenants. Also, we recommend that the Director of the Departmental Enforcement Center pursue civil money penalties and administrative sanctions against the owner for regulatory agreement violations.

What We Found

The owner of Lighthouse Inn did not comply with the regulatory agreement and HUD requirements. Specifically, it did not ensure (1) that all disbursements were eligible and supported, (2) that all receipts from tenants were eligible, (3) prompt mortgage payments, (4) the annual submission of audited financial reports, (5) proper maintenance of the tenant security deposit account, (6) the accuracy of books and accounts, and (7) that the facility was in good repair and condition. These conditions occurred because the owner disregarded the stipulations in the executed regulatory agreement. Consequently, Lighthouse Inn disbursed approximately $147,000 in ineligible costs and $208,000 in unsupported costs and collected $10,950 in ineligible fees. In addition, HUD paid a claim of nearly $5.8 million to the lender on February 20, 2013. Then, on August 20, 2013, HUD sold the note on the facility for a little over $1 million.

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BACKGROUND AND OBJECTIVE

Lighthouse Inn is an assisted living facility located in Pompano Beach, FL. The U.S. Department of Housing and Urban Development (HUD) insured the $5.1 million mortgage on the facility under the Section 232 program. Section 232 of the National Housing Act authorizes the Federal Housing Administration (FHA) to insure mortgages made by private lenders to finance the development of nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. The Office of Residential Care Facilities, under HUD's Office of Healthcare Programs, manages the Section 232 program. Federal regulations at 24 CFR (Code of Federal Regulations) 200.105(a) state that as long as HUD is the insurer or holder of the mortgage, HUD shall regulate the borrower by means of a regulatory agreement providing terms, conditions, and standards established by HUD, or by other prescribed means.

On August 1, 2007, Smith Health Care Properties, LLC, purchased Lighthouse Inn with a bridge loan of $4.85 million. Lighthouse Inn, consisting of two facilities approximately 1.6 miles apart, operated as assisted living facilities before their purchase. Lighthouse Inn North contains 42 beds within 2 separate buildings, and Lighthouse Inn South contains 33 beds within 1 building.

On August 23, 2007, Smith Health Care Properties submitted an application to HUD for a first mortgage loan to be insured under the Section 232 program. On April 22, 2008, HUD insured the mortgage on the Lighthouse Inn properties and executed a regulatory agreement with Smith Health Care Properties. The $5.1 million mortgage paid off the $4.85 million bridge loan.

Lighthouse Inn was managed by an onsite administrator at the North and South facilities. Included among the staff were the marketing director; certified nursing assistants; and housekeeping, maintenance, and food preparation staff. Lighthouse Inn's financial operations were performed from the owner's office in Aurora, IL. The financial records were located at the Aurora, IL office.

Smith Health Care Properties, established in April 2007, was managed by a father and son who each held a 50 percent ownership in the corporation. In April 2011, the son became the sole managing member. Smith Health Care – Clearwater, LLC, managed by the son, also purchased an assisted living facility in Clearwater, FL, on February 25, 2008. The mortgage note on this facility is not insured by HUD.

We performed our audit fieldwork from December 2012 to June 2013. On June 10, 2013, HUD indicated that it would offer the note on the facility for sale on July 31, 2013. On August 20, 2013, HUD sold the note. By final report issuance, the facility is no longer in HUD's portfolio. The report documents what we found while the facility was insured by HUD and the owner was still obligated by the regulatory agreement.

Our overall audit objective was to determine whether the owner of Lighthouse Inn complied with the executed regulatory agreement and HUD requirements.

RESULTS OF AUDIT

Finding: The Owner of Lighthouse Inn Did Not Comply With Its Regulatory Agreement

The owner of Lighthouse Inn did not comply with its regulatory agreement and HUD requirements. It did not ensure (1) that all disbursements were eligible and supported, (2) that all receipts from tenants were eligible, (3) that mortgage payments were prompt, (4) the annual submission of audited financial reports, (5) proper maintenance of the tenant security deposit account, (6) the accuracy of books and accounts, and (7) that the facility was in good repair and condition. These conditions occurred because the owner disregarded the stipulations in the executed regulatory agreement. Consequently, Lighthouse Inn disbursed approximately $147,000 in ineligible costs and $208,000 in unsupported costs and collected $10,950 in ineligible fees.

Ineligible and Unsupported Disbursements

The owner of Lighthouse Inn did not ensure that all disbursements were for reasonable operating expenses and distributions to the owner were made only from surplus cash. Twenty-four of the thirty-five disbursements reviewed for the period January 1, 2010, through October 31, 2012, violated the regulatory agreement and HUD regulations.

Paragraph 6(b) of the regulatory agreement stated that the owners could not, without HUD's prior written approval, assign, transfer, dispose of, or encumber any personal property or pay out funds for other than reasonable operating expenses and necessary repairs except from surplus cash.[1] However, questioned disbursements included

- Six disbursements to the owner's non-HUD-insured assisted living facility to help pay for costs such as its mortgage and payroll expenses,
- Five disbursements made on behalf of the other assisted living facility to pay for costs including the mortgage and water bills, and
- Three disbursements to payees for other than reasonable operating expenses. For example, one of the disbursements was to pay for legal

[1] Paragraph 13(f) of the regulatory agreement defined surplus cash as any cash remaining after (1) the payment of all sums due or required to be paid under the terms of the mortgage or note, all amounts required to be deposited in the reserve fund for replacements, and all obligations of the project other than the insured mortgage and (2) the segregation of an amount equal to all special funds required to be maintained by the project and all tenant security deposits held.

services to negotiate the settlement of the State agency's revocation of Lighthouse Inn's assisted living facility license.

Additionally, paragraph 6(e) of the regulatory agreement stated that the owners could not, without HUD's prior written approval, make, receive, and retain any distribution[2] of assets or income of the project except from surplus cash so long as there was no default under the agreement or mortgage. Specifically, the questioned disbursements included

- Five distributions to the owner to repay funds he contributed to the facility, and
- Five distributions to the owner's other companies to repay funds he or the other company contributed.

Lighthouse Inn was not in a surplus cash position to make any distributions to or on behalf of the owner or for unreasonable operating expenses. The owner stated that Lighthouse Inn had not computed surplus cash and that it did not generate surplus cash. The 2010 and 2011 financial information provided indicated that the facility generated a cash deficiency for both years. Additionally, HUD did not authorize Lighthouse Inn to make such disbursements. Thus, the 24 unauthorized disbursements, totaling $146,983, were ineligible (see appendix C).

The check detail report showed that there were additional disbursements, totaling $208,154, to some of the same payees with questioned ineligible costs. Because the description and amount of the additional disbursements to these same payees were similar to those questioned as ineligible, and explanations from the owner or staff indicated that they were for the same purpose for which we questioned the ineligible costs, we assessed these other disbursements as unsupported costs. Therefore, Lighthouse Inn must support that these additional costs comply with the regulatory agreement. The table below summarizes the questioned ineligible and unsupported costs.

[2] Section 2-10 of HUD Handbook 4370.2 defined distributions as 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.

Disbursements to:	Ineligible cost	Unsupported cost	Total questioned costs
Owner	$ 42,042	$ 23,868	$ 65,910
Non-HUD-insured assisted living facility	$ 43,314	$ 89,989	$ 133,303
Payees on behalf of the noninsured assisted living facility	$ 28,140	$ 41,422	$ 69,562
Owner's other companies	$ 27,500	$ 23,900	$ 51,400
Payees for unreasonable operating expenses	$ 5,987	$ 28,975	$ 34,962
Total	$146,983	$ 208,154	$ 355,137

Similarly, a previous Office of Inspector General audit report, issued on April 26, 2011, questioned unsupported costs of $386,562 for potential ineligible transfers, unauthorized owner distributions, and unsupported payments to the owner and affiliated entities (see Follow-up on Prior Audit section). Costs questioned in the previous report are not included in the costs questioned in this report.

Ineligible Fee

The owner of Lighthouse Inn charged some of its tenants an ineligible fee. Paragraph 6(g) of the regulatory agreement stated that the owners could not, without HUD's prior written approval, require, as a condition of the occupancy or leasing of any unit in the project, any consideration or deposit other than the prepayment of the first month's rent plus a security deposit in an amount not to exceed 1 month's rent to guarantee the performance of the covenants of the lease.

In 2010, Lighthouse Inn stopped collecting tenant security deposits and instead collected a nonrefundable fee to pay for any repairs or damages caused by the tenant after the tenant vacated the unit. The amount the tenant paid ranged from $0 to $500 and depended on the tenant's economic condition. According to Lighthouse Inn's general ledger, for the period January 1, 2010, through September 30, 2012, it collected such fees from 22 tenants totaling $10,950 (see appendix D). However, HUD did not approve the collection of the fee. Therefore, the practice violated the regulatory agreement, and the fees were inappropriately collected.

Late Mortgage Payments

The owner of Lighthouse Inn did not make prompt mortgage payments and defaulted on its HUD-insured loan. It also did not continue to maintain a reserve fund for replacements. Paragraphs 1 and 2(a) of the regulatory agreement required the owner to promptly make all payments due under the note and mortgage and establish or continue to maintain a reserve fund for replacements monthly. Lighthouse Inn made its first mortgage payment in June 2008. Beginning with the August 2009 payment, it was consistently late in making its mortgage payments. The August 2010 mortgage payment was the last payment made on the loan, resulting in a default of the loan as of September 1, 2010. The table below details the delinquent payments made on the mortgage.

Mortgage due date	**Mortgage paid date**	**Payment amount**	**Days delinquent** (a)
08/01/2009	08/17/2009	$43,132	2
09/01/2009	09/16/2009	$43,132	1
10/01/2009	10/16/2009	$43,132	1
11/01/2009	12/22/2009	$44,041 (b)	37
12/01/2009	12/22/2009	$44,041 (b)	7
01/01/2010	02/17/2010	$46,541	33
02/01/2010	03/17/2010	$44,041	30
03/01/2010	04/13/2010	$46,541	29
04/01/2010	05/13/2010	$48,296	28
05/01/2010	07/06/2010	$48,296	52
06/01/2010	08/11/2010	$43,041	57
07/01/2010	09/17/2010	$43,000 (c)	64
07/01/2010	10/19/2010	$ 2,765 (c)	96
08/01/2010	01/24/2011	$10,000 (d)	162
08/01/2010	04/13/2011	$15,000 (d)	241
08/01/2010	06/14/2011 (e)	$20,765 (d)	303

Notes:
(a) The loan became delinquent when the mortgage payment was not received by the 15-day grace period, or on the 16th of the month.
(b) The funds to pay the mortgage came from the reserve fund for replacements.
(c) The two payments comprised the July 2010 mortgage payment.
(d) The three payments comprised the August 2010 mortgage payment.
(e) This was the last mortgage payment made on the insured loan.

The lender assigned the insured loan to HUD on August 15, 2012. On February 20, 2013, HUD paid a final settlement claim to the lender for approximately $5.8 million.

The owner explained that Lighthouse Inn experienced a decline in revenue because of the slumping economy, which decreased the ability of many tenants to pay the full rent. He also stated that there was a decrease in the State’s financial assistance provided to the facility’s tenants. Due to the shortfall in income, the owner helped subsidize Lighthouse Inn’s operations. Lighthouse Inn’s 2011 year-end financial information showed that the facility owed the owner more than $349,000.

The decrease in revenue may have contributed to the delinquent mortgage payments and subsequent default. Yet, the bank statements of Lighthouse Inn's operating accounts support that it had the funds to pay some or the entire monthly mortgage amount for several of the months after it made its last payment. The July 2011 to August 2012 bank statements showed that the facility had daily balances that exceeded the mortgage amount for 10 of the 14 months.

Audited Financial Statements Not Submitted

The owner of Lighthouse Inn did not submit annual audited financial reports that complied with HUD requirements. Paragraph 9(e) of the regulatory agreement required the owner to furnish HUD with a complete annual financial report based upon an examination of the books and records of the borrower prepared in accordance with HUD requirements. In November 2010, Lighthouse Inn engaged an independent auditor to perform an audit of its financial statements. Although Lighthouse Inn submitted its 2008 audited financial statements on April 4, 2012, the report was several years past the due date, and the independent auditor did not express an opinion on the financial statements because the facility provided insufficient records. Lighthouse Inn did not submit audited financial statements for other years. The owner stated that the facility did not have the financial resources to continue to hire an independent auditor to complete the audited financial statements for later years. The effective monitoring of a facility's financial performance and implementation of prompt corrective actions by HUD to protect the solvency of the FHA fund is dependent on the provision of accurate audited financial reports to HUD in a timely manner.

Tenant Security Deposits Improperly Maintained

The owner of Lighthouse Inn improperly maintained its tenant security deposits. Sections 2-9A and 2-9B of HUD Handbook 4370.2[3] required that funds in the security deposit account not be commingled with other funds, and that disbursements be only for refunds to tenants and for payment of appropriate expenses incurred by the tenant. Lighthouse Inn commingled funds collected from tenant security deposits with other funds and allowed their use for unauthorized purposes. Specifically, for three of four transactions reviewed,

- Two were transfers of security deposit funds to the operating and payroll accounts and used for operating and payroll costs; and
- One was disbursed as a loan to the owner's other assisted living facility.

[3] HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, applies to HUD-insured, coinsured, and HUD-held multifamily rental projects under a charter or regulatory agreement permitting HUD to exercise control over project administration and operation.

Additionally, paragraph 6(g) of the regulatory agreement required that funds collected as security deposits be kept separate and apart from all other funds in the project in a trust account that must at all times equal or exceed the sum of all outstanding obligations of the account. Our reconciliation indicated that although the security deposit bank account had a zero balance, the general ledger showed that Lighthouse Inn owed tenants security deposits totaling more than $65,000. Our review of five other security deposit disbursements showed that Lighthouse Inn had to return the tenants' security deposits from its operating account rather than the security deposit account because the latter account did not contain sufficient funds to make the payments.

When Lighthouse Inn allowed the use of the tenant security deposit funds for unauthorized purposes, the result was insufficient funds in the security deposit account to cover the obligations due to tenants. Consequently, by not maintaining the funds separately and using them for authorized purposes, the facility did not ensure that funds were available.

In response to our request for information, Lighthouse Inn indicated that there were five tenants still due security deposits totaling $9,875 as of February 11, 2013. After our inquiry, Lighthouse Inn started the process of removing the liability from its books by applying the security deposit to future rent payments for four tenants and by requesting and obtaining an agreement with one tenant to not increase the rent in exchange for the security deposit.

Inaccurate Books and Accounts

The owner of Lighthouse Inn did not accurately maintain its books and accounts. Paragraph 9(c) of the regulatory agreement required that the mortgaged property, equipment, books, contracts, and records be maintained at all times in reasonable condition for proper audit. The audit of the 2008 financial statements evidenced that the facility's records were not in reasonable condition for audit. The audit was substantially delayed due to difficulties in obtaining financial data, the inability of the owner to recall the reason for certain disbursements, and the need to rebuild the financial history and an accounting system. Although it took 16 months to complete the audit, the independent auditor could not express an opinion because insufficient records were provided.

In addition, paragraph 9(d) of the regulatory agreement required that the books and accounts of the operations of the mortgaged property be kept in accordance with HUD requirements. Specifically, section 2-3B of HUD Handbook 4370.2 required books and accounts of the project to be accurate. Our reconciliations of the tenant security deposit bank accounts and general ledger accounts showed that the general ledger did not accurately reflect what was in the security deposit bank accounts, and the balance on the general ledger security deposit asset accounts did not agree with the contra liability accounts.

The owner stated that staff turnover in accountants and the lack of a skilled accountant contributed to the poor conditions of the books and records. By not maintaining its books and accounts accurately and in a reasonable condition, Lighthouse Inn could not assure HUD of its true financial condition and may have made management decisions based on faulty financial information.

Physical Condition Not Up To Standards

The owner of Lighthouse Inn did not maintain the facility to HUD standards. Paragraph 7 of the regulatory agreement required the owner to maintain the mortgaged premises, accommodations, and the grounds and appurtenant equipment in good repair and condition. Owners of HUD housing must maintain the housing in a manner that meets the physical condition standards to be considered decent, safe, sanitary, and in good repair as stipulated in 24 CFR 5.703. HUD's Real Estate Assessment Center conducts physical inspections on HUD-owned, -insured, or -subsidized rental housing to assess the condition of its properties and ensure they are maintained in safe and sanitary conditions. The Real Estate Assessment Center stated that a score of below 60 may indicate that the tenants are not receiving the quality of housing to which they are entitled.

Lighthouse Inn received a score of 63 in 2010, 45 in 2011, and 39 in 2012. In each year, the inspector cited one or more exigent or fire, health, and safety deficiencies. The decrease in scores stemmed from an increase in the number of deficiencies cited over the years. If tenants are not living in decent, safe, and sanitary conditions, it may lead to financial and legal risks to the facility and the FHA fund. Additionally, some tenants residing in the facility were subject to exigent health and safety risks.

Other Issues

Lighthouse Inn was in jeopardy of losing its assisted living facility license with the State. Lighthouse Inn has operated under conditional licensure since October 2011. In March 2013, the State agency overseeing the licensing indicated its plans to proceed in revoking Lighthouse Inn's license based on 11 deficiencies cited during agency inspections. On June 3, 2013, the agency amended its intent to deny the facility's license on the basis of a demonstrated pattern of deficient performance, not meeting licensure requirements, and not paying an outstanding fine.

In addition, on June 10, 2013, HUD advised the owner that HUD will be offering the mortgage loan on the Lighthouse Inn property in a competitive note sale, scheduled for July 31, 2013. On August 6, 2013, HUD accepted a bid to purchase the note on the facility for $1,046,000 and on August 20, 2013, HUD sold the note. Given the sale, the owner is no longer under the obligations of the regulatory agreement. We adjusted the recommendations to reflect this change; however, the owner will remain liable for actions taken while the facility was insured by HUD.

Conclusion

The owner of Lighthouse Inn did not comply with its regulatory agreement and HUD requirements. Specifically, it did not (1) ensure that all disbursements were eligible and supported, (2) ensure that all receipts from tenants were eligible, (3) make prompt mortgage payments, (4) submit the annual audited financial reports, (5) properly maintain the tenant security deposit account, (6) ensure the accuracy of books and accounts, and (7) maintain the facility in good repair and condition.

Consequently, the facility disbursed $146,983 in ineligible costs and $208,154 in unsupported costs, collected $10,950 in ineligible fees from tenants, and had inaccurate books and accounts.

No distributions to the owner are allowed if the owner cannot show that the project generated surplus cash. Although the economy or reduction in State funding caused Lighthouse Inn’s revenue to decrease, distributions to the owner and his other companies also contributed to the facility’s poor financial condition.

When HUD insured the mortgage under the Section 232 program, the owner executed a regulatory agreement with HUD, agreeing to the stipulations stated within. In violating these requirements in the regulatory agreement, the owner chose to disregard such stipulations. The owner’s disregard of the regulatory agreement provisions to ensure the proper management of the facility increased HUD’s risk.

On February 20, 2013, HUD paid a claim to the lender for nearly $5.8 million. Subsequently, on August 20, 2013, HUD sold the note on the facility whereby the owner is no longer under the obligations of the regulatory agreement. The recommendations reflect this change.

Recommendations

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

1A. Require the owner of Lighthouse Inn to reimburse HUD’s Federal Housing Administration insurance fund $146,983 for the ineligible disbursements cited in this report.

1B. Require the owner of Lighthouse Inn to provide documentation to support the $208,154 in unsupported disbursements cited in this report or reimburse

HUD's Federal Housing Administration insurance fund for the applicable portion.

1C. Require the owner of Lighthouse Inn to reimburse the 22 tenants for ineligible fees collected totaling $10,950, from non-project funds.

We also recommend that the Director of the Departmental Enforcement Center

1D. Pursue civil money penalties and administrative sanctions, as appropriate, against the owner or their principal for their part in the regulatory agreement violations cited in this report.

SCOPE AND METHODOLOGY

Our objective was to determine whether the owner of Lighthouse Inn complied with the executed regulatory agreement and HUD requirements. Specifically, our scope focused on Lighthouse Inn's (1) promptness in making its mortgage payments, (2) submission of annual audited financial reports, (3) recording and depositing of receipts, (4) eligibility of disbursements, (5) maintenance of a separate tenant security deposit account, (6) continuance of an active assisted living facility license, and (7) physical condition.

Our review generally covered the period January 1, 2010, through October 31, 2012, and was extended as necessary. We performed the work from December 2012 to June 2013, at the Miami HUD audit office and at Lighthouse Inn. To accomplish our objective, we reviewed the executed regulatory agreement, relevant Federal regulations, and HUD guidance; performed Internet research; interviewed HUD officials to obtain information about Lighthouse Inn and discuss areas of concern; and interviewed the owner and staff of Lighthouse Inn to understand the operational and financial procedures and to obtain clarifications during the fieldwork. More specifically,

- To determine Lighthouse Inn's promptness in making its mortgage payments, we analyzed the loan and escrow activity reports, for the period April 22, 2008 through October 30, 2012, and April 1, 2008 through November 20, 2012, respectively, and communicated with lender officials to obtain clarification about the reports.

- To determine whether Lighthouse Inn submitted its audited financial reports, we accessed HUD's integrated Real Estate Management system to obtain relevant reports and reviewed written comments made by HUD officials. We also reviewed Lighthouse Inn's 2008 audited financial statements.

- To test the eligibility of disbursements, we selected our sample using Lighthouse Inn's "check detail" report for the period January 1, 2010, to October 31, 2012. We selected our sample by first focusing on certain payees. The payees selected were (1) the owner and any affiliated entities; (2) those payees that appeared not to have been paid for an ordinary expense of the project or that appeared questionable; and (3) individuals who were regularly paid over time. We identified 20 payees for further review based on the above factors. Disbursements to the 20 payees totaled $778,649, which comprised 16.2 percent of the total disbursements for the audit period. From the 20 payees, we selected 35 disbursements based on a combination of the dollar amount, the date, and the comments or descriptions indicated in the check detail report. For example, a disbursement with a lower dollar amount was selected because of what was stated in the check detail description or because the disbursement was more recent. The 35 disbursements totaled $174,310, or 29 percent of the total disbursements to the 20 payees.[4] We reviewed printouts from Lighthouse Inn's accounting system, copies of invoices, and written explanations to support the disbursements.

We found that 24 of the 35 disbursements were ineligible. The 24 disbursements were made out to 11 payees. The check detail report listed other disbursements to eight of the payees. We questioned the additional disbursements as unsupported costs because (1) the descriptions and disbursement amounts in the check detail report are similar to the purpose and amounts for those we questioned as ineligible costs, and (2) the explanation provided by the owner or staff indicated that disbursements made to some of the payees were for the same purpose for which we questioned the ineligible cost. The additional disbursements to the eight payees totaled $208,154.

- To determine whether Lighthouse Inn properly maintained its tenant security deposits, we reconciled the general ledger security deposit asset accounts with the contra liability accounts and the general ledger security deposit asset accounts with the amounts in the bank statements. The general ledger covered the period January 1, 2010 through September 30, 2012, and the security deposit bank statements covered the period January 1, 2010 through March 31, 2011, with the account closing on March 4, 2011. We also selected for review transactions from the five general ledger security deposit accounts with disbursements for the period, for a total of nine transactions. The nine transactions total $118,956, or 65 percent of the total dollar amount. For four security deposit accounts, two transactions with the largest dollar amount were selected and for one security deposit account, the single transaction was selected. We reviewed printouts from Lighthouse Inn's accounting system, tenant rent contract, and written explanation to support the transactions.

- To determine whether Lighthouse Inn operated under an active license, we performed research on Florida's Agency for Health Care Administration Web site and also obtained information from Lighthouse Inn's attorney.

- To determine the physical condition of Lighthouse Inn, we reviewed the inspection reports prepared by HUD's Real Estate Assessment Center. We also performed onsite visits of Lighthouse Inn North and Lighthouse Inn South to observe the deficiencies cited by the 2012 Real Estate Assessment Center inspection report.

Given our methodology, the results of our review apply only to the receipts, disbursements, and security deposits selected for review and cannot be projected to the universe of the receipts received, disbursements made, or security deposits recorded during the period.

We assessed whether disbursed and receipt amounts were accurately recorded in the financial system by tracing them to the bank statements to ensure that the disbursed amount entered into the financial system was the actual amount paid out and that the receipt amount entered into the

[4] The disbursements to the 20 payees totaling $778,649 included those disbursements that were questioned in the prior Office of Inspector General (OIG) audit noted in the Follow-up on Prior Audits section of the report. Subtracting the costs questioned in the prior audit, the disbursements to the 20 payees totaled $599,065. The 35 disbursements selected did not include any of the costs questioned in the prior audit.

financial system was the actual amount deposited. Our review showed that the disbursed and receipt amounts recorded in Lighthouse Inn's financial system matched the amounts contained in the bank statements and, thus, could be relied upon to support the unsupported and ineligible costs questioned in the audit report.

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. 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:

- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that program implementation is consistent with laws and regulations.
- Relevance and reliability of information - Policies and procedures that management has implemented to reasonably ensure that operational and financial information used for decision making and reporting externally is relevant, reliable, and fairly disclosed in reports.
- 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 Deficiencies

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

- The owner of Lighthouse Inn lacked the financial and operational controls to ensure that the facility complied with its regulatory agreement and HUD requirements.

FOLLOW-UP ON PRIOR AUDITS

The Office of Healthcare Programs' Monitoring of the Section 232 Program 2011-FW-0002

On April 26, 2011, the Office of Inspector General (OIG) issued a report based on its audit of HUD's Office of Healthcare Programs. The audit was conducted to determine whether the Office of Healthcare Programs had implemented adequate controls to properly monitor Section 232-insured mortgages. OIG cited the Office of Healthcare Programs for being unaware of important ongoing regulatory violations and used the financial review of Lighthouse Inn and other facilities to support its assessment. The review of Lighthouse Inn's financial records from January 2009 to September 2010 revealed potential ineligible transfers, unauthorized owner distributions, ineligible owner health insurance payments, and unsupported payments for or on behalf of the owner and other entities that may have been affiliated with the owner, resulting in unsupported costs of $386,562.

As a result of the audit, OIG recommended that the Office of Healthcare Programs review the $386,562 in unsupported costs identified for Lighthouse Inn, determine the costs' validity, and take appropriate action.

On May 10, 2013, the Office of Residential Care Facilities issued a letter to the owner of Lighthouse Inn demanding the repayment of these unsupported costs. The final action target date to resolve the recommendation was revised to June 30, 2013.

As of August 27, 2013, the management decision on the recommendation was overdue and the recommendation remained open.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$ 146,983	
1B		$ 208,154
1D	$ 10,950	
Total	$ 157,933	$ 208,154

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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

THE TICKTIN LAW GROUP
"The lawyers you want between you and your problems"

JAMIE ALAN SASSON
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August 5, 2013

Sent via E-Mail

[redacted]
Office of Inspector General
Brickell Plaza Federal Building
909 SE 1 Avenue, Room 487
Miami, FL 33131

Re: *Smith Health Care Properties, LLC*
Project Name: Lighthouse Inn North and South FHA No.: 066-22026
REMS No.: 8000225229 Our File No.: 12-1185

Dear [redacted]

As you know, this firm represents Mr. Benjamin A. Smith, IV, who is the managing member of Smith Health Care Properties, LLC, which owns the property known as Lighthouse Inn. Also, please be advised that we are in receipt of your draft of the Audit. Accordingly please let this letter serve as our response and written comments to the Audit draft.

The overall findings specified in the audit state that "[t]he owner of Lighthouse Inn did not comply with its regulatory agreement and HUD requirements." We are disputing the findings contained in the audit and assert that Mr. Smith did comply and/or otherwise make every good faith effort to comply with the regulatory agreement and HUD requirements.

In fact, it was due to HUD's own failure and inability to properly maintain its loan documents and records that the loan ultimately came to be in default, resulting in the alleged violations asserted in the audit.

Specifically, the audit asserts several specific findings on which the overall finding is based, the specific allegations are outlined in detail below.

Ineligible and Unsupported Disbursements

Comment 1

The audit begins by alleging ineligible and unsupported disbursements. Specifically, first it mentions disbursements made to and on behalf of the owner's non-HUD insured assisted living facility, and three disbursements to payees for other than reasonable operating expenses.

Lighthouse Inn made disbursements to Mr. Smith's other non-HUD insured assisted living facility. These disbursements are substantiated operating expenses and were nothing more than repayment of a loan that was provided to Lighthouse Inn. Any additional amount over the principal of such loan was due based on the terms of the loans, and Mr. Smith has submitted the promissory notes to HUD, evidencing Lighthouse Inn's obligation to repay the loan. Mr. Smith's non-HUD insured assisted living facility funded the operations of Lighthouse Inn for years and Lighthouse Inn was simply repaying the debt.

Further, HUD also asserts Mr. Smith made disbursements for other than reasonable operating expenses. We dispute this finding. The disbursements made by Mr. Smith were for reasonable operating expenses incurred in the ordinary course of business. For example, an attorney providing legal services, an entertainment company providing entertainment to the facility tenants, a fire marshal, etc., are all expenses that would be considered reasonable and ordinary for the operation of an assisted living facility. Therefore, the findings are inaccurate and baseless.

Additionally, HUD also asserts distributions made to the owner were not satisfactory. Similar to the payments made to Mr. Smith's other non-HUD insured assisted living facility, the disbursements made to him were repayment of previous loans he personally made out of his own pocket and from his other business to Lighthouse Inn. Those payments were obligations of Lighthouse Inn and had Mr. Smith not provided the loans in the first place, the funding to operate Lighthouse Inn would have been insufficient to operate the property.

Mr. Smith, individually and through ownership of his other assisted living facility, was in a position where he could loan money to Lighthouse Inn when it needed the capital. However, at all times Mr. Smith treated those contributions as a valid loan obligation to Lighthouse Inn, which would be ultimately repaid. Lighthouse Inn is obligated to pay its debts, and has done so. For the government and HUD to assert violations because of Lighthouse Inn's payments on its liabilities is an unreasonable assertion, and not properly substantiated.

Comment 2

Ineligible Fee

In continuance, the HUD audit asserts a violation of Mr. Smith to charge its clients an ineligible fee. We dispute this finding. Mr. Smith at no point charged a

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fee in addition to a deposit. Instead, Mr. Smith waived his right to charge a security deposit, and instead charged a fee, which did not exceed $500.00, of which every dollar was spent for beautification and/or improvements of the rooms of his clients. The charge was in lieu of the deposit that he was entitled to collect. Moreover, all monies were spent to enhance the value of the property to the respective customers.

Comment 3

Late Mortgage Payments

Next, HUD's audit asserts a failure of the owner to make prompt mortgage payments, and defaulting on the loan with HUD. As mentioned above, Mr. Smith was current on his loan and made a good faith effort to submit his audited financial statements. Due to the downturn in the economy, Mr. Smith sought a *loan modification* with HUD. After years of submitting financials and seeking a loan modification, HUD finally informed Mr. Smith that the financials were done incorrectly and that he would not even be considered for a modification until they were corrected. HUD's inability to process the financials and promptly notify Mr. Smith put Mr. Smith in an untenable position.

Comment 4

Specifically, when Mr. Smith was finally informed the financials would need to be corrected, in order to be considered for a loan modification, he needed a significant amount of money, over $100,000.00, to have all the prior year financials corrected. At that point, Mr. Smith could not afford to fix all the prior financials, thus HUD was unable to consider the loan modification and with no alternatives Mr. Smith was forced to default.

Comment 4

Audited Financial Statements Not Submitted

HUD's audit also asserts Mr. Smith failed to provide audited financials. As mentioned above, he did provide annual financial statements. The financials were misplaced by HUD, therefore the allegations are disputed and baseless.

Comment 5

Tenant Security Deposits Improperly Maintained

Furthermore, HUD's audit asserts that Mr. Smith comingled the deposits of client's security deposits. Mr. Smith maintained records of all security deposits made to him, and records of security deposits were kept and customers have always been attributed their security deposits. Mr. Smith disputes that the funds were comingled and asserts that he has maintained sufficient records to maintain the source and amounts of each client's security deposit.

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Comment 6

Inaccurate Books and Accounts

Additionally, the HUD audit asserts that the books and accounts of Lighthouse Inn are inaccurate or inadequate. Again, Mr. Smith made every effort to provide the required financial statements. It was not until several years passed of the HUD agreement being in effect, when Mr. Smith sought a modification of the loan, that it was finally brought to his attention that he was not in compliance. Moreover, Mr. Smith disputes that the books and accounts are inaccurate or inadequate.

Comment 7

Physical Conditions Not Up To Standards

The HUD audit asserts that the physical conditions of the property were not kept up to standards. Mr. Smith kept the facility up to standards and corrected any deficiencies that were identified. Although, the audit asserts tenants were at health and safety risks, this allegation is simply untrue and Mr. Smith always kept the facility up to standards that ensured the health and safety of the tenants. The allegations made in the audit are unsubstantiated and baseless without adequate evidence to support such allegations. The property is well kept and in full compliance.

Comment 8

Other Issues

The audit also alleges that Lighthouse Inn is in jeopardy of losing its assisted living facility license. All 11 deficiencies mentioned in the audit have been corrected and are gone. Although, some deficiencies were not dealt with promptly due to a clerical error, the deficiencies have been dealt with at this point. Moreover, the only reason that the State of Florida has raised any issues is because the State is concerned it has issued too many licenses and wants some back. At this time the license is not in jeopardy and the allegations regarding such are disputed.

Conclusion

Comment 9

The audit contains a section entitled "Scope and Methodology." Here the audit discusses what samples of disbursements and payees that were used to determine the unsupported or ineligible disbursements. The audit is using an inadequate sampling technique of both the disbursements and payees to determine total unsupported distributions and which distributions may require more documentation. Based on that procedure used, of a small sample, we are contesting the accuracy of the audit performed and whether any of the results

Comment 9

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obtained stem from an appropriately conducted audit. A full audit of the books was never conducted and a small sample set is insufficient and inaccurate. Therefore the allegations and results of the audit are flawed.

In conclusion, Mr. Smith is hereby contesting all of the assertions contained in the audit regarding the alleged violations of the regulatory agreement and HUD requirements. Please take the time to review our comments and add them to the proposed audit findings.

Thank you for your time and co-operation. In the meantime if you have any questions please feel free to call me at my office number.

Yours very truly,

Jamie Alan Sasson

JS:js
Encl.

OIG Evaluation of Auditee Comments

Comment 1 The auditee did not agree with OIG's assessment of the reviewed disbursements, such as the disbursements to the owner's non-HUD-insured assisted living facility and his other companies, an attorney, an entertainment company, and the fire marshal.

The owner made ineligible disbursements totaling $146,983. Paragraph 6(e) of the regulatory agreement states that owners shall not without the prior written approval of HUD make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except under certain conditions. Since the owner did not receive written approval from HUD and the distribution to the owner and his other companies did not come from surplus cash, these disbursements violated the stipulations of the regulatory agreement and thus are ineligible.

The OIG assessed that the attorney's fees incurred on contesting the State agency's determination to deny Lighthouse Inn's license, based on the facility's failure to pass inspections and numerous license violations, to be ineligible. The billing statement showed that the attorney worked on settlement negotiations to retain Lighthouse Inn North's license and preparing drafts for continuances. In addition, OIG questioned a portion of the disbursement to the fire marshal because the charge related to the owner's Illinois office which, according to a Lighthouse Inn staff, operated three of the owner's other companies. OIG determined that Lighthouse Inn should have only paid a portion of the cost. Further, OIG did not question the disbursement to the entertainment company.

Comment 2 The auditee did not agree with OIG's assessment that the fees collected from tenants are ineligible. It stated the fee was charged in lieu of a security deposit and was used to enhance the value of the property to the respective tenant.

The owner was not allowed to collect a fee in lieu of a security deposit without written approval from HUD. Paragraph 6(g) of the regulatory agreement states that owners shall not without the prior written approval of HUD require, as a condition of the occupancy or leasing of any unit in the project, any consideration or deposit other than the prepayment of the first month's rent plus a security deposit in an amount not in excess of one month's rent. Since the owner did not receive written approval from HUD, the $10,950 in fees collected from the 22 tenants was not an eligible receipt.

Comment 3 The auditee did not disagree that it made late mortgage payments and defaulted on its loan. It reasoned that because HUD did not allow a loan modification to the owner, the owner was forced to default.

It is indeterminate whether a modification of the HUD loan would have prevented the late mortgage payments and subsequent default of the loan. Additionally, had the facility made consistent partial payments, at an amount that would have resulted if the desired loan modification occurred, it could have shown HUD that Lighthouse Inn can remain solvent if HUD approved the loan modification. Lighthouse Inn's bank statements, for the months after it stopped making mortgage payments, showed that there were funds available to make, at least, partial mortgage payments. However, the owner stopped making payments toward the mortgage in July 2011, allowing the loan to go into default and eventually be assigned to HUD for claim.

Comment 4 The auditee refuted that financial statements were not submitted and reasoned that the owner did not know at the time that the information submitted did not comply with HUD requirements.

Paragraph 9(e) of the regulatory agreement requires the mortgagor to provide HUD with a complete annual financial report based upon an examination of its books and records in accordance with HUD requirements. Although the auditee provided financials, they were not audited as required. In October 2010, the owner was made aware that he had not provided HUD with compliant audited financial statements. In November 2010, the owner engaged an independent auditor to perform an audit of the facility's financial statements for the period ending December 31, 2008. The 2008 audited financial statements were submitted on April 4, 2012, but the independent auditor did not express an opinion on the financial statements because the facility provided insufficient records. Audited financial statements for later years were not submitted.

Comment 5 The auditee disputed that security deposit funds were commingled and stated that the owner maintained sufficient records.

Sections 2-9A and 2-9B of HUD Handbook 4370.2 require that funds in the security deposit account not be commingled with other funds and that disbursements be only for refunds to tenants. OIG's review of three transactions supports the violation of this requirement. In addition, the OIG report did not state that the owner did not maintain sufficient records on tenants' security deposit amounts. The report indicates that the owner allowed the use of operating funds to return tenants' security deposits in violation of paragraph 6(g) of the regulatory agreement, which requires any funds collected as security deposits be kept separate and apart from all other project funds.

Comment 6 The auditee disagreed with OIG's assessment that books and accounts were inaccurate.

The OIG report states that the owner violated paragraphs 9(c) and 9(d) of the regulatory agreement and supported the violations with the audit of the 2008 financial statements performed by the independent auditor who could not express an opinion on them because of the condition of the records; and the inaccurate recording of tenants' security deposits in the general ledger. Because Lighthouse

Inn did not provide sufficient records, the independent auditor could not express an opinion on the financial statements. In addition, the reconciliation of the tenant security deposit bank accounts and general ledger accounts showed that the general ledger did not accurately reflect what was in the security deposit bank accounts, and the balance on the general ledger security deposit asset accounts did not agree with the contra liability accounts. Therefore, the books and accounts for Lighthouse Inn were inaccurate.

Comment 7 The auditee disagreed with OIG's assessment that the facility was not maintained to HUD standards.

OIG based its assessment on the 2010 through 2012 reports prepared by HUD's Real Estate Assessment Center on physical inspections performed on the facility. Lighthouse Inn received decreasing scores of 63 in 2010, 45 in 2011, and 39 in 2012. In each year, the inspector cited one or more exigent or fire, health, and safety deficiencies.

Comment 8 The auditee disputed that Lighthouse Inn's license is in jeopardy.

The OIG report states that Lighthouse Inn was in jeopardy of losing its license based on the June 3, 2013, letter from the State agency which amended its intent to deny the facility's license, not based on the 11 deficiencies, but on a demonstrated pattern of deficient performance, not meeting licensure requirements, and not paying an outstanding fine. The auditee provided no evidence that the State agency retracted its intent or that the violations supporting its basis were cleared.

Comment 9 The auditee disagreed with OIG's methodology in obtaining the review sample and thus contested the results from the sample. The auditee stated a full audit of the books was not conducted and a small sample set is insufficient.

One of the areas reviewed to determine whether the owner complied with the regulatory agreement was to test the eligibility of Lighthouse Inn's disbursements. We did not look at 100 percent of the disbursements but selected a sample for review (see the Scope and Methodology section for further detail). Government auditing standards state that when sampling, the method of selection depends on the audit objective. Specifically, a targeted selection may be most effective when auditors have isolated risk factors or other criteria to target the selection. We conducted this audit in accordance with generally accepted government auditing standards and believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

Appendix C

LIST OF INELIGIBLE DISBURSEMENTS

#	Date	Disbursement to (see note)	Disbursed amount	Ineligible amount
1	11/01/2010	E	$ 4,200.00	$ 4,200.00
2	02/24/2011	B	$ 10,000.00	$ 10,000.00
3	05/19/2011	B	$ 13,556.02	$ 13,556.02
4	07/05/2011	A	$ 9,000.00	$ 9,000.00
5	09/09/2011	A	$ 12,500.00	$ 12,500.00
6	01/23/2012	D	$ 2,500.00	$ 2,500.00
7	02/17/2012	C	$ 2,080.00	$ 2,080.00
8	03/08/2012	A	$ 5,737.00	$ 5,737.00
9	04/09/2012	C	$ 11,452.24	$ 11,452.24
10	06/11/2012	E	$ 100.00	$ 75.00
11	06/18/2012	B	$ 1,440.00	$ 1,440.00
12	06/18/2012	B	$ 1,000.00	$ 1,000.00
13	07/20/2012	C	$ 1,813.00	$ 1,813.00
14	08/05/2012	C	$ 1,342.23	$ 1,342.23
15	08/06/2012	D	$ 5,000.00	$ 5,000.00
16	08/17/2012	D	$ 10,000.00	$ 10,000.00
17	10/09/2012	E	$ 3,607.50	$ 1,712.50
18	12/14/2010	A	$ 7,555.00	$ 7,555.00
19	12/22/2010	A	$ 7,250.00	$ 7,250.00
20	01/27/2011	B	$ 10,000.00	$ 10,000.00
21	03/24/2011	B	$ 7,317.58	$ 7,317.58
22	12/09/2011	C	$ 11,452.24	$ 11,452.24
23	05/08/2012	D	$ 5,000.00	$ 5,000.00
24	10/25/2012	D	$ 5,000.00	$ 5,000.00
	Total			**$ 146,982.81**

Note:
A = Disbursement made to owner (total = $42,042)
B = Disbursement made to the non-HUD-insured assisted living facility (total = $43,313.60)
C = Disbursement made on behalf of the non-HUD-insured assisted living facility (total = $28,139.71)
D = Disbursement made to owner's other companies (total = $27,500)
E = Disbursement for unreasonable operating expense (total = $5,987.50)

Appendix D

LIST OF INELIGIBLE FEES COLLECTED

#	General ledger account	Date	Invoice #	Amount
1	532	09/01/2010	2708	$ 500
2	603	02/10/2011	2772	$ 500
3	603	02/12/2011	2837	$ 500
4	603	03/02/2011	2840	$ 500
5	603	04/14/2011	2951	$ 500
6	603	05/01/2011	3034	$ 500
7	603	05/25/2011	3094	$ 500
8	603	06/07/2011	3108	$ 500
9	603	06/08/2011	3107	$ 500
10	603	06/30/2011	3177	$ 500
11	603	07/08/2011	3209	$ 500
12	603	08/10/2011	3249	$ 500
13	603	09/13/2011	3318	$ 500
14	603	10/21/2011	3444	$ 500
15	603	11/18/2011	3510	$ 500
16	603	01/19/2012	3660	$ 450
17	603	03/05/2012	3734	$ 500
18	603	04/30/2012	3968	$ 500
19	603	07/01/2012	4051	$ 500
20	532	09/10/2012	4189	$ 500
21	531	09/26/2012	4252	$ 500
22	532	09/27/2012	4249	$ 500
	Total fees collected			**$10,950**