Issue Date October 29, 2010
Audit Report Number 2011-AO-1002

TO: Scott G. Davis, Director, Disaster Recovery and Special Issues Division, DGBD

FROM: Nikita N. Irons, Regional Inspector General for Audit, Gulf Coast Region, 11AGA

SUBJECT: The State of Louisiana, Baton Rouge, LA, Did Not Always Ensure That Disbursements Under Its First Time Homebuyer Program Complied With Federal Regulations and Program Requirements

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG) Supplemental Disaster Recovery program funds, administered by the State of Louisiana, Office of Community Development (State). Specifically, we wanted to determine whether the State ensured that disbursements made under its First Time Homebuyer Program (Program) complied with Federal regulations and the cooperative endeavor agreement (agreement) with its subrecipient, the Finance Authority of New Orleans (Finance Authority). The audit was initiated as part of the Office of Inspector General's (OIG) strategic plan to review activities related to Gulf Coast hurricane disaster relief efforts.

What We Found

The State did not always ensure that disbursements made under its Program complied with Federal regulations and the agreement. Specifically, disbursements to Program participants were not always eligible and supported. This deficiency occurred because the State did not ensure that (1) the Finance Authority implemented Program policies and procedures before making disbursements under the Program, (2) Program policies and procedures adequately addressed the Program requirements, and (3) the Finance Authority followed the Program policies and procedures once they were implemented. As a result, the State disbursed $268,415 for ineligible Program costs and was unable to support more than $1.2 million in Program costs.

In addition, the State disbursed funds to the Finance Authority on a fee per loan basis, which was unallowable. This deficiency occurred because the State did not ensure that a budget amendment complied with Federal regulations or the agreement. The State also did not ensure that the findings in its monitoring reviews were resolved before continuing disbursements to the Finance Authority. As a result, it disbursed more than $1.3 million for unallowable costs and did not have assurance that costs were reasonable or necessary. Furthermore, the State did not have reasonable assurance that the Finance Authority used every opportunity to (1) maximize the disaster funds and (2) increase the number of individual families that were served by the Program.

What We Recommend

We recommend that HUD's Disaster Recovery and Special Issues Division require the State to (1) repay its Program the $268,415 in ineligible costs and (2) support or repay its Program more than $1.2 million in unsupported costs. In addition, the State must support or repay its Program more than $1.3 million disbursed to the Finance Authority on a fee per loan basis and cease payment of the fee per loan to the Finance Authority.

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 a draft report to the State on September 30, 2010. We held an exit conference with the State on October 7, 2010. We asked the State to provide written comments to the draft report by October 15, 2010, and it provided written comments on that day. The State generally agreed with our results. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

Between December 2005 and December 2007, Congress approved a total of $19.7 billion in supplemental Community Development Block Grant (CDBG) disaster recovery assistance funds for Gulf Coast hurricane relief. Of that amount, the U.S. Department of Housing and Urban Development (HUD) awarded $13.4 billion to the State of Louisiana (State) for its recovery efforts. The Louisiana Recovery Authority, in conjunction with the State, developed action plans outlining the programs and methods used to administer the $13.4 billion in supplemental CDBG funds. In Louisiana, the State is HUD's principal grantee and the entity primarily responsible for the $13.4 billion in allocated disaster funds. Therefore, the State is responsible for administering and monitoring the CDBG disaster-related programs generated from the HUD allocations. The State uses the supplemental CDBG funds to fill the gaps in funding in the areas of housing, infrastructure, and economic development.

Of the $13.4 billion in CDBG funds allocated to Louisiana, the State budgeted $40 million for the First Time Homebuyer Program (Program) under its housing programs category. As allowed by HUD, the State executed a subrecipient agreement with the Finance Authority of New Orleans (Finance Authority) to administer $27.8 million of the $40 million for Orleans Parish. The agreement was effective March 1, 2008.

The Program's purpose is to promote home ownership by allowing low- and moderate-income households to purchase one- and two-family properties that are "ready to occupy," as well as unrepaired one- and two-family properties for which the purchaser would carry the home through the repair process. Participating properties must either be (1) those properties that received severe or major damage through the storms of 2005 or (2) properties located in locally designated redevelopment zones.[1]

To be considered eligible for the Program, applicants must be first-time home buyers with annual household incomes at or below 120 percent of the area median income who are acquiring a principal residence. The Program offers two types of assistance. The first is a forgivable soft-second home mortgage loan through participating lenders, not to exceed $65,000, to cover the affordability gap between (1) the maximum first mortgage financing for which the home buyer qualifies and (2) the purchase price of the home. Under the second type of assistance, the Program offers closing cost assistance, not to exceed $10,000, to cover closing costs related to the mortgage loan and required prepaid items, such as insurance, interest, and taxes. All participants do not qualify to receive closing cost assistance.

As of March 2010, the State had expended more than $23.9 million of the $27.8 million administered by the Finance Authority, for assistance to Program participants and Program administrative costs[2].

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[1] The properties could either be formerly rental or ownership properties.

[2] The State disbursed $23,924,748 for the Program administered by the Finance Authority. Of that amount, $22,577,877 was for assistance to Program participants and $1,346,871 was for Program administrative costs.

Our overall objective was to determine whether the State ensured that disbursements made under its Program complied with Federal regulations and the agreement with the Finance Authority. Specifically, we wanted to determine whether (1) disbursements to Program participants were eligible and supported and (2) the State disbursed funds to the Finance Authority in accordance with Federal regulations and the agreement for the Program.

RESULTS OF AUDIT

Finding 1: Disbursements to Participants Were Not Always Eligible and Supported

Disbursements to Program participants were not always eligible and supported as required by Federal regulations, the agreement, and Program policies. This deficiency occurred because the State did not ensure that the Finance Authority (1) implemented policies and procedures before making disbursements under the Program, (2) developed Program policies which adequately addressed Program requirements as outlined in its action plan and agreement, and (3) followed the Program policies and procedures once they were implemented. As a result, the State disbursed $268,415 for ineligible Program costs and was unable to support more than $1.2 million in Program costs.

More than $1.4 Million Paid for Ineligible and/or Unsupported Program Costs

According to the agreement, the State required the Finance Authority to follow the Program policies and procedures and Federal regulations including, 24 CFR (Code of Federal Regulations) 84.21 through 28, 24 CFR 85.21, and Office of Management and Budget (OMB) Circular A-87. Those regulations required the Finance Authority to follow the required accounting principles and procedures, use adequate controls, and maintain adequate source documentation for all costs incurred. However, a review of disbursements, totaling $2,302,609, to 36[3] Program participants determined that 25 (69 percent) participants received disbursements which included costs that were ineligible and/or unsupported (see appendix C).

Costs in disbursements were ineligible because participants' income exceeded the HUD income limit [4] or the closing cost grant award was incorrectly calculated, resulting in an overpayment. According to the Program requirements, closing cost grant assistance was provided based upon the participant's need and if other Program requirements were met. Regarding the closing cost grant, the State required the Finance Authority to consider the participant's reserves, including cash in the bank or liquid assets, to determine need and in its calculation of the grant assistance. To determine need, the Finance Authority determined a maximum amount of reserves allowed by using the following formula:

(housing payment x 3) + $3,000 = maximum reserves allowed

[3] Two Program participants did not receive a grant award for closing costs.
[4] This occurred in three instances. Participants' household income could not exceed 120 percent of the area median income.

The Finance Authority then subtracted the maximum reserves allowed from the participant's actual reserves. Any amount exceeding the maximum reserves allowed was subtracted from the total allowable closing cost grant assistance to determine the amount of the closing cost grant award. However, 12 participants who received a closing cost grant award either (1) received an overpayment because the allowable closing cost grant assistance was not correctly reduced by the amount exceeding the maximum reserves allowed or (2) did not qualify to receive the award because the excess reserves exceeded the allowable closing cost grant assistance. In one instance, a participant, who received the maximum $10,000 closing cost grant award, had more than $60,000 in excess reserves and therefore, did not qualify to receive the award.

Costs in disbursements were unsupported because files did not include required documentation to support eligibility under the Program policies, such as documentation to support[5]

- **The Program participants' first-time home buyer status** - Program policies required that participants be first-time home buyers. To qualify as a first-time home buyer, the participant had to either be an individual who (1) had no ownership in a principal residence during the 3-year period ending on the date of purchase of the property; (2) was a single parent who owned with a former spouse while married; (3) was a displaced homemaker and owned with a spouse; (4) owned a principal residence not permanently affixed to a permanent foundation; or (5) owned a property that was not in compliance with State, local, or model building codes and could not be brought into compliance for less than the cost of constructing a permanent structure. According to the Finance Authority, it used credit reports to verify that participants had no ownership in a principal residence during the 3-year period ending on the date of purchase of the property. However, four files did not include a credit report or other documentation supporting that the participants met the qualifying criteria.

- **The Program participants' household income amount** - Program policies required that participants' household income be at or below 120 percent of the area median income under HUD's income limits. To verify a participant's household income and to determine income eligibility, Program policies required documentation of the participant's last 2 years' tax returns and Internal Revenue Service forms W-2, a verification of employment form, and the pay stubs for each pay period over the past 3 months. However, seven files did not include all of the required documentation. In addition, documentation of the household size was needed to determine the appropriate income limit applicable to the participant. However, two files did not include sufficient documentation

[5] Some files had multiple issues which rendered the disbursement(s) unsupported.

to support the participants' household size used in making the income eligibility determination.

- **That the participating property was within a designated disaster area or sustained at least $5,200 in damages as a result of either Hurricane Katrina or Rita -** Program policies required that participating properties be located in a designated disaster area or had sustained at least $5,200 in hurricane damages. According to the Finance Authority, if a property was not in a designated disaster area, it verified the dollar amount of property damage using a damage assessment report, insurance claim, or property repair receipts. Further, regarding the damage assessment reports, the Finance Authority asserted that as long as the damage assessment report indicated that the property damage was at least 10 percent, it considered the property to have met the Program requirement of having sustained at least $5,200 in hurricane damages. However, 13[6] files did not include documentation to support the dollar amount or percentage of property damage. In addition, the Program policies did not (1) state that the percentage could be used in lieu of a dollar amount or (2) establish a set percentage for determining whether the property damage met the Program requirements.

- **The Program participants' total debt ratio did not exceed the 45 percent established limit -** Under HUD's Federal Housing Administration (FHA) requirements, the maximum total debt ratio allowed to qualify for a mortgage loan is 43 percent. In certain circumstances, HUD allows FHA lenders to consider compensating factors, such as previous credit history, down payment, and assets, to allow applicants to exceed the allowed percentage amount. The Program policies did not follow these guidelines and established a maximum total debt ratio of 45 percent. However, using the participants' monthly housing payment, monthly income, and monthly debt, we determined that in six instances, the participants' total debt ratio exceeded the established Program limit by 2 to 15 percent. In addition, for the participants whose debt ratio exceeded 45 percent, it appeared that the Finance Authority adjusted either the monthly income or monthly debt amounts to qualify participants at or below the 45 percent limit.

As a result, of $2,302,609 in Program disbursements, the State spent $1,470,659 (63 percent) in questioned costs[7]. Despite minor documentation issues, the remaining $831,950 in Program disbursements was eligible and supported. The State must repay $268,415 and support or repay more than $1.2 million.

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[6] 18 files did not contain documentation to support the dollar amount of property damage. Of the 18, in addition to the lack of support for the dollar amount of property damage, 13 did not include documentation to support the percentage of property damage either.

[7] This amount includes $268,415 in ineligible and more than $1.2 million in unsupported Program disbursements.

Insufficient Program Controls

Program policies and procedures were not effective until February 2010. By that time, more than $23 million in Program funds had been disbursed. Without adequate controls, the Finance Authority could not ensure consistency when processing files or that files were processed in accordance with Federal and Program requirements. In addition, once Program policies and procedures were established, they did not adequately address the Program requirements reflected in the agreement. For instance, the policies and procedures did not address how "need" should be determined, a Program requirement related to the closing cost grant assistance, nor did the policy detail the calculation for determining the closing cost grant assistance amount. Also, regarding the verification of household income, the policy required that the applicant provide pay stubs for each pay period over the past 3 months but did not specify from what date, such as the application or closing date. Further, once the policies and procedures were implemented, the Finance Authority did not always follow them when determining the eligibility of participants or maintaining supporting documentation. Implementation of detailed Program policies and procedures before making Program disbursements could have aided in ensuring that Program disbursements were eligible and supported as required by Federal and Program requirements.

Participant Files Reviewed

During the assignment, the State reviewed the files of some of our sampled Program participants and discussed with us its findings related to those files. In addition, during an update meeting, the State explained that it intended to review the files of our entire sample of Program participants. We acknowledge the State's efforts in resolving the identified deficiencies.

Conclusion

Disbursements to Program participants were not always eligible and supported in keeping with Federal and Program requirements. This deficiency occurred because the State did not ensure that the Finance Authority (1) implemented policies and procedures before making disbursements, (2) developed Program policies which adequately addressed Program requirements as outlined in the agreement, and (3) followed Program policies and procedures once they were implemented. As a result, the State disbursed $268,415 for ineligible Program costs and was unable to support more than $1.2 in Program costs.

Recommendations

We recommend that the Director of HUD's Disaster Recovery and Special Issues Division require the State to

1A. Repay its Program $268,415 in ineligible Program disbursements.

1B. Support or repay its Program $1,202,244 in unsupported Program disbursements.

Finding 2: The State Paid More Than $1 Million in Unallowable Costs

The State reimbursed the Finance Authority on a fee per loan basis, which was unallowable according to Federal regulations and the agreement. This deficiency occurred because the State did not ensure that a budget amendment to the initial agreement complied with Federal regulations or the agreement before disbursing funds to the Finance Authority. In addition, the State did not ensure that the findings in its monitoring reviews were resolved before continuing disbursements to the Finance Authority. As a result, the State paid more than $1.3 million in unallowable costs and did not have assurance that costs were reasonable and necessary, as required by OMB Circular A-87. In addition, the State did not have reasonable assurance that the Finance Authority used every opportunity to leverage funds to (1) maximize the current disaster funds and (2) increase the number of individual families that were served by the Program as required by the agreement.

$1.3 Million Disbursed for Unallowable Costs

As of March 4, 2010, the State had reimbursed the Finance Authority more than $1.3 million in Program administrative costs on a fee per loan basis, which violated 24 CFR 85.22 and the agreement. Regulations at 24 CFR 85.22 prohibit the payment of a fee, profit, or other increment above allowable costs to a grantee or subgrantee. Payment of a fee or profit was allowed only to contractors. Since the Finance Authority was the State's subgrantee, it did not qualify to receive a fee per loan. According to the State, initially there was some confusion with regard to whether the Finance Authority was considered a subgrantee or a contractor. Since the Finance Authority was not a contractor, it should not have been paid on a fee per loan basis. In addition, payment of the fee per loan violated the agreement, which did not allow for the reimbursement of this administrative type of fee.

Although the fee per loan was unallowable, the agreement did allow for payment of eligible items and direct Program delivery costs actually incurred by the Finance Authority. However, because the State allowed the fee per loan, it did not require the Finance Authority to submit supporting documentation with its payment requests and, therefore, did not maintain documentation to support actual Program costs incurred by the Finance Authority as required in its agreement. Specifically, as of March 4, 2010, the State had reimbursed the Finance Authority $3,815 for each of the 353 grants closed through 15 payment requests. A review of the 15 payment requests determined that for all 15, the Finance Authority did not submit documentation that showed actual Program costs incurred. The only documentation included with the Finance Authority's payment requests to the State was documentation to support the number of loans processed. The State then reimbursed the Finance Authority the set fee of $3,815 for each loan processed.

The State must support or repay its Program the $1,346,871 disbursed for the fee per loan.

Number of Families Served Decreased by Amended Budget

The initial budget for the agreement included 15 cost categories for Program costs, totaling $505,000, which were to be reimbursed based upon actual costs incurred. An amendment to the budget reflected an amount of $3,815 as a fee per loan for 365 loan closings. In addition, the amended budget added 16 new cost categories and increased the total Program costs to nearly $1.4 million as shown below.

Number of Program cost categories	Initial budget	Amended budget
15	$505,000	$1,144,438
16		248,220
Totals	**$505,000**	**$1,392,658**

Under the amended budget, costs increased by $639,438 for the 15 cost categories included in the initial budget and included 16 new cost categories totaling $248,220. The 16 new cost categories also included indirect costs, whereas the initial budget had none.

Regarding the indirect costs added under the amended budget, the State did not have documentation reflecting the distribution of indirect costs among other programs administered by the Finance Authority as required by OMB Circular A-87. Further, although the amended budget included descriptions for all 31 cost categories, it did not include documentation or provide justification for inclusion of the additional 16 cost categories or the increases in amended amounts for the 15 cost categories included in the initial budget.

In amending the budget for Program administrative costs, the funding available for assistance to Program participants was reduced by $887,658, which could have served at least 11 more families. Because the funding was taken away from Program assistance and budgeted as Program administrative costs without adequate documentation, the State did not have reasonable assurance that the Finance Authority used every opportunity to leverage funds to maximize the disaster funds and increase the number of individual families served by the Program as required by the agreement.

Issues With Fee Per Loan Identified

The State conducted a monitoring visit on November 23, 2009. The results of the monitoring visit determined that the Finance Authority did not provide supporting documentation concerning the individual line item costs for its fee per loan. Although the State identified this issue with the fee per loan, it continued to reimburse the Finance Authority before resolving its monitoring review findings. The State should have ceased payments to the Finance Authority for the fee per loan until the Finance Authority resolved the findings. The State must cease payment of the fee per loan to the Finance Authority, thereby only reimbursing the Finance Authority for supported direct Program delivery costs actually incurred.

Action Taken

During an update meeting, the State asserted that its compliance unit was reviewing all payment requests from the Finance Authority, including supporting documentation, as available. The State also asserted that it would recoup any unsupported or ineligible Program costs. We acknowledge the State's efforts in validating the Program costs.

Conclusion

The State did not ensure that it disbursed disaster funds to the Finance Authority in accordance with Federal regulations or the agreement. Specifically, although the agreement allowed for payment of costs actually incurred by the Finance Authority, the State reimbursed the Finance Authority on a fee per loan basis, which violated Federal regulations and the agreement. This deficiency occurred because the State did not ensure that a budget amendment to the initial agreement complied with the agreement or Federal regulations before disbursing funds to the Finance Authority. Additionally, the State did not ensure that the findings in its monitoring reviews related to those costs were resolved before continuing disbursements to the Finance Authority.

As a result, the State paid more than $1.3 million in unallowable costs and did not have assurance that costs were reasonable or necessary, as required by Federal regulations. In addition, the State did not have reasonable assurance that the Finance Authority used every opportunity to leverage funds to (1) maximize the current disaster funds and (2) increase the number of individual families that were served by the Program as required by the agreement.

Recommendations

We recommend that the Director of HUD's Disaster Recovery and Special Issues Division require the State to

2A. Support or repay its Program the $1,346,871 disbursed for the fee per loan.

2B. Cease payment of the fee per loan to the Finance Authority, thereby only reimbursing the Finance Authority for supported direct Program delivery costs actually incurred.

SCOPE AND METHODOLOGY

We conducted our audit at the State's office in Baton Rouge, LA, and the Finance Authority and HUD Office of Inspector General (OIG) office in New Orleans, LA. We performed our audit between March and September 2010.

To accomplish our objective, we used disbursement data from Program inception through February 28, 2010,[8] which consisted of 353 Program participants who received disbursements totaling more than $22.5 million.[9] Through file reviews, we determined that the disbursement data were generally reliable. We used a stratified sampling approach to select 36 of the 353 participants who received disbursements, totaling more than $2.3 million, for review. We chose this method because it allowed selections to be made without bias from the audit population and allowed conclusions to be reached about the population or activity being tested, based on mathematically defensible projections from the sample. We reviewed files for the 36 Program participants who received disbursements to determine whether the disbursements were eligible and supported.

In addition to the disbursement file reviews, we

- Reviewed all payment requests and supporting documentation, as available, submitted by the Finance Authority to the State specifically for the fee per loan,
- Reviewed the HUD-approved action plan, HUD and State grant agreements, the State and Finance Authority cooperative endeavor agreement including the budget with amendments, Program policies and procedures, the Code of Federal Regulations, public laws, and other legal authorities relevant to the CDBG disaster recovery grant,
- Reviewed monitoring reports prepared by the State and the monthly reports prepared by the Finance Authority, and
- Interviewed key HUD, State, and Finance Authority staff.

Our audit period covered March 2008 through March 2010. We expanded our audit period as necessary. 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.

[8] Closings were held within this timeframe; however, invoices submitted by the Finance Authority to the State were paid between March 2009 and March 2010.
[9] $22,577,877 = $19,656,529 (soft second loans) + $2,921,348 (closing cost grant awards)

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 objectives:

- Policies and procedures implemented and/or followed by the State to ensure compliance with applicable laws and regulations when making disbursements under the Program.

We assessed the relevant controls identified above.

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

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The State did not ensure that controls were implemented before making Program disbursements or that Program controls were adequate to ensure that disbursements to participants were always eligible and supported (see finding 1).

- The State’s controls were not adequately designed to ensure compliance with Federal regulations and its agreement when making disbursement to the Finance Authority (see finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$268,415	
1B		$1,202,244
2A		$1,346,871
Totals	$268,415	$2,549,115

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

Auditee Comments

BOBBY JINDAL
GOVERNOR

PAUL W. RAINWATEI
COMMISSIONER OF ADMINISTR

State of Louisiana

Division of Administration
Office of Community Development
Disaster Recovery Unit

October 15, 2010

Nikita N. Irons
Acting Regional Inspector General for Audit
Gulf Coast Region
Hale Boggs Federal Building
500 Poydras Street, 11th Floor
New Orleans, Louisiana 70130

Re: OCD/DRU response to HUD-OIG Audit Report on
First Time Homebuyer Program

Dear Ms. Irons:

The Division of Administration (DOA), Office of Community Development, Disaster Recovery Unit (OCD/DRU) is providing this letter in response to the HUD Office of Inspector General (OIG) Audit Report concerning the First Time Homebuyer Program administered by the Finance Authority of New Orleans (FANO). We have taken under consideration the findings and recommendations contained in this report.

HUD/OIG's audit objective was to determine whether the State ensured that disbursements made under the First Time Homebuyer Program complied with both the Federal regulations and the cooperative endeavor agreement (CEA) with the State's sub-recipient, FANO.

The audit report details that some of the disbursements made by the State under the Program did not comply with Federal regulations and the CEA. The report contains two findings, each with two recommendations. Presented below are OCD/DRU's comments on the findings and the accompanying recommendations contained in the audit report.

Finding 1: Disbursements to Program Participants Were Not Always Eligible and Supported

Comment 1 OCD/DRU has reviewed many of the files the HUD-OIG reviewed in conducting this audit and is in general agreement that disbursements to Program participants were not always eligible or supported as required by Federal regulations, the CEA, and Program policies. OCD/OCD also agrees that disbursements to Program participants were not always eligible or supported because

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OCD/DRU did not ensure that FANO (1) implemented policies and procedures before making disbursements, (2) developed policies which adequately addressed Program requirements and (3) followed the Program policies and procedures once they were implemented.

The OIG recommends that the Director of HUD's Disaster Recovery and Special Issues Division Require the State to:

Comment 1

1A. Repay its Program $268,415 in ineligible Program disbursements.

OCD/DRU intends to address all concerns with FANO. OCD/DRU is requiring FANO to review all ineligible Program disbursements cited in the OIG report and for those disbursements FANO determines are eligible, to provide documentation to support the eligibility. OCD/DRU will review the documentation provided by FANO and determine if it is sufficient to support eligibility. For disbursements that FANO cannot provide documentation to support eligibility, OCD/DRU will pursue recovery of those funds from FANO. The results of this review will be provided to HUD.

Comment 1

OCD/DRU has set a timeline of October 15, 2010, for FANO to have such documentation. FANO may request a 15 day extension.

1B. Support or repay its Program $1,202,244 in unsupported Program disbursements.

OCD/DRU will follow the same process as described in recommendation 1A above to resolve the unsupported Program disbursements.

Finding 2: The State Paid More Than $1 million in Unallowable Costs

OCD/DRU concurs that it reimbursed FANO on a "fee per loan" basis, which is unallowable according to Federal regulations and the CEA. OCD/DRU would like to note that while the audit report states that, "As of March 4, 2010, the State had reimbursed the Finance Authority more than $1.3 million in Program administrative costs on a fee per loan basis, which violated 24 CFR 85.22 and the agreement", OCD/DRU's compliance unit has worked with FANO in obtaining supporting documentation for actual Program costs eligible for reimbursement. This will substantially reduce the $1.3 million in CDBG funds disbursed for unallowable costs as reported by the OIG.

The OIG recommends that the Director of HUD's Disaster Recovery and Special Issues Division Require the State to:

Comment 2

2A. Support or repay its Program the $1,346,871.

OCD/DRU's compliance unit has reviewed actual costs incurred by FANO to finalize those Program costs eligible for reimbursement. At the time of this response the compliance unit has

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not finalized the actual amount that is eligible for reimbursement. OCD/DRU will seek recovery of any unallowable costs from FANO. OCD/DRU will provide the results of this review to HUD.

Comment 2

2B. Cease payment of the fee per loan to the Finance Authority, thereby only reimbursing the Finance Authority for supported direct Program delivery costs actually incurred.

OCD/DRU has informed FANO that the State will no longer reimburse funds on a "fee per loan" basis and that any further reimbursements will only be for supported direct Program delivery costs actually incurred.

We appreciate the cooperation and diligence of your staff conducting this audit. If you have any questions or require additional information please contact me.

Sincerely,

Robin Keegan, Executive Director
Office of Community Development/DRU

C: Mr. Paul Rainwater
Mr. Mark Brady
Ms. Marsha Guedry
Mr. Thomas Brennan
Ms. Lara Robertson
Mr. Richard Gray
Mr. Bradley Sweazy
Mr. Danny Dragg
Mr. Robbie Viator
Mr. Stephen Upton

OIG Evaluation of Auditee Comments

Comment 1 The State asserted that it reviewed many of the files the OIG reviewed in conducting the audit and was in general agreement that disbursements to Program participants were not always eligible and supported as required by Federal regulations, the agreement, and Program policies. Further, the State agreed with the causes cited in the report and stated that it intended to address all concerns with the Finance Authority and pursue recovery of those disbursements that the Finance Authority could not provide documentation to support eligibility. The State plans to provide the results of its review to HUD.

We acknowledge the State's efforts in pursing the validation and recovery of questioned costs. Since the State's review had not been finalized, questioned costs as identified in Appendix A will remain the same.

Comment 2 The State concurred that it reimbursed the Finance Authority on a fee per loan basis, which was unallowable according to Federal regulations and the agreement. The State commented that its compliance unit had worked with the Finance Authority in obtaining supporting documentation for actual Program costs eligible for reimbursement. The State believed that the reported $1.3 million in unallowable CDBG fund disbursements would be substantially reduced. However, the State agreed to seek recovery of unallowable costs from the Finance Authority. The State plans to provide the results of its review to HUD.

In addition, the State indicated that it informed the Finance Authority that it will no longer reimburse funds on a fee per loan basis and that any further disbursements will only be for supported direct Program delivery costs actually incurred.

We acknowledge the State's proposed actions in pursing the validation and recovery of questioned costs. The State should provide supporting documentation to HUD's staff showing that it ceased payment of the fee per loan to the Finance Authority. HUD's staff will then assist the State with resolving recommendation 2B.

Appendix C

RESULTS OF OIG SAMPLED FILES REVIEWED

Sample	Total disbursement	OIG-identified eligible costs	OIG-identified ineligible costs	OIG-identified unsupported costs
1	$44,624		$1,312	$43,312
2	$74,188	$74,188		
3	$71,237		$269	$70,968
4	$42,041	$33,348	$8,693	
5	$75,000			$75,000
6	$75,000		$75,000	
7	$59,465			$59,465
8	$33,870			$33,870
9	$73,000	$73,000		
10	$72,606	$72,606		
11	$72,466		$7,466	$65,000
12	$71,695	$65,000	$6,695	
13	$58,294	$58,294		
14	$52,048			$52,048
15	$63,000			$63,000
16	$69,009	$69,009		
17	$71,282			$71,282
18	$63,522	$63,522		
19	$64,320		$245	$64,075
20	$61,019	$61,019		
21	$64,083			$64,083
22	$64,240	$64,240		
23	$29,614	$29,614		
24	$33,017	$33,017		
25	$65,522		$116	$65,406
26	$67,070			$67,070
27	$65,000[10]			$65,000
28	$73,865		$279	$73,586
29	$75,000			$75,000
30	$70,093	$70,093		
31	$72,875		$72,875	
32	$75,000		$10,000	$65,000
33	$75,000		$10,000	$65,000
34	$65,000[11]		$65,000	
35	$66,077		$1,998	$64,079
36	$73,467	$65,000	$8,467	
Totals	**$2,302,609**	**$831,950**	**$268,415**	**$1,202,244**

[10] Program participant did not receive a closing cost grant award.
[11] Program participant did not receive a closing cost grant award.