

Report Number: 1004595

Investigation Overview: On October 17, 2007, the Department of Commerce signed a \$2.3 million grant contract with a non-profit housing organization for the purchase of five parcels of land for the Hilltop Renaissance Community project in Tacoma. The contract was later amended to add additional funds to be used for architectural and engineering services, demolition, site preparation, construction management and equipment costs. The Department also awarded a \$400,000 loan to the non-profit through the Brownfields Program for cleanup of hazardous waste located on the property.

In August 2009, the Department became aware that the Executive Director and Chief Financial Officer of the non-profit had left the organization. The Department hired a certified public accountant (CPA) to determine if the non-profit had used the grant money in accordance with the terms of the contract. The CPA reviewed the financial records of the non-profit and the records of a subsidiary organization owned by the non-profit. The CPA found that the non-profit was either overpaid or mis-used funds totaling \$1.8 million. On October 8, 2009, the Department notified the State Auditor's Office (SAO) of the potential loss of public funds.

Using the work of the CPA, SAO determined that the Department had overpaid the non-profit \$1.8 million. The overpayment resulted from a lack of internal controls to ensure all contractor costs are allowable and funds used as intended.

Recommendation: The auditors recommended that the Department:

- Perform on-site financial reviews for all state and federal contracts to ensure information contractors report is accurate and grant money is used as intended. The information should be kept in accordance with records retention schedules.
- Additionally, all state and federal non-financial reviews such as on-site inspections to determine project completion status should be documented to support project costs.
- Ensure its programs communicate payment information to each other in instances in which they provide the same type of services.
- Consult with its legal counsel and determine how to recover the almost \$1.8 million owed to the state.
- Consult with its federal grantor to determine what actions should be taken regarding the \$50,380 brownfields loan payment.

Agency Response: The Department first became aware of the problems with the Hilltop Renaissance Community project in August 2009 and took immediate action to minimize risk for future capital projects. The Department agrees with the auditor's recommendations and has initiated corrective action, as follows:

Perform on-site financial reviews for all state and federal contracts. The Department currently performs on-site financial reviews for most of its state and federal contracts. The Community Services and Housing Division has implemented new standards for programs that perform project monitoring. Programs have agreed to standardized letters, communication with fund recipients, monitoring terms, checklists and follow-up procedures.

Document all state and federal non-financial reviews. All of the programs in the Community Services and Housing Division that involve capital expenditures perform on-site non-financial reviews, either during the project or after project completion. Some perform the non-financial review at the same time as the financial review, while others perform them separately depending on the timing and program requirements. The Department will determine how to improve non-financial reviews and what supporting information is appropriate to inspect and retain concerning project completion and expenditure of funds.

Ensure programs communicate payment information to each other. The Community Services and Housing Division now has quarterly meetings to discuss contractor risk issues across programs. Programs from other parts of the agency are included as appropriate.

Consult with legal counsel and determine how to recover the almost \$1.8 million owed to the state. The Department has been working with legal counsel over the past year to determine the best course of action to recover the funds. The Department has also been discussing several options with the non-profit to help them meet the original legislative intent and recover the funds.

Consult with federal grantor regarding the brownfields loan payment. The Department continues to keep the Environmental Protection Agency (EPA) Region 10 brownfields program manager updated about the status of the defaulted brownfields loan. Currently, EPA is allowing the Department to manage the negotiation. Loan cost recovery could potentially come through the non-profit or another party that acquires the cleaned property. The brownfields loan is secured by a first lien position on two of the project parcels.

In addition to the corrective action noted above, the Department commissioned an independent review and made changes to its Capital Programs contracting processes and documentation requirements for capital projects of \$250,000 or more that involve non-profits.

For non-profit projects that involve the acquisition of real property, construction, or major renovations, the Department requires a deed of trust and promissory note that favors the Department for a period lasting at least ten years following the date of the last payment of the grant. The deed of trust must be recorded in the county where the project is located and the original returned to the Department before any project funds will be released.

Additionally, Capital Project contractors must purchase an extended coverage lender's policy of title insurance insuring the Department lien position of the deed of trust in an amount not less than the amount of the grant.

Existing Capital Programs contract provisions relating to the establishment of property values have been amended as follows:

- When property is purchased from an independent third-party seller, the value of the property shall be evidenced by a current appraisal prepared by a licensed Washington state commercial real estate appraiser.

- When property is purchased from a non-profit's subsidiary organization, such as an affiliated LLC, the value of the property shall be evidenced by a current appraisal prepared by a licensed Washington state commercial real estate appraiser or the prior purchase price of the property plus holding costs, whichever is less.

Contracts are now required to contain a provision that enables the Department to recapture all funds disbursed under a Capital Programs contract in the event a grantee fails to perform in accordance with state or federal laws or any of the terms and conditions of the subject contract. Additionally, the Department can recover all contract funds disbursed to grantees when there is evidence of fraud or misrepresentation.

The Department also modified billing procedures to prevent double billings and nonpayment of vendors. In addition to providing proof that grantees have incurred project costs, Capital Programs now require that grantees submit proof that the vendors have actually been paid at the time the voucher is initially submitted or within 30 days thereafter.

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