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Audit Report Number	2011-DE-1002

TO: Roger Miller, Deputy Assistant Secretary for Healthcare Programs, HU

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

SUBJECT: Blue Mountain Hospital, Blanding, UT, a HUD Section 242 Insured Mortgagee,
Did Not Have Adequate Written Procedures for Its Project Funds

HIGHLIGHTS

What We Audited and Why

We reviewed Blue Mountain Hospital (Hospital) based on a request from the Office of Healthcare Programs. The objective of our review was to determine whether the Hospital had adequate written procedures for collecting, dispersing, and accounting for project funds.

What We Found

The Hospital did not have adequate written procedures for collecting, disbursing, and accounting for project funds. This condition occurred because management did not make the development of detailed written procedures a priority. As a result, the Hospital's project funds were vulnerable to misuse.

What We Recommend

We recommend that the Director of HUD's Office of Healthcare Programs require that the Hospital establish and implement written procedures for the financial department positions involved with collecting, disbursing, and accounting for project funds.

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

Auditee's Response

We provided the draft report to Hospital officials on April 28, 2011 and requested their written response by May 12, 2011. During the exit conference on May 11, 2011, we extended the written response date to May 16, 2011. The Hospital has not provided a written response, nor has it responded to our attempts to follow up. During the exit conference, Hospital officials stated that they concurred with the finding and recommendations and were working on developing the written procedures.

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BACKGROUND AND OBJECTIVES

Blue Mountain Hospital (Hospital) is a Section 501(c)(3) nonprofit corporation established for the purpose of constructing and operating an 11-bed acute care hospital which serves the medical needs of residents in and around San Juan County, UT. The founding members, consisting of two individuals and two organizations, signed articles of incorporation on October 15, 2002, and contributed a combination of cash and in-kind services to establish the nonprofit corporation. The Hospital's four founding members had power to appoint board members, amend the bylaws, and hold meetings. The founding members appointed a six-member board of directors. The two individuals and two representatives from each of the organizations were the initial officers and also the initial board of directors of the corporation. The board of directors was responsible for managing all aspects of the Hospital's financing, construction, development, and operations.

On December 20, 2006, the Hospital and the U.S. Department of Housing and Urban Development (HUD) signed a Section 242 regulatory agreement for a HUD-insured mortgage of more than \$14.5 million. HUD's Section 242 Mortgage Insurance for Hospitals program encourages the provision of essential health care services by providing mortgage insurance for the construction and development of hospitals within areas of proven need. To qualify for mortgage insurance, borrowers must comply with applicable HUD requirements and standards.

On December 20, 2006, the Hospital and U. S. Bank National Association signed the mortgage note to fund the development, construction, and initial operation of the Hospital. The Hospital defaulted on the mortgage note before HUD's final endorsement of the loan. As a result, U.S. Bank National Association assigned the mortgage note to HUD in January 2011.

The Hospital completed construction and started operations in mid-2009. At the start of operations, a chief executive officer, chief financial officer, and other staff responsible for collecting, disbursing, and accounting for project funds were hired. In June 2010, the two officers were dismissed, and officials from one of the Hospital's founding member organizations assumed the positions of chief executive officer and acting chief financial officer. At the time of our review, they were working with HUD to establish a management agreement for the Hospital.

The objective of the review was to determine whether the Hospital had adequate written procedures for collecting, disbursing, and accounting for project funds.

RESULTS OF AUDIT

Finding 1: The Hospital Did Not Have Adequate Written Procedures

The Hospital did not have adequate written procedures for collecting, disbursing, and accounting for project funds. This condition occurred because management did not make the development of detailed written procedures a priority. As a result, the Hospital's project funds were vulnerable to misuse.

The Hospital Did Not Have Adequate Written Procedures

The Hospital did not have written procedures for collecting, disbursing, and accounting for project funds. The Hospital's regulatory agreement and HUD Handbook 4370.2 REV-1, Financial Operations and Accounting Procedures for Insured Multifamily Projects, required an internal control structure that complied with Generally Accepted Accounting Principles. These Principles include establishing and implementing written procedures for cash handling and other financial functions. The handbook contained specific requirements which needed to be incorporated into the written policies.

The Hospital had only a general finance policy manual, which was developed after operations started. It did not have the required written procedures for each of the financial department positions; therefore, the staff members did not have ready references detailing their responsibilities.

Management Did Not Make the Development of Written Procedures a Priority

Management did not make the development of detailed written procedures a priority. The Hospital was concentrating on setting up a new operation and had a high turnover of initial staff, and its financial managers had to reconstruct the development and construction financial records.

The Hospital was a new facility, which started operations in about June 2009. All aspects of the Hospital's operations had to be established. The original chief executive officer and chief financial officer did not ensure that the required procedures were established. The chief executive officer and chief financial officer of one of the Hospital's founding member organizations assumed those

positions for the Hospital in June 2010. They worked at the Hospital and also retained their original positions.

As of November 2010, most of the staff members in the finance department had been employed with the Hospital for only a few months. Management was working with the staff members to provide on-the-job training but had not established detailed written procedures.

The financial management team had to review extensive development and construction records and reconstruct the books of account for 2002 through 2008. They also had to determine the accuracy of the 2009 and 2010 operations books.

Project Funds Were Vulnerable to Misuse

Without the required procedures, the Hospital's project funds were vulnerable to misuse. Although, we did not identify improper uses of the operations funds, the control structure provided opportunities for misuse. For example, management thought that two people were involved with preparing and making the bank deposits. However, one person received all payments, entered the receipts into the computer billing system, prepared the deposit, and took it to the bank. One person performing all of the cash collections functions provided the opportunity for inappropriate recording or misuse of funds.

Recommendations

We recommend that the Director of HUD's Office of Healthcare Programs

- 1A. Require the Hospital to establish and implement written procedures for the financial department positions involved with collecting, disbursing, and accounting for project funds.
- 1B. Provide technical assistance to the Hospital to ensure that written procedures comply with HUD requirements.

SCOPE AND METHODOLOGY

Our review period relating to the initial operations of the Hospital was June 1, 2009, through October 31, 2010. We performed our onsite review work from November through December 2010 at the Hospital at 802 South 200 West, Blanding, UT.

To accomplish our review objective, we identified and reviewed Section 242 of the National Housing Act as amended in 1968, applicable HUD regulations, HUD handbooks, and Hospital policies. We did not rely on computer-processed data to complete the review work. To evaluate the controls over the operations of the hospital, we interviewed pertinent employees to gain an understanding of what they do and reviewed the books of account and related original documents. This process included reviewing monthly accounting reports, 20 vendor files which included the largest operating purchases, and the bank reconciliations for the operations bank accounts.

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:

- Controls over collecting, disbursing, and accounting for project funds.

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 Hospital did not have adequate written procedures for all staff positions involved with collecting, disbursing, and accounting for project funds (see finding 1).