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TO: Paul Webster
Director, Financial Management Division, DGBF

Gregory Hamilton
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FROM: D. Michael Beard
Regional Inspector General, 6AGA

SUBJECT: Audit of the City of New Orleans
Section 108 Program
Louisiana ArtWorks
New Orleans, Louisiana

INTRODUCTION

As part of our audit of the City of New Orleans, we audited the City of New Orleans' (City) Section 108 loan to the Louisiana Artists Guild to construct Louisiana Artworks. With respect to Louisiana Artworks, our audit objectives were to determine whether Louisiana ArtWorks will create enough low- and moderate-income jobs to justify the loan, expended funds for eligible purposes, and adequately documented its expenditures.

In accordance with HUD Handbook 2000.06, REV-3, within 60 days, please furnish this office, for each recommendation without a management decision, in this report, a status on: (1) corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued related to the audit.

We appreciate the assistance of your staff and officials with Louisiana Artworks and the City in performing our audit. Please call William W. Nixon, Assistant Regional Inspector General, at (817) 978-9309 if you or your staff has any questions.

SUMMARY

Both the City and the Louisiana Artists Guild stated systems were in place to ensure that Louisiana Artworks would create sufficient jobs for the \$7.1 million Section 108 loan.¹ We were persuaded by the responses and would suggest the City monitor Louisiana Artworks to ensure it creates the promised jobs. While Louisiana Artworks expended the vast majority of the funds reviewed properly, it overpaid the City's attorney by \$1,659 and could not support an additional \$17,723 paid to the attorney. Both the City and Louisiana Artworks agreed to support or recover the amounts. Further, Louisiana Artworks needs to strengthen controls over its procurement and administration of contracts. In one instance, Louisiana Artworks did not have a contract with a financial analyst and the expenditure appears to be duplicative. Louisiana ArtWorks should repay the \$3,000 that it paid the financial analyst.

BACKGROUND

On September 24, 2001, the Louisiana Artists Guild² applied to the City for a \$7.1 million Section 108 loan. HUD guaranteed the loan on February 6, 2002. The City and the Louisiana Artists Guild signed the loan agreement in July 2002. The Louisiana Artists Guild used the loan proceeds to develop and construct the Louisiana ArtWorks Project. According to the loan agreement, the Louisiana Artists Guild would construct Louisiana Artworks, an approximately 90,000-squarefoot multiple arts facility to provide shared and individual studio artist space, retail shops, and office space for the Louisiana Artists Guild and the Arts Council of New Orleans. In addition to the new construction, the project incorporated an existing historic structure and the restoration of an early 20th century commercial building facade. Louisiana Artworks is located at the corner of Howard Avenue and Carondelet Street in New Orleans, Louisiana.

As of March 31, 2004, the estimated total project costs for Louisiana Artworks was about \$29.4 million. Expenditures as of that date were:

¹ We raised the issue of Louisiana Artworks potentially not creating sufficient jobs in a draft report dated August 24, 2004. Based upon the responses and other evidence, we removed this finding from the final report.

² The Arts Council of New Orleans originated the Louisiana ArtWorks concept. It created the Louisiana Artists Guild to manage the Louisiana ArtWorks Project.

Source of Funds	Amount Available	Expended
<i>Federal</i>		
Section 108 loan	\$7,100,000	\$4,720,478
Institute of Museum and Library Services	\$ 173,863	\$ 173,863
Total Federal	\$7,273,863	\$4,894,341
<i>State of Louisiana</i>		
Whitney Bank line of credit	\$8,250,000	\$4,634,082
Contributions	\$2,000,000	\$1,000,000
Project totals	\$11,853,137	\$10,726,928
	\$29,377,000	\$21,255,351

Louisiana ArtWorks’ mission is to encourage the growth of small arts businesses and low-to-moderate-income artists by providing facilities, public access, and marketing strategies needed to successfully transition from artist to entrepreneur. According to the loan application, the project, upon completion, will meet the national objective of benefiting persons of low- and moderate-income through job creation.³

The Arts Council and Louisiana ArtWorks are both located at Suite 1712, 225 Baronne Street, in New Orleans, Louisiana. However, it is anticipated that they will move to Louisiana ArtWorks once completed.

AUDIT SCOPE

To accomplish our objectives, we performed the following audit procedures related to the City’s Section 108 Loan Program and Louisiana ArtWorks:

- Reviewed applicable HUD, City, and Louisiana ArtWorks regulations and procedures, specifically as the requirements relate to how HUD processed, approved, and disapproved Section 108 loan applications and how the City and Louisiana ArtWorks processed and managed this Section 108 loan;
- Interviewed HUD, City, and Louisiana ArtWorks personnel regarding Section 108 and Louisiana ArtWorks;
- Reviewed the City's and Louisiana ArtWorks’ management reports and other documents to identify indications of weaknesses;
- Reviewed and evaluated the loan application and attachments and other applicable documents;
- Reviewed and obtained a log of all draw requisitions for the Section 108 loan project;

³ 24 CFR §570.208(a)(4) Job creation is an activity designed to create or retain permanent jobs where at least 51 percent of the jobs, computed on a full-time equivalent basis, involves the employment of low- and moderate-income persons.

- Reviewed the City's and Louisiana ArtWorks' system for collecting and accounting for Section 108 loan repayments; and
- Reviewed and analyzed the loan status.

We reconciled all draws to the requisition log to confirm amounts, dates, and balances. To determine whether the City used the funds in accordance with HUD requirements, we reviewed \$2,102,191 (31 percent) of Louisiana ArtWorks' \$6,794,109 in draws as of April 22, 2004.

We initially selected the first three draws because they included examples of transactions with all of the contractors. We expanded our sample to include draws 4 through 7 to obtain a better coverage of the draw universe. We reviewed only 7 of the 14 draws because the universe was too large to review all transactions and statistical concepts were not appropriate.⁴ Additionally, we determined that draws 8 through 14 were primarily construction costs and were low risk due to our conclusions on other draws and review of procurements.

Louisiana ArtWorks did not provide any computer-generated data. However, it provided automated spreadsheets disclosing loan payments and draws. We tested the reliability of the data and did not note any problems affecting our audit objectives.

We provided a discussion draft on August 24, 2004, and held exit conferences with local HUD officials, Louisiana ArtWorks, and the City on September 2 and 3, 2004. We received responses from the Counsel to Louisiana Artists Guild,⁵ HUD headquarters,⁶ and the City of New Orleans.⁷ The responses addressed and resolved many of the issues. Consequently, we extensively revised the memorandum including removing the resolved issues. As such, we only incorporated germane comments from the City and Louisiana ArtWorks in the body of the memorandum.

Our audit generally covered the project development, construction, and operational activities regarding Section 108 funds during the period of July 2002 through April 2004. We expanded the scope when deemed necessary. We performed the audit from August 2003 to April 2004. We conducted the audit in accordance with generally accepted government auditing standards.

⁴ Since we did not perform a statistical selection, the ineligible and unsupported amounts cannot be extrapolated.

⁵ September 14, 2004.

⁶ September 15, 2004.

⁷ October 7, 2004.

RESULTS

Louisiana ArtWorks Paid \$19,382 in Ineligible and Unsupported Costs

Based on a nonstatistical review of seven draws totaling \$2,102,191,⁸ Louisiana ArtWorks over paid an attorney \$1,659 and could not support a \$17,723 payment to the attorney. The attorney overcharged Louisiana Artworks \$1,659 and included \$17,723 on an invoice without adequate support. According to Louisiana ArtWorks, the attorney represented the City in preparing HUD required paperwork for the Section 108 loan. While the attorney⁹ was under contract to the City, Louisiana ArtWorks paid the attorney directly for services rendered. According to the City's not to exceed \$400,000 contract, attorney fees were limited to \$150 per hour for attorney services, \$125 per hour for associate services, and \$50 per hour for paralegal services. However, a review of the attorney's invoices showed the attorney charged \$175 for attorney and associate services. Further, the attorney charged \$60 per hour for paralegal services. As a result, Louisiana ArtWorks paid excess charges totaling \$1,659 between March 31, 2001, and September 20, 2002. Additionally, Louisiana ArtWorks paid one invoice from the attorney which included a past due balance of \$17,723 without supporting documentation. Louisiana ArtWorks should repay the \$19,382 if it cannot support the costs.

Louisiana ArtWorks Needs to Strengthen Controls over Contracting

In several instances,¹⁰ Louisiana ArtWorks could not document its procurement of Section 108 contractors nor could it provide copies of the contracts with those firms. The City compounded the procurement problems by imposing geographical restrictions on the use of contractors and in some instances requiring Louisiana ArtWorks to use specific contractors including a construction consultant, an attorney, and a financial analyst. Louisiana ArtWorks and the City should better document its compliance with procurement requirements.

In one instance, the City attorney recommended and a City director insisted on using a specific financial analyst even though Louisiana ArtWorks already had a financial analyst under contract. Contrary to federal regulations,¹¹ the financial analyst recommended by the City attorney was not under contract with the City or Louisiana ArtWorks. Louisiana ArtWorks spent \$3,000 in Section 108 funds for the financial analyst's services. Because neither the City nor Louisiana ArtWorks contracted with the financial analyst and the

⁸ Between July 31, 2002, and April 22, 2004, Louisiana made 14 draws of Section 108 funds totaling \$6,794,109.

⁹ The same attorney was used on the Jazzland Theme Park. See Report number 2004-FW-1003, dated March 15, 2004: Audit of the City of New Orleans Section 108 Loan Program, Jazzland Theme Park, New Orleans, Louisiana.

¹⁰ More than \$150,000 prior to grant execution. The City and Louisiana ArtWorks noted the costs were in the applications and were for eligible activities. HUD indicated it would allow the costs if they were for eligible activities.

¹¹ 24 CFR §85.36.

services appear to be duplicative, the costs are ineligible, and Louisiana ArtWorks should repay the amount.

AUDITEE COMMENTS

Both the City and Louisiana ArtWorks agreed to support or repay the \$19,382 paid for legal fees. Neither the City nor Louisiana ArtWorks specifically addressed the \$3,000 paid to the financial analyst or the need for improved management controls.

EVALUATION OF AUDITEE COMMENTS

We appreciate the efforts of the City and Louisiana ArtWorks staffs to resolve the issues presented and are encouraged by their actions.

RECOMMENDATIONS

We recommend the New Orleans Community Planning and Development Director require the City to:

- 1A. Require Louisiana ArtWorks to repay the \$1,659 in excess charges for legal fees.
- 1B. Require Louisiana ArtWorks to repay the \$17,723 of unsupported funds paid to the attorney or provide adequate support.
- 1C. Establish necessary management controls to ensure compliance with procurement requirements, including maintaining a contract log, filing system, and procurement history.
- 1D. Require Louisiana ArtWorks to repay \$3,000 paid to the financial analyst for duplicative services.

INTERNAL CONTROLS

In planning and performing our audit, we obtained an understanding of the internal controls that were relevant to our audit. Management is responsible for establishing effective internal controls. Internal controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Internal controls include the processes for planning, organizing, directing, and controlling program operations. Internal controls include the systems for measuring, reporting, and monitoring program performance.

We determined the following internal controls were relevant to our audit objectives:

- Adequacy of controls over project operations;
- Management capability;
- Compliance with program requirements and procedures including procurement requirements;
- Documentation of compliance with program requirements and procedures including compliance with national objectives;
- Ensuring proper procurement of services;
- Safeguarding assets; and
- Assuring eligibility of expenditures.

A significant weakness exists if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against fraud, waste, and abuse; and that reliable data is obtained, maintained, and fairly disclosed in reports. We believe weaknesses existed in the following areas:

- Ensuring proper procurement of services and
- Eligibility of expenditures.

Prior Period Audit

This is our first audit of the City of New Orleans' Section 108 loan for the Louisiana ArtWorks Project, New Orleans, Louisiana. However, it is our second audit of a City of New Orleans Section 108 loan.

In our audit of the Section 108 loan for Jazzland Theme Park,¹² we concluded the City did not comply with Section 108 requirements regarding applicant eligibility, loan requirement, grant administration, and performance reviews. Further, the City paid \$7,685,703 in ineligible and unsupported expenditures. We cited poor management, lax oversight, and a failure to follow requirements, as the reasons this occurred. We made 14 recommendations including that the City support or repay the funds, and implement policies and procedures to ensure compliance with program requirements. HUD and the City are working to close the 11 recommendations still open.

¹² Audit of the City of New Orleans Section 108 Loan Program, Jazzland Theme Park, New Orleans, Louisiana, Report number 2004-FW-1003, dated March 15, 2004.

Schedule of Questioned Costs

<i>Recommendation</i>	<i>Ineligible¹</i>	<i>Unsupported²</i>
1A	\$1,659	
1B		\$17,723
1D	3,000	
Totals	\$4,659	\$17,723

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- 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 costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. 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.