# EXECUTIVE DEPARTMENT

# STATE OF LOUISIANA

FINANCIAL AUDIT SERVICES
MANAGEMENT LETTER
MARCH 14, 2018

**LOUISIANA LEGISLATIVE AUDITOR**
**1600 NORTH THIRD STREET**
**POST OFFICE BOX 94397**
**BATON ROUGE, LOUISIANA 70804-9397**

**LEGISLATIVE AUDITOR**
DARYL G. PURPERA, CPA, CFE

**ASSISTANT LEGISLATIVE AUDITOR**
**FOR STATE AUDIT SERVICES**
NICOLE B. EDMONSON, CIA, CGAP, MPA

**DIRECTOR OF FINANCIAL AUDIT**
ERNEST F. SUMMERVILLE, JR., CPA

# Louisiana Legislative Auditor

**Daryl G. Purpera, CPA, CFE**

## Executive Department

March 2018

*Audit Control # 80170024*

## Introduction

As a part of our audit of the State of Louisiana's Comprehensive Annual Financial Report (CAFR) and the Single Audit of the State of Louisiana (Single Audit) for the fiscal year ended June 30, 2017, we performed procedures at the Executive Department to provide assurances on financial information that is significant to the State's CAFR; evaluate the effectiveness of the Executive Department's internal controls over financial reporting and compliance; and determine whether the Executive Department complied with applicable laws and regulations. In addition, we determined whether management has taken actions to correct the findings reported in the prior year.

## Results of Our Procedures

### Follow-up on Prior-year Findings

Our auditors reviewed the status of the prior-year findings reported in the Executive Department management letter dated December 28, 2016. We determined that management has resolved the prior-year finding related to Inadequate Internal Audit Function. The prior-year findings related to Inadequate Grant Recovery of Homeowner Assistance Program (HAP) Awards, Inadequate Recovery of Small Rental Property Program (SRPP) Loans, and Inadequate Disaster Recovery and Business Continuity Planning have not been resolved and are addressed again in this letter.

Regarding the prior-year finding related to Misclassification of State Funds, the State continues to make annual payments on an obligation that was incurred to fund the purchase of equipment used to modernize a shipyard. Although the State received funding in 2011 as a settlement payment to cover this obligation, the funding was used for other purposes, and the State will continue to incur interest and administrative costs until the debt is defeased.

## Current-year Findings

### Inadequate Grant Recovery of Homeowner Assistance Program Awards

For the fiscal year ended June 30, 2017, the Division of Administration (DOA), Office of Community Development (OCD), Disaster Recovery Unit (DRU) identified $281 million in noncompliant HAP awards for 7,477 homeowners through post-award monitoring for the Community Development Block Grant/State's Program (CDBG). Because the noncompliant awards identified for grant recovery have not been recovered as of June 30, 2017, we consider these amounts as questioned costs. In addition, questioned costs from previous years totaling $788 million remain in recovery status.

Of the $8.9 billion total HAP awards disbursed as of June 30, 2017, 28,175 awards totaling $1.07 billion are in grant recovery. OCD states that as of October 19, 2017, 25,943 of these files have been submitted to a law firm to pursue collection efforts; 432 applicants have requested a plan for payment; 1,531 files are in review; and 269 files with obligations were paid off or were cleared since June 30, 2017.

OCD's failure to recover benefits from noncompliant homeowners could result in disallowed costs. The state could be liable for noncompliant awards if disallowed by the Federal grantor; however, it is unknown whether the Federal government would demand repayment of these awards.

In response to hurricanes Katrina and Rita, the State was awarded approximately $9.5 billion to administer HAP as part of the Road Home program, in accordance with its Action Plan approved by the U.S. Department of Housing and Urban Development (HUD). The State's Action Plan stipulates that eligible homeowners must agree in legally-binding documents, referred to as covenants, to follow through on certain future actions in exchange for up to $150,000 in compensation for their damaged property. Funds are disbursed to the homeowner upon the effective date of signing the covenant, which is referred to as the closing date. Homeowners agree in the covenant to provide OCD with evidence that they will occupy their damaged property or replacement property within three years of the closing date, maintain homeowner's insurance on their property, maintain flood insurance if necessary, and ensure that any required elevation conforms to the advisory base flood elevation regulation for the parish in which their home is located. The State's Action Plan states that homeowners who fail to meet all of the program's requirements may not receive benefits or may be required to repay all or some of the compensation received back to the program.

In the initial stages of the program, OCD focused on making payments to disaster victims as quickly as possible, because the state had made a decision to accept additional risks associated with expedited payments with the understanding that any ineligible or unallowable payments would be detected and corrected in post-award monitoring. Awards are included in grant recovery because of duplication of benefits (homeowner's insurance proceeds or other Federal assistance), lack of documentation evidencing owner-occupancy of the property, and noncompliance with one or more award covenants. In addition, individual homeowner awards

have been identified for grant recovery because of errors made by the program's former contractor, ICF International Inc., in determining the grant calculation or obtaining the required documentation.

In August 2015, HUD amended the grant terms and conditions to formalize a partnership between the State and HUD and created the Road Home closeout plan, which continues to address noncompliance. Additional opportunities allow for the review of awards to determine if any unmet needs or additional assistance is necessary for participants to return home, including reclassification of the Road Home Elevation Incentive award and allowing interim housing as an unmet need. OCD has forwarded noncompliant awards to a law firm for collection in accordance with the Road Home closeout plan.

OCD should continue its post-award monitoring process to identify awards to be placed in recovery and continue its recovery efforts to collect those awards determined to be noncompliant. OCD's response indicates concurrence with the finding stating that OCD anticipated providing a final determination to all noncompliant applicants regarding compliance by December 31, 2017, allowing OCD to shift resources from identifying noncompliant applicants into working more with homeowners to become compliant and resolve grant compliance issues (see Appendix A, pages 1-2).

**Inadequate Recovery of Small Rental Property Program Loans**

For the fiscal year ended June 30, 2017, OCD-DRU identified $28,144,386 in SRPP loans for 272 property owners under the CDBG Program who failed to comply with one or more of their loan agreement requirements and were assigned to loan recovery status. Since OCD has not recovered these loans, we consider these amounts totaling $28,144,386 to be questioned costs, which if disallowed could be due back to the Federal grantor. In addition, questioned costs from previous fiscal years totaling $68,571,287 remain in recovery status. Of the $439.4 million in SRPP outstanding loans at June 30, 2017, 1,088 loans totaling $96,715,673 are in recovery status. Of the 1,088 files, OCD is currently pursuing recoupment of loan amounts from 358 applicants using OCD's collection guidelines. OCD continues to work with the remaining applicants to bring them into compliance with the State's continuing requirements of the program.

In response to hurricanes Katrina and Rita, the State was awarded and has allocated approximately $649 million to the SRPP as part of the Road Home program. In accordance with the State's HUD-approved Action Plan Amendment 24, the SRPP offers forgivable loans to qualified property owners who agree to offer rental properties at affordable rents to be occupied by lower-income households. In exchange for accepting loans ranging between $10,000 and $100,000 per rental unit, property owners are required to accept limitations on rents and incomes of renters during an "affordability period," a specified period of time based on the amount of funding received and the type of work being done (renovation or full construction) ranging between three and 20 years. The loan amounts are determined based on location of property, number of bedrooms, and the poverty level of the renter. In addition to accepting limitations on rents and income of renters, property owners also agree to maintain property insurance and

maintain flood insurance, if necessary. These requirements become effective one year after the closing date and remain until the expiration of the "affordability period." According to the loan agreements, failure to comply with any of the loan requirements shall constitute default and mandatory repayment. Good internal controls would ensure that policies and procedures are in place with an established timeline to monitor compliance with the loan agreements and provide for specific actions (i.e., loan modification, foreclosure, or repayment) if a property owner fails to comply with the loan agreement or does not provide evidence of compliance as required by the loan agreement.

In June 2016, HUD issued a monitoring review report that included a finding that states the SRPP design lacks sufficient fiscal accounting controls and procedures to ensure that CDBG funds identified as ineligible expenses are able to be recaptured and repurposed for eligible uses. In March 2016, OCD began sending out demand letters on a quarterly basis to all applicants who have not met a national objective as per HUD guidelines, and OCD is communicating the progress of these efforts to HUD. In May 2017, HUD issued a monitoring report and provided a status update on the finding noting that Louisiana has made significant progress on reviewing the SRPP documentation and implementing the corrective actions described in the June 2016 monitoring report. HUD states it will continue to work with the State to determine final enforcement procedures and potential recapture amounts.

Ultimately, OCD's failure to take appropriate action to recover loans from noncompliant property owners could result in disallowed costs. OCD should continue its monitoring to identify awards to be placed in recovery and continue the corrective actions as recommended by HUD to recover funds from noncompliant property owners. Management stated in its response that it will continue the efforts to recover ineligible awards and will continue to work with rental property owners to become compliant and resolve grant compliance issues to reduce or eliminate the need to recapture funds from rental property owners (see Appendix A, pages 3-4).

**Inadequate Disaster Recovery and Business Continuity Planning**

For the second consecutive year, the Office of Technology Services (OTS) does not have a prioritized listing of critical services and applications for its user agencies and does not have identified personnel and resources within these agencies necessary for proper decision-making and execution of procedures in the event of a disaster. As a result, components of OTS' new disaster recovery plan that depend on agency continuity of operations plans may be inadequate or not fully executable.

On July 1, 2014, OTS was created as the centralized provider of Information Technology (IT) support services for executive cabinet agencies of state government and is designated as the sole authority for IT procurement. Without a prioritized list of critical agency services and applications, OTS cannot properly determine and restore each agency's systems and services in correct order, potentially causing costly delays if agency services cannot resume in the necessary timeframe. A lack of identified agency personnel and resources may lead to unperformed duties or unavailable system alternatives, such as hardware, software, or offsite locations.

OTS should continue to work with user agencies to perform business impact analysis on operations and determine the criticality and prioritization of their applications. When completed, agencies and OTS should (1) update their continuity of operations and disaster recovery plans accordingly; (2) distribute the plans to properly trained personnel; and (3) test the plans on at least an annual basis. Management did not concur with the finding, stating that each individual agency included in the consolidation of IT services was instructed to follow its existing disaster recovery and business continuity plans until OTS is able to complete a comprehensive plan (see Appendix A, pages 5-6).

**Additional Comments:** The existing plans at user agencies cannot properly account for changes to OTS' services since the consolidation; therefore, agency plans that rely on these services may be inadequate.

**Improper Authorization for Payment of Exempt Property Taxes**

OCD improperly authorized and provided CDBG funds for the payment of $196,389 in ad valorem property taxes on land and property in Orleans Parish obtained by the Louisiana Land Trust (LLT) under the Road Home program and subsequently transferred to the New Orleans Redevelopment Authority (NORA), which we consider questioned costs. These payments resulted in noncompliance with Federal regulations and increase the risk of disallowed costs that would require repayment to the Federal grantor.

Such property acquired by NORA from LLT would be statutorily deemed to be used for a public purpose and thus exempt from assessment and taxation while owned by NORA and LLT under Article VII, Section 21 of the Louisiana Constitution, which provides that public lands and other public property used for public purposes shall be exempt from ad valorem taxation. OCD contends that LLT is not a public entity and is not exempt from paying taxes.

OCD and LLT should seek an Attorney General opinion or a declaratory judgement regarding LLT's responsibility for the payment of ad valorem taxes and request reimbursement for taxes paid in error. Management did not concur with the finding and recommendation and provided a memorandum obtained from a law firm supporting the department's position that LLT is a private, nonprofit corporation and was responsible for the payment of ad valorem taxes (see Appendix A, pages 7-13).

**Additional Comments:** The legal opinion attached as a part of management's response asserts that LLT is a private nonprofit corporation and was responsible for the payment of ad valorem taxes since (1) it was not created by the Legislature, (2) LLT's powers are broader than those defined by the Legislature, (3) LLT's property does not belong to the public, and (4) LLT's functions are not exclusively of a public character performed solely for the benefit of the public.

We maintain that LLT is a public nonprofit entity for the following reasons: the Governor, by statute, appoints all members of its Board of Directors; LLT's creation was authorized by statute; LLT's powers and functions are established and restricted by statute; the Program properties acquired by LLT are funded through Federal Grant funds to which the State is the recipient; and

LLT's property is held on behalf of the State under the Program, and all of its property vests to the State upon its dissolution. Since the properties in question appear to be tax exempt public property while owned by LLT and NORA, any assessment of taxes on these properties appears to be null and void under State law. We continue to recommend that OCD and LLT seek an Attorney General opinion or a declaratory judgement regarding LLT's responsibility for the payment of ad valorem taxes.

## Comprehensive Annual Financial Report (CAFR) – State of Louisiana

As a part of our audit of the CAFR for the year ended June 30, 2017, we considered internal control over financial reporting and examined evidence supporting certain account balances and classes of transactions, as follows:

**Division of Administration (Agency 107):**

- Liabilities resulting from claims and litigations

**Division of Administration, Office of Facility Planning and Control (Agency 115):**

- Non-payroll expenditures
- Accrued payables
- Construction contracts and retainage payable
- Amounts held on deposit for others

**Louisiana GO Zone Loan Fund (Agency 862):**

- Notes receivable

We also evaluated certain controls and compliance relating to procurement at DOA, Office of State Procurement.

Based on the results of these procedures, we reported a finding related to Inadequate Disaster Recovery and Business Continuity Planning, which will also be included in the State of Louisiana's Single Audit Report for the fiscal year ended June 30, 2017. In addition, the account balances and classes of transactions tested are materially correct.

## Federal Compliance - Single Audit of the State of Louisiana

As a part of the Single Audit for the year ended June 30, 2017, we performed internal control and compliance testing as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) on the Executive Department's major federal program, as follows:

**Division of Administration, Office of Community Development**

Community Development Block Grants/State's Program (CFDA 14.228)

Those tests included evaluating the effectiveness of the Executive Department's internal controls designed to prevent or detect material noncompliance with program requirements and tests to determine whether the department complied with applicable program requirements. In addition, we performed procedures on information submitted by the department to the DOA's Office of Statewide Reporting and Accounting Policy for the preparation of the State's Schedule of Expenditures of Federal Awards (SEFA) and on the status of the prior-year findings for the preparation of the State's Summary Schedule of Prior Audit Findings, as required by Uniform Guidance.

Based on the results of these Single Audit procedures, we reported findings related to Inadequate Grant Recovery of Homeowner Assistance Program Awards, Inadequate Recovery of Small Rental Property Program Loans, and Improper Authorization for Payment of Exempt Property Taxes. These findings will also be included in the Single Audit for the year ended June 30, 2017. In addition, the department's information submitted for the preparation of the State's SEFA and the State's Summary Schedule of Prior Audit Findings is materially correct.

## Other Procedures

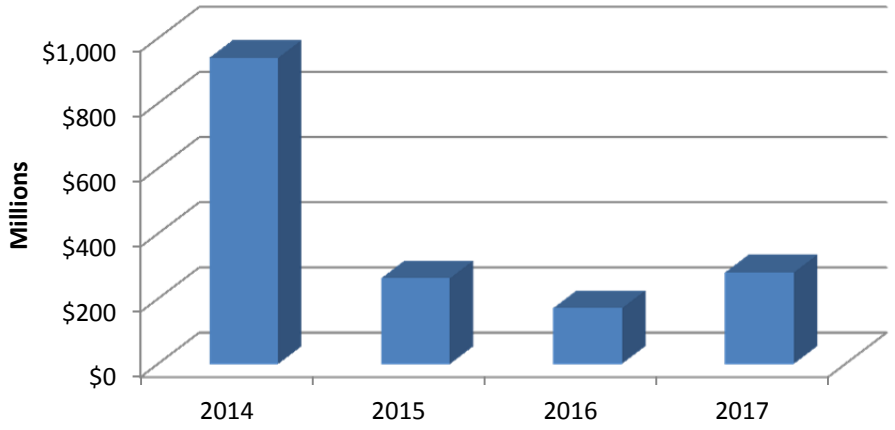
In addition to the CAFR and Single Audit procedures noted above, we performed certain procedures that included obtaining, documenting, and reviewing internal control and compliance with related laws and regulations over the internal audit function. Based on the results of these procedures performed, we found no issues or weaknesses that were required to be reported.

## Trend Analysis

We compared the most current and prior-year financial activity using the Executive Department's Annual Fiscal Reports and/or system-generated reports and obtained explanations from management for any significant variances. We also prepared an analysis of awards added to recovery for the CDBG-HAP (Exhibit 1) and SRPP programs (Exhibit 2) for fiscal years 2014 through 2017.

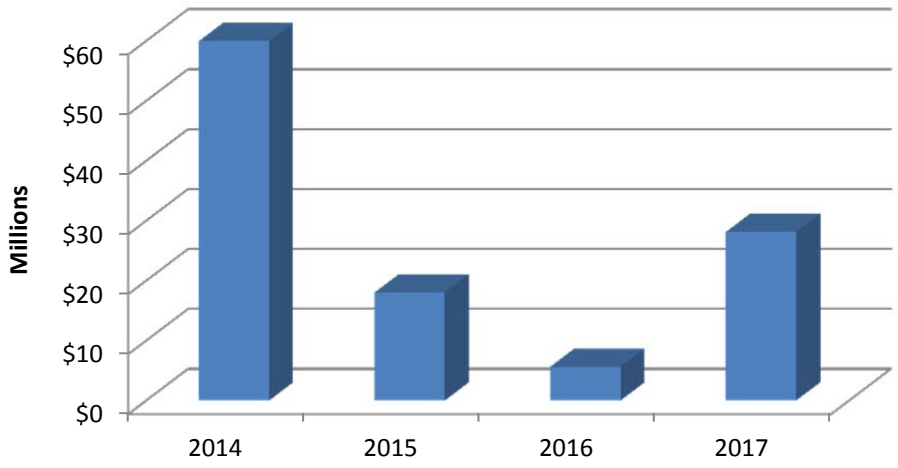
Since fiscal year 2014, both programs show a decline in amounts added to recovery; however, the 2017 increases are primarily due to a final determination being made as a result of being in the final stages of these programs. OCD-DRU has continued its monitoring to identify awards to be placed in recovery.

**Exhibit 1**
**HAP Awards Added to Recovery,**
**By Fiscal Year**




**Source:** OCD Grant Recapture Reports

**Exhibit 2**
**SRPP Awards Added to Recovery,**
**By Fiscal Year**

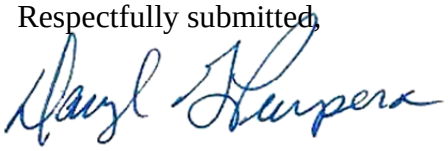



**Source:** OCD Loan Recovery Reports

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the department. The nature of the recommendations, their implementation costs, and their potential impact on the operations of the department should be considered in reaching decisions on courses of action. The findings related to compliance with applicable laws and regulations should be addressed immediately by management.

Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,



Daryl G. Purpera, CPA, CFE
Legislative Auditor

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EXECUTIVE 2017

# APPENDIX A: MANAGEMENT'S RESPONSES

Office of Community Development
Disaster Recovery Unit
State of Louisiana
Division of Administration

JOHN BEL EDWARDS
Governor

JAY DARDENNE
Commissioner of Administration

November 27, 2017

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804-9397

RE: Inadequate Grant Recovery of Homeowners Assistance Program Awards

Dear Mr. Purpera:

As requested in the Louisiana Legislative Auditor's letter dated Nov. 13, 2017, the Division of Administration's Office of Community Development, Disaster Recovery Unit (OCD-DRU) is submitting its response to the audit finding titled "Inadequate Grant Recovery of Homeowners Assistance Program Awards."

OCD-DRU continues to fulfill its obligations per the amended grant agreement and Road Home close-out plan, which was executed with HUD in August 2015. The amended grant terms and conditions formalized a partnership between the state and HUD to address noncompliance by some homeowners who received awards through the Homeowners Assistance Program. The additional opportunities allowed OCD-DRU to reclassify some or all of the Road Home Elevation Incentive awards for 80 percent of those applying, thus reducing non-compliance and questioned costs. The approval of APA 65, which allows for interim housing as an unmet need, has reduced recapture amounts for more than 350 homeowners, thus decreasing repayment amounts by $10 million to date. Finally, OCD-DRU has forwarded noncompliant awards to a law firm for collections, in accordance with the collection process.

The process outlined above has allowed OCD-DRU to identify noncompliant applicants. Once identified, applicants have numerous opportunities to bring the property into compliance, before a final determination is made. Although this is a thorough and lengthy process, OCD-DRU anticipates that all files will have completed the process, and all noncompliant applicants will receive a final determination regarding their compliance by December 31, 2017. This will allow OCD-DRU to shift resources from identifying noncompliant applicants into working with homeowners to become compliant and resolve grant compliance issues, thus reducing or eliminating the need to recapture funds from homeowners, where appropriate.

Edwin Legnon, OCD-DRU Director of Finance and Administration, is the contact person responsible for the corrective action. After HUD approval, the anticipated completion date for this corrective action plan will coincide with the closing of the HAP program.

If you have any questions or require additional information, please feel free to contact us.

Sincerely,

Patrick W. Forbes, P.E.
Executive Director

C: Jay Dardenne, Commissioner of Administration
Desireé Honoré Thomas, Assistant Commissioner of Statewide Services
Marsha Guedry, Internal Audit Administrator

Office of Community Development
Disaster Recovery Unit
State of Louisiana
Division of Administration

JOHN BEL EDWARDS
GOVERNOR

JAY DARDENNE
COMMISSIONER OF ADMINISTRATION

November 27, 2017

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804-9397

RE: Inadequate Recovery of Small Rental Property Program Loans

Dear Mr. Purpera:

As requested in the Legislative Auditor's letter dated Nov. 13, 2017, the Division of Administration, Office of Community Development, Disaster Recovery Unit (OCD-DRU) is submitting its response to the audit finding titled "Inadequate Recovery of Small Rental Property Program Loans."

OCD-DRU's primary focus for the Small Rental Property Program (SRPP) is to assist property owners in achieving and maintaining compliance, i.e., creating affordable housing, as opposed to foreclosure and/or recapture of funds. OCD-DRU has allocated approximately $649 million to the SRPP program to fund approximately 4,500 applicants and we maintain an ongoing monitoring process to ensure compliance.

In June 2016, OCD-DRU, working with the Louisiana Housing Corporation (LHC) and the U.S. Department of Housing and Urban Development (HUD), identified 397 SRPP applicants that did not meet a National Objective. As of June 30, 2017, of the 397 files identified, 35 files have since become compliant and funds have been recaptured from two files. OCD-DRU has initiated recapture efforts on all remaining 360 applicants. Notice of default letters have been sent to all 360 applicants. Our Legal Section has been handling all calls from non-compliant applicants and evaluating proposed workouts from the applicants. A total of 287 applicants have contacted OCD-DRU to discuss the borrower's options. These files are being processed to either reach compliance or identify another viable workout plan.

The remaining files identified by the Louisiana Legislative Auditor (LLA) as non-compliant have met a National Objective and have satisfied HUD's requirements; however, they have since become non-compliant with the guidelines of the state's continuing requirements of the program.[1] Both OCD-DRU and LHC continue to work with applicants to bring them into compliance.

In conclusion, OCD-DRU and LHC will continue the efforts to recover those awards determined to be ineligible, in accordance with policies and procedures that are acceptable to HUD. Concurrently, OCD-DRU will also continue to work with rental property owners to become compliant and to resolve loan compliance issues, thus increasing available affordable rental housing and reducing or eliminating the need to recapture funds from rental property owners, where appropriate.

The contact person responsible for the corrective action is Edwin Legnon, OCD-DRU Director of Finance and Administration. Once approved by HUD, the anticipated completion date for this corrective action plan will coincide with the closing of the SRPP program.

If you have questions or require additional information, please feel free to contact me.

Sincerely,

Patrick W. Forbes, P.E.
Executive Director

C: Jay Dardenne, Commissioner of Administration
Desireé Honoré Thomas, Assistant Commissioner of Statewide Services
Marsha Guedry, Internal Audit Administrator

[1]An important note with respect to these files is that since there have been periods of compliance, a portion of each loan is forgiven, reducing the amount outstanding and collectible on the loan.

Office of Technology Services
State of Louisiana
Division of Administration

JOHN BEL EDWARDS
GOVERNOR

JAY DARDENNE
COMMISSIONER OF ADMINISTRATION

December 6, 2017

Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Purpera,

In response to your letter dated December 1, 2017, we offer the following response to the audit finding titled "Inadequate Disaster Recovery and Business Continuity Planning." This finding results from an Information Technology (IT) audit of the Division of Administration's (DOA's) statewide IT systems to include the Office of Technology Services (OTS).

The DOA does not concur with the finding. Each individual agency included in the consolidation of IT services has continued to be instructed to follow their existing Disaster Recovery (DR) and Business Continuity Plans (BCPs) through the Agency Relationship Managers (ARMs) until OTS completes the labor intensive process of updating and provisioning a comprehensive OTS DR/BCP. As IT consolidation has progressed, data integrity and backup processes have continued and have even been improved. System availability has improved through existing DR processes that have been enhanced with additional infrastructure and redundancy across data centers.

OTS continues to perform a testing restoration on LaGov twice a year. In addition, a cold site has been established in Atlanta, Georgia in the event there is outage in the Data Center Operations (DCO) located in the Baton Rouge area.

OTS will continue to help document procedures that may be required to procure and provision IT equipment at alternate work locations. The DR/BCP team continues to review agency DR/BCP plans. This effort will include completing a business impact analysis (BIA) of the IT systems used by the executive branch agencies. The business impact analyses have been completed for the Department of Transportation and Development (DOTD), the Department of Natural Resources (DNR), the Coastal Protection and Restoration Authority (CPRA), the Louisiana Department of Revenue (LDR), Louisiana Economic Development (LED) and the Office of Financial Institutions (OFI). In addition, the Louisiana Department of Health (LDH) business impact analysis is approximately 60% completed and the Department of Education (DOE) analysis has commenced. The remaining agencies' agency relationship managers are continuing to compile information in anticipation of their business analysis interviews.

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As a result of the DOTD BIA which was completed in February 2017, the development of an overall disaster recovery plan for OTS in-scope agencies is being vetted. This overall plan will include redundancy between the two OTS datacenters, server virtualization, and hardening of the network service connectivity. Due to the scope of this endeavor, it is essential that OTS be allowed time to implement the best possible solutions for the systems it manages, to structure the DR plan as a line of service, and to systematically implement the solution so there will be no negative impacts to ongoing business operations. Complete documentation of the team's efforts will culminate in the release of a comprehensive DR/BCP plan that will include the overall responsibilities of OTS as it relates to DR/BCP.

In addition to the efforts referenced above, OTS has in place a comprehensive Incident Management and Problem Management Plan for the End User Computing Division of OTS. This plan was implemented in January 2017 and covers interruptions to services. It includes Classification of Incidents, a Communication Plan, Process Workflows, as well as contact lists, priority schema and roles for the incident response team. The Incident Management and Problem Management Plan is the fundamental starting point for any disaster recovery related activations.

We appreciate the opportunity to respond to this issue and welcome your continued recommendations and support to ensure that OTS continues to provide services based upon best practices.

Sincerely,

Richard Howze

Richard "Dickie" Howze
Chief Information Officer

Office of Community Development
Disaster Recovery Unit
State of Louisiana
Division of Administration

JOHN BEL EDWARDS
Governor

JAY DARDENNE
Commissioner of Administration

March 5, 2018

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804-9397

RE: Audit Finding Regarding Payment of Ad Valorem Taxes

Dear Mr. Purpera:

As requested in the Louisiana Legislative Auditor's letter dated Dec. 20, 2017, the Division of Administration's Office of Community Development, Disaster Recovery Unit (OCD-DRU) is submitting its response to the audit finding titled "Improper Authorization for Payment of Exempt Property Taxes."

OCD-DRU does not concur with the finding and recommendation. The Louisiana Land Trust – formerly known as the Road Home Corporation (LLT), is one of OCD-DRU's sub-recipients of Community Development Block Grant Funds. The LLA considers LLT to be a public entity and exempt from all ad valorem taxes. The LLA's position ignores express statutory language, is based on a flawed application of Louisiana jurisprudence, and is contrary to the very purpose for which the LLT was established, reducing the risk of liability and complications of having the state in the chain of title of properties involved in the Road Home Program.

Within the statutory framework that authorizes the involvement of the LLT in the Road Home Program, the Louisiana Legislature expressly disavows a public entity nature of the LLT:

As found at Revised Statute 40:600.62, in the definitions:

> (3) "Road Home Corporation" means the nonprofit corporation authorized to be formed by this Chapter, or any corporation succeeding to the principal functions thereof or to which the powers conferred upon the corporation by this Chapter shall be given by law. ***Such corporation may amend its articles of incorporation to change its name to Louisiana Land Trust. It is further declared that any such corporation shall not constitute a state agency, board, or commission; nor shall it constitute an instrumentality of the state or of any political subdivision.***

(Emphasis added)

Given that the LLT is expressly **not** a state entity, the Louisiana Legislature did specifically provide which laws apply to the LLT, at 40:600.35:

> § 600.35. Applicable laws to Road Home Corporation
>
> The Road Home Corporation shall be subject to the Public Records Law, the Open Meetings Law, and the Code of Governmental Ethics. The Road Home Corporation is subject to examination, audit, and review by the legislative auditor.

The Louisiana Attorney General has characterized this list an "exclusive and nonillustrative list of laws". La. Atty. Gen. Op. No. 08-0346 (2009). The LLA should not be seeking to expand the list in contravention of the statutes.

In connection with your audit finding, the Division of Administration requested an opinion from the law firm of Jones Walker with respect to the questions which your staff has raised regarding the potential of the Louisiana Land Trust being exempt from ad valorem taxes. Jones Walker issued a memorandum opinion dated February 7, 2018, a copy of which is attached. The opinion contains a brief history on the reason for the involvement of the LLT and legal analysis of the jurisprudence which your staff has indicates impacts the LLT. The opinion is consistent with the interpretation and practices of Louisiana Land Trust and the Office of Community Development Disaster Recovery Unit. We continue to be confident that the payment was an appropriate expenditure.

Edwin Legnon, OCD-DRU Director of Finance and Administration, is the contact person responsible for addressing this finding.

If you have any questions or require additional information, please feel free to contact us.

Sincerely,

Patrick W. Forbes, P.E.
Executive Director

Enclosure

C: Jay Dardenne, Commissioner of Administration
Desireé Honoré Thomas, Assistant Commissioner of Statewide Services
Marsha Guedry, Internal Audit Administrator

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**MEMORANDUM**

**To:** Rick McGimsey

**From:** Matthew W. Kern
Lauren E. De Witt

**Date:** February 7, 2018

**Re:** Louisiana Land Trust as a Private Entity

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Following Hurricanes Katrina and Rita in 2005, the State of Louisiana (the "*State*") established the Road Home Program as part of its disaster recovery effort to assist affected homeowners. The Road Home Program was funded by Community Development Block Grants ("*CDBG*") administered by the U.S. Department of Housing and Urban Development ("*HUD*"). One aspect of the Road Home Program allowed homeowners to dispose of damaged property to the State or an entity designated by the State at pre-storm valuations. To protect the State from potential liability arising from environmental contamination or other chain of title issues related to the properties acquired under the Road Home Program, the Louisiana Legislature (the "*Legislature*") adopted Act No. 654 in 2006, codified as Chapter 3-C of Title 40 of the Louisiana Revised Statutes of 1950, as amended, and cited as the "Louisiana Road Home Housing Corporation Act" (the "*Act*"). The Act authorized the creation of a nonprofit corporation known Road Home Corporation, which now conducts its business under the trade name Louisiana Land Trust (the "*Corporation*").

Throughout the course of participating in the Road Home Program, the Corporation acquired thousands of properties across the State with the use of CDBG funds disbursed by the Louisiana Office of Community Development Disaster Recovery Unit. The Corporation sold, donated, or otherwise conveyed the properties to private individuals or to various parishes or local redevelopment authorities in accordance with the State's action plan approved by HUD. In the event tax liens for *ad valorem* taxes owed in prior years affected any properties, it is our understanding that the Corporation did not pay the outstanding tax liens on such properties. In some cases in Orleans Parish, however, *ad valorem* taxes were assessed and owed for the tax year following the year of the Corporation's acquisition in accordance with La. R.S. 47:1703(B). It is our understanding that the Corporation paid these taxes. It is also our understanding that in several cases, the Corporation reimbursed the New Orleans Redevelopment Authority ("*NORA*") for *ad valorem* taxes that were assessed and owed for the tax year following the year of the Corporation's acquisition.

The Louisiana Legislative Auditor ("*LLA*") now contests the Corporation's payment of *ad valorem* taxes in connection with the acquisition and disposition of certain properties located in Orleans Parish. Specifically, LLA maintains that the Corporation is a public entity and therefore, the Orleans Parish tax collector is required to accept *pro rata* payment of taxes for any *ad valorem* taxes assessed and owed for the tax year in which a property was sold to the Corporation, in accordance with the provisions of La. R.S. 47:2135. This memorandum discusses the status of the Corporation as a private, nonprofit corporation. Additionally, this memorandum addresses the timing of the exemption from *ad valorem* taxation on property acquired by the Corporation in Orleans Parish and the inapplicability of La. R.S. 47:2135 to the Corporation.

## I. The Corporation is a private non-profit corporation.

LLA's concerns arise predominately from LLA's conclusion that the Corporation is a public entity. Despite language contained in the Act declaring that the Corporation is not a state agency, board, commission, or instrumentality of the State or any political subdivision (which LLA explicitly acknowledged), LLA finds the Corporation to be a public entity as a result of an incorrect application of the four factor test created by the Louisiana Supreme Court in *State v. Smith*, 357 So. 2d 505 at 507 (La. 1978) (the "*Smith Test*"). LLA's conclusion is incorrect because the Legislature declared within the Act that the Corporation is not a state agency, board, commission, or instrumentality of the State or any political subdivision. Furthermore, and although further analysis is unnecessary in light of the plain statutory language, LLA's conclusion is incorrect because an accurate application of the *Smith* Test affirms the Corporation's status as a private entity.

Under the authority of the Act, the Corporation was formed by a private individual on October 30, 2006 and incorporated on November 13, 2006 as a nonprofit corporation pursuant to the provisions of the Louisiana Nonprofit Corporation Law (Title 12, Chapter 2 of the Louisiana Revised Statutes of 1950, as amended). On July 1, 2008, the Internal Revenue Service granted the Corporation the status of a private organization that is exempt from federal income taxation under Section 501(a) of the Internal Revenue Code of 1986, as amended (the "*Code*"), as an organization described in Section 501(c)(3) of the Code. In order to dispel any doubt about the private entity status of the Corporation, the Legislature specifically provided in the Act that the Corporation "shall not constitute a state agency, board, or commission; nor shall it constitute an instrumentality of the state or any political subdivision."

In addition, an application of the *Smith* Test affirms that the Corporation is a private entity. The Louisiana Supreme Court created the four factor *Smith* Test to determine whether an entity is private or public in nature by evaluating the following: (1) whether the entity was created by the legislature, (2) whether the powers of the entity are specifically defined by the Legislature, (3) whether the property of the entity belongs to the public, and (4) whether the entity's functions are exclusively of a public character and performed solely for the benefit of the public. Each prong of the test described by *State v. Smith* "must be present in order for a court to determine that an entity is public."[1] Although the Corporation need only fail one prong of the *Smith* Test in order to qualify as a private rather than public entity, the Corporation fails each of the four prongs of the *Smith* Test. Therefore, the Corporation is also considered a private entity by application of the *Smith* Test.

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[1] Property Ins. Ass'n of La. v. Theriot, 31 So. 3d 1012 at 1014-15 (La. 2010); *see also* La. High School Athletics Ass'n, Inc. v. State, 107 So. 3d 583 at 602-603 (La. 2013).

### A. *The Corporation was not created by the Legislature.*

The first factor of the *Smith* Test provides that an entity may be a public entity if it is created by the Legislature. While the Legislature *authorized* the creation of the Corporation pursuant to the Act, the Legislature itself did not *create* the Corporation. The Act is not self-operating, but instead provides in Section 600.63 that "[t]here is hereby authorized the formation and incorporation of a nonprofit corporation." Opinion No. 07-0007 of the Louisiana Attorney General opined on this point, stating that "[w]hile this provision authorized the formation of [the Corporation], it doesn't actually create [the Corporation]. Neither this statute nor any other statute enacted in the [Act] mandates that any particular person or entity form [the Corporation]. We also note that the provisions of the [Act] place no restrictions on who may form [the Corporation]."

The Louisiana Supreme Court further addressed the distinction between statutes creating an entity contrasted with statutes merely authorizing the creation of an entity in *Property Insurance Association of Louisiana v. Theriot*.[2] In *Theriot*, the Supreme Court held that a statute authorizing fire insurance companies to organize the Louisiana Rating and Fire Prevention Bureau did not, in and of itself, create the Louisiana Rating and Fire Prevention Bureau.[3] The Court contrasted this with the language in La. R.S. 22:2056, whereby the Legislature created the Louisiana Insurance Guaranty Association, which states "[t]here is *created* a private nonprofit unincorporated legal entity known as the 'Insurance Guaranty Association . . . '" (emphasis added).[4]

As in the case of *Theriot*, the Act merely authorizes the creation of the Corporation and does not, in and of itself, create the Corporation. The Corporation was created by the act of a private individual filing articles of incorporation with the Louisiana Secretary of State in accordance with the Louisiana Nonprofit Corporation Law and pursuant to the authorization contained in the Act. Because the Legislature did not create the Corporation, the Corporation fails the first factor of the *Smith* Test and is therefore a private entity.

### B. *The Corporation's powers are broader than those defined by the Legislature.*

The second factor of the *Smith* Test provides that an entity may be a public entity if its powers are specifically defined by the Legislature. Section 600.66 of the Act lists several specific powers and responsibilities of the Corporation. However, this same section also provides that these powers are "[i]n addition to the powers granted [the Corporation] by the general Nonprofit Corporation Law." The Corporation is free to engage in any and all lawful activities under Louisiana Nonprofit Corporation Law, regardless of whether such activities are administered by the State. The Act does not limit the Corporation's powers, but rather provides a non-exclusive list of the activities the Corporation may undertake and specifically states that such activities are "in addition" to the activities allowed under the Louisiana Nonprofit Corporation Law.

Conversely, in *Louisiana Insurance Guaranty Association v. Commission on Ethics for Public Employees*,[5] the Louisiana First Circuit Court of Appeals found that the Louisiana Insurance Guaranty Association met the second prong of the *Smith* Test because the Louisiana Insurance Guaranty Association could only operate within specific legislative parameters and was not authorized to act in any manner

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[2] *Theriot*, 31 So. 3d 1012 (La. 2010).
[3] Id. at 1016-17.
[4] Id.
[5] 656 So. 2d 670 (La. App. 1st Cir. 1995).

inconsistent with the powers expressly granted under its creation statute. Unlike the statute creating the Louisiana Insurance Guaranty Association, the Act does not constrain the Corporation's powers. Instead, it expressly provides that the Corporation has all the additional powers afforded under the Louisiana Nonprofit Corporation Law. As such, the Corporation fails the second prong of the *Smith* Test and is a private entity.

### C. *The Corporation's property does not belong to the public.*

The third factor of the *Smith* Test provides that an entity may be a public entity if the property of the entity belongs to the public. LLA argues that because Section 600.68 of the Act provides that property owned by the Corporation vests in the State upon its dissolution unless the Legislature creates a successor corporation, such property is public. The mere provision that the Corporation's property may vest in the State upon the Corporation's dissolution, however, does not make the property public during the time that the Corporation owns the property. Section 600.66 of the Act grants the Corporation direct, immediate, and exclusive authority over any property acquired by it, providing that the Corporation may "finance, own, lease as lessee or lessor, sell, exchange, donate, or otherwise hold or transfer a property interest in housing stock damaged by Hurricane Katrina or Hurricane Rita." Such powers confer all the characteristics of private ownership defined in La. C.C. art. 477. Moreover, it is important to note that the Act specifically provides that the Corporation may donate or pledge its property. Such power would be unconstitutional pursuant to Article VII, Section 14(A) of the Louisiana Constitution of 1974, as amended (the "*Constitution*"), if the property of the Corporation was public. Legislative acts are presumed to be constitutional until declared otherwise by the final decision of the courts. As such, the Corporation's property does not belong to the public, and the Corporation is a private entity for failing to satisfy the third prong of the *Smith* Test.

### D. *The Corporation's functions are not exclusively of a public character and performed solely for the benefit of the public.*

The final factor of the *Smith* Test provides that an entity may be a public entity if the entity's functions are exclusively of a public character and performed solely for the benefit of the public. LLA claims that the Corporation held property on behalf of the State and received CDBG funds as part of the administration of the Road Home Program and thus, the Corporation's ownership of the property was for a public purpose. In *State v. Smith*, the Court found that although Community Advancement, Inc. ("*CAI*") received public funds to be used for certain purposes, CAI did not differ from other private nonprofit corporations, stating that "[t]he presence of public funds flowing through this private nonprofit corporation was not enough to transform it into an agency of the Parish."[6] Similarly, the Corporation's receipt of CDBG funds and participation in the Road Home Program are not enough to transform the Corporation into a public entity. The Corporation's function is not materially different from any other private nonprofit corporation, as any private nonprofit corporation is operated exclusively for charitable purposes. Furthermore, the Corporation has the authority to undertake any action allowed under the Louisiana Nonprofit Corporation Law. It is not limited solely to participation in the Road Home Program and, in fact, the Corporation has participated in and is currently participating in programs completely unrelated to the Road Home Program. Because the Corporation's functions are not exclusively of a public character, the Corporation is a private entity for failing to satisfy the fourth prong of the *Smith* Test.

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[6] *Smith*, 357 So. 2d 505, 508 (La. 1978).

**II. Properties acquired by the Corporation in Orleans Parish are subject to the Corporation's *ad valorem* tax exemption beginning in the assessment cycle following the year of the Corporation's acquisition.**

As a private nonprofit corporation organized for charitable purposes, Article VII, Section 21(B)(1)(a)(i) of the Constitution provides that property owned by the Corporation shall be exempt from *ad valorem* taxation. However, La. R.S. 47:1703(B) states that "[i]n the parish of Orleans, the status of real and personal property on the first day of August of each year, . . . , shall determine its liability for exemption from taxation for the following calendar year." As a result, all property subject to *ad valorem* taxation in Orleans Parish as of August 1 of any calendar year will be subject to *ad valorem* taxation for the following calendar year, regardless of a subsequent transfer of the property to an entity enjoying a constitutional exemption from *ad valorem* taxes. Accordingly, the Corporation was required to pay *ad valorem* taxes on certain properties it acquired in Orleans Parish because of the timing of the acquisition of such properties.

LLA maintains that the Corporation improperly paid such *ad valorem* taxes because La. R.S. 47:2135 provides that "[t]he tax collector is directed to accept the payment of *pro rata* taxes on property purchased in full ownership for rights-of-way or other purposes by the state of Louisiana or any of its political subdivisions . . . , for the period of time for which the liability for taxes have been due by the private owner or owners of the property." In accordance with this statute, LLA argues that the tax collector should have submitted a bill to the former owner of the property for their *pro rata* portion of the taxes owed on the property and any remaining portion of *ad valorem* taxes would not be collectible against the Corporation. This statute is inapplicable, however, because it provides that the tax collector must accept the proration of taxes only if the acquiring entity is the State or a political subdivision. The Act expressly declares that the Corporation is not a political subdivision. As such, the Corporation cannot prorate taxes for the year in which it acquired property subject to *ad valorem* taxes. In order to avoid a tax lien on these properties, the Corporation was required to pay the assessed *ad valorem* taxes.

LLA also argues that La. R.S. 47:2135 applies because the Corporation is a public entity and holds the property on behalf of the State. LLA concludes that because the Corporation merely holds the property on the State's behalf, La. R.S. 47:2135 applies and the private seller of property conveyed to the Corporation is responsible for their *pro rata* portion of taxes owed. As discussed herein, however, the Corporation is not a public entity, and its property is not public property. Property owned by the Corporation, therefore, is private, regardless of how such property may be disposed of upon the Corporation's dissolution. Moreover, La. R.S. 47:2135 applies only to acquisitions by the State itself or its political subdivisions. It is immaterial whether any other entity acquiring property is public or private or is acquiring the property for a public or non-public purpose. As such, it was proper for the Corporation to pay the assessed *ad valorem* taxes to avoid the creation of a tax lien.

Finally, LLA claims that the Corporation improperly reimbursed NORA for payment of outstanding *ad valorem* taxes on properties the Corporation conveyed to NORA. As discussed herein, however, under La. R.S. 47:1703(B), property subject to *ad valorem* taxation as of August 1 of any calendar year is subject to *ad valorem* taxation for the following calendar year, regardless of a subsequent transfer of the property to an entity enjoying a constitutional exemption from *ad valorem* taxes. It is irrelevant that property owned by NORA is exempt from *ad valorem* taxation pursuant to Article VII, Section 21(A) of the Constitution. Once the Corporation acquired property that was subject to *ad valorem* taxes because of the status of the property at the time of the Corporation's acquisition, the Corporation was required to pay such *ad valorem* taxes in order to convey merchantable title. In the event such taxes did not become due until after the Corporation conveyed the property to NORA, it was incumbent on the Corporation to reimburse NORA for any such taxes paid by NORA on the Corporation's behalf.

# APPENDIX B: SCOPE AND METHODOLOGY

We performed certain procedures at the Executive Department for the period from July 1, 2016, through June 30, 2017, to provide assurances on financial information significant to the State of Louisiana's Comprehensive Annual Financial Report (CAFR), and to evaluate relevant systems of internal control in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. The procedures included inquiry, observation, review of policies and procedures, and a review of relevant laws and regulations. Our procedures, summarized below, are a part of the audit of the CAFR and the Single Audit of the State of Louisiana (Single Audit) for the year ended June 30, 2017.

- We evaluated the Executive Department's operations and system of internal controls through inquiry, observation, and review of its policies and procedures, including a review of the laws and regulations applicable to the Executive Department.

- Based on the documentation of the Executive Department's controls and our understanding of related laws and regulations, we performed procedures to provide assurances on certain account balances and classes of transactions to support our opinions on the CAFR.

- We performed procedures on the Community Development Block Grants/State's Program (CFDA 14.228) for the year ended June 30, 2017, as a part of the 2017 Single Audit.

- We performed procedures on information for the preparation of the State's Schedule of Expenditures of Federal Awards and on the status of prior-year findings for the preparation of the State's Summary Schedule of Prior Audit Findings for the year ended June 30, 2017, as a part of the 2017 Single Audit.

- We compared the most current and prior-year financial activity using the Executive Department's Annual Fiscal Reports and/or system-generated reports to identify trends and obtained explanations from department management for significant variances.

In addition, we performed procedures on the Executive Department's internal control and compliance with related laws and regulations over the internal audit function. The scope of these procedures was significantly less than an audit conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is solely to describe the scope of our work at the Executive Department and not to provide an opinion on the effectiveness of the Executive Department's

internal control over financial reporting or on compliance. Accordingly, this report is not intended to be, and should not be, used for any other purposes.

We did not audit or review the Executive Department's Annual Fiscal Reports, and accordingly, we do not express an opinion on those reports. The Executive Department's accounts are an integral part of the State of Louisiana's CAFR, upon which the Louisiana Legislative Auditor expresses opinions.