



North Carolina Department of Commerce, Raleigh, NC

Small Cities Community Development Block Grant

**Office of Audit, Region 4
Atlanta, GA**

**Audit Report Number: 2018-AT-1003
April 16, 2018**



To: Matthew King, Director, Office of Community Planning and Development, 4FD

//Signed//

From: Nikita N. Irons, Regional Inspector General for Audit, 4AGA

Subject: The North Carolina Department of Commerce, Raleigh, NC, Generally Administered Its Grant Program in Accordance With HUD Regulations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the North Carolina Small Cities Community Development Block Grant.

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 8M, requires that OIG post its publicly available reports on the OIG website. 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.



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The North Carolina Department of Commerce, Raleigh, NC, Generally Administered Its Grant Program in Accordance With HUD Regulations

Highlights

What We Audited and Why

We audited the North Carolina Department of Commerce's Small Cities Community Development Block Grant (CDBG). We began our review of the Department of Commerce's administration of its CDBG program because it aligns with a goal in the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's annual audit plan to improve HUD's execution of and accountability for grant funds. Our audit objectives were to determine whether the Department of Commerce (1) awarded funds to local governments that met a CDBG national objective, (2) spent funds only for activities that were eligible and supported, and (3) included all methods of distribution in its action plan.

What We Found

The Department of Commerce generally administered its Small Cities CDBG funds in accordance with HUD regulations. It ensured that each activity reviewed met its national objective and was eligible and that funds were supported and used for eligible expenses. However, it did not include the Main Street Revitalization grant program as a part of its 2015 annual action plan method of distribution as required. This condition occurred because Department of Commerce management did not follow the requirement. It believed the grant program was similar to other programs identified in the action plan and no amendment was necessary. As a result, the Department of Commerce was not transparent to the public and did not consistently allow citizens an opportunity to provide input on the distribution of Federal funds.

What We Recommend

We recommend that the HUD Director of the Greensboro Office of Community Planning and Development require the North Carolina Department of Commerce to (1) amend its 2015 annual action plan to include the Main Street Revitalization program and (2) implement controls and procedures to ensure that all future action plans include all methods of distributing grant funds or amend the plan as required if programs are added after approval.

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Background and Objectives

Under the State Community Development Block Grant (CDBG) program, States award grants to smaller units of general local government that develop and preserve decent, affordable housing to provide services to the most vulnerable in our communities and to create and retain jobs. Annually, each State develops funding priorities and criteria for selecting projects. Since States are in the best position to know and respond to the needs of local governments, Congress amended the Housing and Community Development Act of 1974 in 1981 to give each State the opportunity to administer its CDBG funds for nonentitlement areas. Nonentitlement areas include those units of general local government that do not receive CDBG funds directly from the U.S. Department of Housing and Urban Development (HUD). Nonentitlement areas are cities with populations of less than 50,000 (except cities that are designated as principal cities of metropolitan statistical areas) and counties with populations of less than 200,000.

North Carolina General Statutes 143B-431(d)(3) gave the North Carolina Department of Commerce authority to pledge current and future Federal fund appropriations to the State from the CDBG program. The Department of Commerce's Division of Community Assistance administered the CDBG program until it was reorganized in 2013 to become the Rural Economic Development Division. In 2013, the General Assembly of North Carolina mandated, through legislation,¹ that CDBG funds be divided between the Department of Commerce and the Department of Environmental Quality, formerly the Department of Environment and Natural Resources. The Department of Commerce would distribute grant funds to local governments pertaining to economic development, while the Department of Environmental Quality would distribute grant funds concerning infrastructure. The Department of Commerce² serves as the grantee for the State of North Carolina and is ultimately responsible for the administration of CDBG funds.

The Department of Commerce received more than \$174 million in CDBG funding for fiscal years 2013-2016. As of February 20, 2018, it had drawn down more than \$35 million and had more than \$139 million available to draw.³

Our audit objectives were to determine whether the Department of Commerce (1) awarded funds to local governments that met a CDBG national objective, (2) spent funds only for activities that were eligible and supported, and (3) included all methods of distribution in its action plan.

¹ North Carolina Sessions Laws 2013-363 states that the Federal block grant funds allocated to the infrastructure category must be transferred from the Department of Commerce to the Department of Environment and Natural Resources.

² The Community Development Block Grant Programs Department of the Rural Economic Development Division of the North Carolina Department of Commerce is responsible for administering the State CDBG program.

³ The North Carolina Department of Commerce received more than \$43 million for its 2017 CDBG funding on September 25, 2017.

Results of Audit

Finding 1: The Department of Commerce Generally Administered Its Grant Program in Accordance With HUD Regulations

The Department of Commerce ensured that each CDBG activity met its national objective and that funds were used for eligible expenses and supported. However, it did not include the Main Street Revitalization grant program as a part of its 2015 annual action plan method of distribution as required. This condition occurred because Department of Commerce management did not follow the requirement. It believed the grant program was similar to other programs identified in the action plan and no amendment was necessary. As a result, the Department of Commerce was not transparent to the public and did not consistently allow citizens an opportunity to provide input on the distribution of Federal funds.

Grant Activities Met National Objectives, Were Eligible, and Were Properly Supported

The Department of Commerce's CDBG activities reviewed (see appendix A) properly met a national objective, and the funds were eligible and properly supported. We reviewed five activities that received more than \$12 million in CDBG funds. All five activities met the national objective of either low-and-moderate-income clientele, job creation, or low-and-moderate-income area. All five projects were also eligible to receive grant funds because the Department of Commerce's action plans allocated funds to be used for both economic development and infrastructure. In addition, all five projects were properly supported by drawdown requests and invoices.

The Main Street Program Was Not Included in the Annual Action Plan

The Department of Commerce did not always distribute grant funds according to its 2015 action plan. Specifically, it did not include the Main Street Revitalization grant program as a part of its 2015 annual action plan method of distribution. According to 24 CFR (Code of Federal Regulations) 91.320(k)(1), the action plan must set forth the Department of Commerce's method of distribution and include a description of how all CDBG resources will be allocated among funding categories and the threshold factors and grant size limits that are to be applied.

According to Department of Commerce staff, the former Assistant Secretary for Commerce suggested that the staff use the grant funds for the Main Street Revitalization program because it was difficult to meet the 80 percent deadline for the timely obligation of CDBG funds. The Main Street Revitalization grant program was designed to return vacant or underused commercial buildings to economic use for new or expanded businesses. The goal of the program was to prevent or eliminate urban blight. To receive this grant, a local government must partner with a private for-profit business to submit a project to renovate a vacant or underused downtown building for commercial or mixed-use development. Grants were awarded at a maximum of \$500,000. The Department of Commerce awarded 14 Main Street Revitalization grants totaling more than \$6 million, using fiscal year 2015 grant funds. As of January 29, 2018,

more than \$1.3 million had been spent, and \$450,000 had been deobligated, leaving a balance of more than \$4.2 million.

Although the Main Street Revitalization program is considered an eligible use of fiscal year 2015 funds, the Department of Commerce did not identify this program or the method of distribution in its annual action plan. The economic development section of the Department of Commerce's 2015 annual action plan had opportunities listed for cities and towns, which included revolving loan funds and grants (forgivable loans) for businesses that restored vacant buildings and resulted in the creation or retention of permanent, full-time jobs by the company. These grant amounts were to be calculated based on a per job rate for businesses and tax credit eligibility. However, the Main Street Revitalization grant was designated for main street and small town main street communities, and the grant amounts were not based on per job rates or tax credit eligibility.

Although this program was not initially included in the action plan, Department of Commerce management had the opportunity to amend its action plan but did not follow the requirements because it believed the grant program was similar to other programs identified in the action plan. Consolidated plan regulations at 24 CFR 91.505(a) require that a jurisdiction amend its approved plan whenever it makes a change in its allocation priorities or the method of distribution of funds.

Conclusion

The Department of Commerce did not always distribute CDBG funds according to its 2015 action plan as required. Since management believed the Main Street grant program was similar to other programs identified in the action plan, it did not amend its action plan as required. Consequently, the Department of Commerce was not transparent to the public and did not consistently allow citizens an opportunity to provide input on how the grant funds were distributed.

Recommendations

We recommend that the HUD Director of the Greensboro Office of Community Planning and Development require the Department of Commerce to

- 1A. Amend its 2015 annual action plan to include the Main Street Revitalization program.
- 1B. Implement controls and procedures to ensure that all future action plans include all methods of distributing grant funds or amend the plan as required if programs are added after approval.

Scope and Methodology

We performed our fieldwork at the North Carolina Department of Commerce at 301 North Wilmington Street, Raleigh, NC. We performed our audit work from August 2017 through February 2018. Our audit period was October 1, 2012, through September 30, 2016. We expanded the audit period as needed to accomplish our objectives.

To accomplish our objectives, we

- Reviewed and obtained an understanding of the Department of Commerce’s policies and procedures, relevant laws, regulations, grant agreements with HUD, and HUD’s guidance.
- Obtained and reviewed Department of Commerce organization charts.
- Reviewed HUD monitoring reports.
- Reviewed the Department of Commerce’s annual action plans and consolidated annual performance and evaluation reports for its fiscal years 2012 through 2016.
- Reviewed the Department of Commerce’s audit and internal reports for its fiscal years 2013 through 2015.
- Reviewed CDBG project applications, activity files, and financial documents, including but not limited to financial statements, vendor invoices, and drawdown requests.
- Interviewed Department of Commerce employees, subgrantees, and HUD staff.

We selected five CDBG activities awarded during our audit period to determine whether they met the national objectives and were eligible and whether funds were used for eligible expenses and supported. We selected three activities that were categorized under economic development, while the remaining two were selected to ensure that we reviewed activities associated with infrastructure. We randomly selected one infrastructure activity from fiscal year 2014 and one from fiscal year 2015. These five activities totaled more than \$12 million in grant funds.

We selected a nonstatistical sample of five Main Street Revitalization grants totaling \$2.15 million to determine whether the Department of Commerce distributed CDBG funds that were not identified in its action plan. The Department of Commerce awarded 14 Main Street Revitalization grants totaling more than \$6 million, using fiscal year 2015 grant funds. This amount represented approximately 36 percent of the Main Street grant universe.

The results of the audit apply only to items selected for review and cannot be projected to the universe or population.

We relied in part on computer-processed data in the Department of Commerce’s system to achieve our audit objective. Although we did not perform detailed assessments of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes. The tests for reliability included but were not limited to comparing computer-processed data to vendor payments, financial records, and other supporting documentation.

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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that file maintenance, expenditure, and financial reporting activities are conducted in accordance with applicable laws and regulations.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that expenditure and financial reporting activities comply with applicable laws and regulations.

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 Department of Commerce did not include the Main Street Revitalization grant program in its action plan (finding).

Appendixes

Appendix A

Department of Commerce Projects Reviewed

Project number	Recipient	Project activity	National objective	Grant amount
1	Town of Butner	Economic development	Low-and-moderate-income clientele	\$ 7,857,496
2	Polk County	Economic development	Job creation	211,387
3	Forest City	Economic development	Job creation	600,000
4	Town of Maxton	Infrastructure	Low-and-moderate-income area	2,600,000
5	Town of Dover	Infrastructure	Low-and-moderate-income area	737,200
Total				12,006,083

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1



ROY COOPER
Governor
ANTHONY M. COPELAND
Secretary
NAPOLEON WALLACE
Deputy Secretary

March 22, 2018

Ms. Nikita N. Irons
Regional Inspector General for Audit
Office of Audit (Region IV)
76 Spring Street SW., Room 330
Atlanta, Georgia 30303

Re: Office of Inspector General's audit of the NC Department Commerce
Small Cities Community Development Block Grant

Dear Ms. Irons:

In response to your letter dated March 8, 2018 and as a follow up to the meeting held on March 20, 2018 at NC Commerce and via conference call, we acknowledge review of the information pertaining to HUD's Office of Inspector General's audit. Commerce does not dispute the finding and will make the necessary changes based on recommendations noted in the letter as well as information conveyed at the meeting. Once we receive the final letter we will move forward with the changes.

Please let me know if I can provide any further information

Sincerely,

A handwritten signature in cursive script that reads "George Sherrill".

George Sherrill
Chief of Staff

OIG Evaluation of Auditee Comments

Comment 1 The Department of Commerce agreed to make the necessary changes based on the recommendations noted in the report once the report is final.

We acknowledge the Department of Commerce's agreement with our finding and recommendations. The Department of Commerce should make sure the required documentation is provided to HUD to clear the recommendations during the audit resolution process.