



Issue Date May 26, 2010

Audit Report Number 2010-KC-1004

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

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The State of Iowa Did Not Implement Adequate Controls Over Its Business Rental Assistance Program

HIGHLIGHTS

What We Audited and Why

We audited the State of Iowa's (State) business rental assistance program (program). Our objective was to determine whether the State ensured that the City of Cedar Rapids (City) provided rental assistance to eligible businesses based on appropriate leases.

We audited the State because it received \$799 million in disaster funding from the U.S. Department of Housing and Urban Development (HUD). The funding was comprised of \$282 million through the Community Development Block Grant (CDBG) program in 2008 and an additional \$517 million in disaster aid in 2009 to help it recover from the floods of 2008.

What We Found

The State did not implement adequate controls over its program. It did not provide adequate guidance for determining whether leases were market rate. It also did not perform a complete duplicate benefits check to verify that the businesses did not receive duplicate benefits from any other program, insurance,

or source before awarding the disaster assistance funds. In addition, it did not perform onsite monitoring reviews to evaluate program operations.

What We Recommend

We recommend that the Director, Disaster Recovery and Special Issues Division, require the State to provide documentation to support that program funds were properly paid or reimburse the CDBG program from non-Federal sources any amounts that it cannot support. We also recommend that the Director require the State to implement adequate controls over the program.

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 the State on April 30, 2010, and requested a response by May 17, 2010. The State provided written comments on May 17, 2010.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

In the late spring and early summer of 2008, Iowa suffered a series of tornados followed by massive floods. In some cases, the same community was hit by both events. Cedar Rapids, Iowa's second largest city, was especially hard hit. An estimated 2,400 businesses were damaged physically, and more than 3,000 others suffered economic losses.

On May 27, 2008, the Federal Emergency Management Agency (FEMA) declared various counties in Iowa as disaster areas as a result of severe storms, tornadoes, and flooding. The disaster declaration allowed those counties to receive Federal aid from FEMA, the Small Business Administration (SBA), and the U.S. Army Corp of Engineers.

The State of Iowa (State) was awarded \$282 million in disaster funding through the Community Development Block Grant (CDBG) program in 2008 and an additional \$517 million in disaster aid in 2009 to help it recover from the floods, bringing the State's total disaster funding to \$799 million.

The Iowa Department of Economic Development (Department) was tasked with administering the disaster recovery activities of the State. The Department's mission is to enhance the economic development of the State and provide for job creation and increased prosperity and opportunities for the citizens of the State by providing direct financial and technical assistance and training to businesses and individuals and by coordinating other State, local, and Federal economic development programs. The Department has a nine-member voting board appointed by the governor and seven ex officio nonvoting members and is administered by an executive director who is appointed by the governor.

The Department contracted with the City of Cedar Rapids (City) to administer the \$7.5 million business rental assistance program (program). The City in turn subcontracted the administration of the program. The program was meant to provide financial assistance to businesses located in or planning to locate in a business rental space that was physically damaged by the 2008 natural disaster(s) and which had entered into or intended to enter into a minimum 1-year, market-rate lease. An eligible business could receive up to 6 months of rental assistance to help offset building rental lease payments. Each business could receive a maximum of \$50,000

This is our second audit of the State's disaster funding. Our first audit identified that the State awarded more than \$10 million of its CDBG disaster funding without adequate documentation and did not perform adequate checks for duplicate benefits before awarding the funds (report number 2010-KC-1001, dated March 10, 2010).

Our objective was to determine whether the State ensured that the City provided rental assistance to eligible businesses based on appropriate leases.

RESULTS OF AUDIT

Finding 1: The State Did Not Implement Adequate Controls Over Its Program

The State did not implement adequate controls over its program. This condition occurred because the State implemented the program quickly due to urgent needs resulting from the floods. As a result, the State did not know whether the amounts of the City's awards were correct or whether they were made to eligible recipients.

Lack of Guidance

The State did not provide adequate guidance for administering the program in compliance with the requirements. Iowa State law and the U.S. Department of Housing and Urban Development (HUD)-approved action plan specify that to be eligible for the program, a business must have entered into or intend to enter into a minimum 1-year, market-rate lease.

The State did not provide adequate guidance for determining whether leases were market rate. The guidance should have included or instructed the City to develop a standard market-rate lease matrix showing a range of reasonable lease rates considering various factors. These factors could include the type of space, class of space, and the property location. In addition, the State did not instruct the City to obtain the necessary information from the applicants. To determine whether a lease is market rate, the City needed to obtain the lease amount, total square feet being leased, type/class of space, and location/area of the property. Finally, the guidance should have instructed the City to analyze and compare the price per square foot to the standard to determine whether it was market rate.

Incomplete Duplication of Benefits Check

The State did not adequately verify that the businesses did not receive duplicate benefits through any other program, insurance, or source before awarding disaster assistance funds. This verification is necessary to satisfy the Stafford Act, which provides that no business will receive assistance for any loss for which it has already received financial assistance. The State did check with SBA and did not find any duplication of benefits. However, this SBA check was not complete because it did not address funding received from insurance companies and other sources of funding.

Lack of On-Site Monitoring

The State did not perform onsite monitoring reviews to evaluate program operations. Monitoring needs to occur in the ordinary course of operations and includes regular management and supervisory activities and other actions needed to assess the quality of the internal control system. Management needs appropriate procedures in place to monitor on an ongoing basis or to periodically evaluate the administration and effectiveness of the program.

Inadequate State Oversight Caused by Urgent Need

The program was a new program that had to be implemented quickly because of the urgent needs resulting from the floods. This program was a learning experience for the State, which believed that it could contract with local entities for proper administration of the program. The State felt that the local entities could do the best job of establishing market-rate criteria, since lease rates vary based on locale. The State did not provide the local entity with guidance on determining fair-market leases but did ask that administrative entities document their files. Additionally, the State believed that its desktop monitoring of the program activities was sufficient. Finally, the State was in the process of developing a duplication of benefit system that addressed insurance and other sources of funding at the time it disbursed program funds.

Eligibility of Recipients in Doubt

The State did not know whether the amounts of the City's awards were correct or whether they were made to eligible recipients.

Our review of a sample of recipient files found that none of the files contained a market-rate analysis. In addition, some files contained no square footage information, and many of these same files contained no explanation or analysis of possible identity-of-interest relationships between the lessor and lessee. The City's subcontractor administering the program indicated that these results were representative of how the files were processed. The subcontractor did not require applicants to supply the square footage information but did have the square footage in the applicants' files if it was a part of the lease. Further, the subcontractor did not perform a lease-per-square-foot calculation or determine whether it was market rate. However, the subcontractor stated that it had identified one applicant who had an identity of interest with the lessor, whose lease was for \$120 per square foot. The subcontractor negotiated this amount down to \$17 per square foot, which it believed to be a good market rate. While this was a positive step, since the subcontractor did not routinely calculate lease

per square foot, there may have been other applicants with very high lease amounts. Also, there was no documentation showing whether the new per-square-foot cost was market rate.

Further, the State did not know whether awards were made to recipients that had unreimbursed needs. The applicants may have been ineligible for further amounts if insurance or other sources had already provided sufficient funds to cover their needs.

Recommendations

We recommend that the Director of the Disaster Recovery Assistance and Special Issues Division require the State to

- 1A. Provide documentation to support that program funds were paid to businesses having a minimum 1-year, market-rate lease as required by the Iowa Administrative Code or reimburse the CDBG program from non-Federal sources for amounts that it cannot support.
- 1B. Develop and implement improved controls over the program.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed applicable Code of Federal Regulations requirements, the Stafford Act, Office of Management and Budget circulars, HUD handbooks, waivers, guides and manuals, applicable sections of the Iowa Administrative Code, State duplication of benefits procedures, relevant audit reports, applicable contracts, agreements, and the program's applicant files. We also interviewed applicable State and City contractor staff.

The State had paid more than \$4.5 million in program funds to the City as of January 2010. We reviewed 20 business rental assistance applications funded by the City to determine whether they contained sufficient support regarding market-rate leases, identity-of-interest issues, and low and moderate income status.

During the audit, we obtained computerized spreadsheets showing program funding activities, and we used these data for background purposes only.

We performed audit work from January through March 2010 at the Department's office at 200 East Grand Avenue, Des Moines, IA, and at the Corridor Company Works office at 222 3rd Street SE, Suite 600, Cedar Rapids, IA. Our audit period generally covered May 2009 through January 2010.

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 an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 to ensure that CDBG funds were disbursed only to businesses with eligible leases.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- The State did not have adequate controls in place to ensure that CDBG funds were disbursed only to eligible recipients.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



May 17, 2010

Mr. Ronald J. Hosking
Regional Inspector General for Audit
U.S. Dept. of Housing and Urban Development
Office of Inspector General
Region VII Office of Audit
Gateway Tower II – 5th Floor
400 State Avenue
Kansas City, Kansas 66101-2406

Dear Mr. Hosking:

The Iowa Department of Economic Development manages the State of Iowa's Community Development Block Grant disaster assistance program under an agreement with the U.S. Department of Housing and Urban Development (HUD). This letter will provide comments on the Discussion Draft Audit Report (Report) prepared by HUD's Office of Inspector General (HUD OIG), which was received under cover of a letter from you dated April 30, 2010.

Our review of the Report reveals five significant issues/recommendations identified by HUD OIG in the report. We have provided our comments on each, grouping our comments to the first three issues because of their similarities. They are as follows:

Issue 1: The Report finds that the State did not provide adequate guidance for administering the program (Business Rental Assistance Program, BRAP) in compliance with the requirements.

Issue 2: The Report finds that the State did not provide the local entities with guidance on determining fair-market leases under BRAP.

Issue 3: The Report finds that the State did not know whether the amounts of the City's awards were correct or whether they were made to eligible recipients.

State's Response to Issues 1-3: In the initial roll-out of the program, through weekly teleconferences, the state provided our administrative entities with verbal guidance to determine what constitutes a market rate lease for the BRAP program applicants. We determined it would be the responsibility of the local communities to determine the market lease rate for their particular communities. The decision to defer to the local community was thought to take into consideration the variety of commercial property market levels that exist in the state rather than encumber all communities with a one size fits all approach. The State disagrees with the statement that there are no controls to ensure leases are market rate. The State adopted rules using the term "market rate" to ensure it could disallow unsupported awards.

The State is requiring the administrative entities to update files to include how a market rate lease was determined. Each BRAP file must provide evidence (checklist/statement) that the administrative entity has reviewed the lease and determined it to be "market rate" based upon a process or methodology developed by the administrative entity. This methodology should specify lease rates which may be square foot based for an area or by types of buildings (e.g. retail, class A commercial etc.) and the file should be documented. Some administrative entities

Chester J. Culver, Governor**IOWA DEPARTMENT OF ECONOMIC DEVELOPMENT**Patty Judge, Lieutenant Governor

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Comment 1

have subcontracted this work to a private party, who is responsible to perform such obligations on behalf of the administrative entity.

The State will also require that the file is documented to disclose any identity-of-interest relationships between the lessor and lessee.

Issue 4: The State did not verify that the businesses did not receive duplicate benefits through programs outside the programs reviewed by the Small Business Administration (SBA), such as insurance and some private funds before awarding disaster assistance.

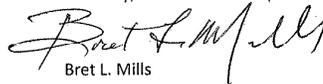
The State's Response to Issue 4: The State had utilized SBA to determine whether there were any duplication of benefits with its applicants. When the state learned the SBA check was not as comprehensive as required, the State developed a more comprehensive duplication of benefits check for future applicants as well as a method to update the duplication of benefits checks for prior recipients. At the time of the monitoring visit, the State had put a process in place for businesses that have previously received benefits under the State's business programs that apply for new business programs with the State. When a business applies for another business program a duplication of benefits determination will be made of their need in order to ascertain: (1) - if they qualify for the additional assistance, and (2) whether they correctly received previous awards. For those businesses that have received benefits previously and do not apply for additional programs, the administrative entities will contact them to complete the duplication of benefits process and a determination will be made as to whether they correctly received previous awards. We will be working closely with our administrative entities and their subcontractors to perform these checks.

Issue 5: The Report finds that the State did not perform onsite monitoring reviews to evaluate program operations.

The State's Response to Issue 5: The State is conducting desk top eligibility reviews on each applicant prior to disbursing funds. The Report did not appear to reflect this review process, which is enhanced through the use of our online database system (Service Point) that provides administrative entities with the ability to upload program documents, including leases, for the State's immediate and complete review. The State's ability to review every application in real time provides greater scrutiny of these activities. The State also plans to follow up with onsite monitoring visits to our administrative entities and their contractors.

Thank you for your consideration of these comments as you draft your Final Report.

Sincerely,



Bret L. Mills

Director

Comment 2

Comment 3

OIG Evaluation of Auditee Comments

- Comment 1** As a result of our audit, the State has agreed to require administrative entities to update their files providing evidence that the lease has been analyzed and determined to be market rate. If the lease amounts are found to be market rate, this will satisfy recommendation 1A.
- Comment 2** We acknowledge the State for developing a more comprehensive duplication of benefits check for both future applicants and prior recipients upon learning that the SBA check was not as comprehensive as required.
- Comment 3** While the State did conduct remote monitoring of this program, it did not identify the fact that the contractor was not evaluating whether leases were market-rate and did not have the necessary information to make that evaluation. We support the State's plans to follow up with onsite monitoring visits.

Appendix B

CRITERIA

Iowa Administrative Code

Section 261, paragraph 79.1(15), states that the purpose of the disaster recovery business rental assistance program is to provide financial assistance to a business located in or planning to locate in a business rental space that was physically damaged by the 2008 natural disaster(s). Assistance will be in the form of rental assistance to help offset building rental lease payments for a maximum of 6 months, not to exceed a total award amount of \$50,000. In-home businesses are not eligible for the funds.

261—79.3(1) An eligible business is a business that:

- a. Is located in or planning to locate in a business rental space that was physically damaged by the 2008 natural disaster(s); and
- b. Has entered into or intends to enter into a minimum one-year, market-rate lease.

261—79.4(1) An eligible business may apply for rental assistance to help offset building rental lease payments for a maximum of six months.

261—79.4(2) The maximum amount of program funds available for rental assistance per business is the equivalent of six months' rent up to a maximum of \$50,000.

Robert T. Stafford Disaster Relief and Emergency Assistance Act, Public Law 93-288, as Amended, 42 U.S.C. (United States Code) 5121-5207

Section 312. Duplication of Benefits (42 U.S.C. 5155) states:

- (a) General prohibition - The President, in consultation with the head of each Federal agency administering any program providing financial assistance to persons, business concerns, or other entities suffering losses as a result of a major disaster or emergency, shall assure that no such person, business concern, or other entity will receive such assistance with respect to any part of such loss as to which he has received financial assistance under any other program or from insurance or any other source.
- (c) Recovery of duplicative benefits - A person receiving Federal assistance for a major disaster or emergency shall be liable to the United States to the extent that such assistance duplicates benefits available to the person for the same purpose.