



Audit Report



OIG-12-065

RECOVERY ACT: The Community Development Financial Institutions Fund Should Revise Policies and Procedures to Clarify Eligibility Reviews Under the New Markets Tax Credit Program

August 3, 2012

Office of
Inspector General

Department of the Treasury

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Abbreviations

ARC	Administrative Resource Center
CCME	Certification, Compliance, Monitoring and Evaluation
CDE	Community Development Entity
CDFI Fund	Community Development Financial Institutions Fund
GAO	Government Accountability Office
NMTC	New Markets Tax Credit
OIG	Office of Inspector General
QEI	Qualified Equity Investment

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*The Department of the Treasury
Office of Inspector General*

August 3, 2012

Donna Gambrell, Director
Community Development Financial Institutions Fund
Department of the Treasury

The American Recovery and Reinvestment Act of 2009¹ (Recovery Act) authorized an additional \$3 billion in tax credit authority to the Community Development Financial Institutions (CDFI) Fund for the New Markets Tax Credit (NMTC) Program's 2008 and 2009 allocation rounds (\$1.5 billion per round). This report presents the results of our audit of CDFI Fund's process for reviewing and selecting applicants to receive NMTC allocations during the calendar years 2008 and 2009 allocation rounds.

We conducted this audit as part of our ongoing oversight of the Department of the Treasury's programs established by, and use of funds authorized by, the Recovery Act. Our overall objective is to evaluate management's accountability, control, and oversight of Recovery Act funds and make recommendations for improving operations and preventing fraud, waste, and abuse with respect to those funds. Through a series of audits, we will report on the CDFI Fund's accountability, control, and oversight of additional funding provided by the Recovery Act.² Our audit objective for this report was to assess CDFI Fund's process for awarding the additional \$3 billion of new markets tax credit authority to applicants under the calendar years 2008 and 2009 award rounds. See appendix 1 for our objectives, scope, and methodology.

¹ Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009).

² OIG-11-079, *RECOVERY ACT: Community Development Financial Institutions Fund Needs to Improve Its Process for Awarding Assistance to Applicants* (July 8, 2011)

Results in Brief

Overall, we found that the CDFI Fund timely allocated the additional \$3 billion of NMTC authority provided to it by the Recovery Act for the calendar years 2008 and 2009 allocation rounds. While we found no exceptions concerning the review and selection of awardees, we noted that the NMTC Program management did not maintain complete records supporting its reviews of applicants' eligibility to receive NMTC allocations. That is, the NMTC Program management could not support whether additional due diligence reviews were performed on potential affiliates³ and/or common enterprises⁴ identified by the program staff. Furthermore, we noted that while the policies and procedures governing the 2008 and 2009 allocation rounds require the due diligence reviews, they did not require that those reviews be documented.

We also brought to the attention of NMTC Program management other instances where NMTC policies and procedures were not followed, noting that there was no impact on the awarding of 2008 and 2009 NMTC allocations. Specifically, we noted that all documentation related to an applicant's qualified equity investment was not being forwarded to Legal Counsel for review and that unqualified candidates were not timely notified of their ineligibility to receive a NMTC allocation. We have since been informed by NMTC Program management that the requirements as written in the NMTC policies and procedures were not practical and did not reflect what was intended for these areas.

In order to provide CDFI Fund management the opportunity to take corrective actions as early as possible, we communicated our finding during the course of the audit. Management acknowledged

³ "Any legal entity that *Controls*, is *Controlled* by, or is under common *Control* with, the *Applicant*." (2009 NMTC Policies and Procedures)

⁴ "...in addition to assessing whether *Applicants* meet the definition of the term "Affiliate" found in the *Allocation Application*, the Fund will consider: (i) whether the activities described in applications submitted by separate entities are, or will be, operated or managed as a **common enterprise** that, in fact or effect, could be viewed as a single entity; and (ii) whether the business strategies and/or activities described in applications submitted by separate entities are so closely related that, in fact or effect, they could be viewed as substantially identical applications." (2009 NMTC Program Allocation Application)

the need to clarify the NMTC policies and procedures with regard to eligibility reviews.

To address these matters, we are recommending to the Director of the CDFI Fund that the NMTC Program policies and procedures be revised to require that all due diligence reviews of applicant's affiliates and/or common enterprises be documented. Furthermore, the NMTC policies and procedures should be revised to clarify the level of documentation necessary for the performance of legal reviews and the timeliness of notifications to ineligible applicants.

The CDFI Fund management agreed with our recommendation, stating that it will revise the "NMTC Program Standard Operating Procedures" to include a requirement that due diligence reviews of an applicant's affiliates and/or common enterprises be documented. It will also clarify the level of documentation necessary for the performance of legal reviews and address the timeliness of notifications to ineligible applicants. Management's response is provided in appendix 2.

Background

The CDFI Fund was established by the Riegle Community Development and Regulatory Improvement Act of 1994⁵ to promote economic revitalization and development of low-income and underserved communities. In 2001, the CDFI Fund was delegated the authority to administer the NMTC Program authorized under the Community Renewal Tax Relief Act of 2000.⁶ The NMTC Program is intended to promote private sector investment in underserved communities by providing incentives to investors in the form of tax credits. Through its allocation authority, the CDFI Fund allocates tax credit authority to a qualified Community Development Entity (CDE) whose primary mission is in serving, and providing capital for, low-income communities and persons. By making qualified equity investments (QEIs) in a CDE, taxpayers can receive a tax credit against their federal income taxes worth 39 percent of the value of the amount invested in the CDE over a 7 year credit allowance period. In turn, CDEs must use substantially

⁵ Pub. L. No. 103-325, 108 Stat. 2160 (Sep. 23, 1994)

⁶ Pub. L. No. 106-554, 114 Stat. 2763A (Dec. 21, 2000)

all the cash received through QEIs for qualified investments in low-income communities in accordance with their allocation agreements with the CDFI Fund and section 45D (b)(1)(B) of the Internal Revenue Code of 1986.⁷

In order to participate in the NMTC Program, an entity must apply to the CDFI Fund for CDE certification. An entity requesting certification must be a legally established domestic corporation or partnership, have a primary mission of serving and providing investment capital to low-income communities, and maintain accountability to the communities that it serves through representation on the governing or advisory boards of the entity.

The CDFI Fund allocates NMTC authority to qualified CDEs through a competitive award process. A CDE applying under a NMTC allocation round must submit an electronic application through “myCDFIFund” system. Once the application submission window closes, applications are processed in the following stages: (1) application intake completeness reviews, (2) applicant eligibility reviews, (3) Phase I application reviews, and (4) Phase II allocation recommendation reviews. It is during intake that applications are screened for completeness by the Bureau of the Public Debt’s (BPD) Administrative Resource Center (ARC)⁸ where a preliminary review is performed to ensure submission of all required application materials and an official award folder is created. Upon completing the application intake review, ARC forwards the application files to the NMTC Program office where a secondary application intake review is performed randomly to assess overall completeness before the NMTC Program team starts its eligibility review.

As part of the application eligibility review process, certain assessments are performed by different groups within the CDFI Fund. For example, the NMTC Program Manager or designee performs eligibility reviews to ensure that no more than one application is submitted by affiliates/common enterprises and reviews the assurances and certifications forms submitted with applications that include general assurances and assurances with

⁷ 26 U.S.C. §45D, “New Markets Tax Credit”

⁸BPD is a Treasury bureau and through ARC provides franchise services to Treasury bureaus and offices and other federal agencies.

regard to suspension, debarments, and other applicant responsibilities. The Certification, Compliance, Monitoring and Evaluation (CCME) Manager is responsible for performing eligibility reviews with regard to applicants who were previous awardees to ensure they were compliant with their prior award agreements and that undisbursed funds from prior awards do not exceed 5 percent of the total includable awards⁹ as of the application deadline. In the case of an applicant being a prior NMTC allocatee, the applicant must demonstrate that it has issued and received a certain percentage of QEIs and QEI commitments from investors related to its prior allocation awards before it is eligible for another. Any concerns arising from eligibility reviews are forwarded to the CDFI Fund's Legal Counsel for review.

An applicant who is deemed eligible is forwarded to Phase I of the application review process which is organized and managed by the NMTC Program Manager. During Phase I, each application is reviewed and scored by an Application Review Team (review team) of up to three reviewers comprised of internal CDFI Fund staff and external reviewers from government or private industry having knowledge and experience in the areas of business, real estate, financing of community based organizations, and economic development. The review team is led by an Application Review Team Leader (team leader) who is either a CDFI Fund staff person or a reviewer with previous NMTC review experience and is responsible for ensuring that reviews are complete and timely, comments are of high quality, scores are consistent with comments and guidance, and responds to technical questions. Each application is evaluated on the following four evaluation criteria: (1) business strategy, (2) community impact, (3) management capacity, and (4) capitalization strategy. Each criterion is worth 25 points for a total score of 100 points. However, applicants may also receive up to 10 additional priority points for demonstrating intent to make investments in unrelated entities (5 points) and having track records of serving disadvantaged businesses and communities (5 points).

It is the responsibility of each review team member to independently score and provide written justifications on each of

⁹ Awards made under the Bank Enterprise Award, CDFI and Native Initiative programs.

the four evaluation criteria and recommend to either award or not award a NMTC allocation. In the case of a scoring anomaly between reviewers, the application is re-scored by a fourth independent reviewer.

Once Phase I reviews are complete, the NMTC Program Manager compiles reviewer recommendations and ranks highly qualified applicants in descending order based upon their total aggregate business strategy and community impact scores, inclusive of adjusted priority points. Prior to the commencement of Phase II reviews, the pool of highly qualified applicants who were previous awardees are reviewed by CCME for potential compliance scoring adjustments of up to a 5 point reduction that is based on the applicants reporting history with the CDFI Fund. The final ranking scores (e.g., Phase I scores or compliance adjusted scores) are generally used to determine the order for allocation recommendation during Phase II reviews performed by the Allocation Recommendation Review Panel (recommendation panel). The recommendation panel consists of a Lead Panelist, being a CDFI Fund staff person and a Panel Manager from the NMTC Program team. The Lead Panelist reviews applications, Phase I reviewer comments, performs due diligence when necessary, and makes recommendations to the Panel Manager. The Panel Manager is primarily responsible for guiding the recommendation panel and making recommendations to the selecting official, usually the NMTC Program Manager. Once an applicant is selected, a "Notice of Allocation" is sent containing the general terms and conditions with which that the awardee (hereinafter referred to as allocatee) must comply. Legal Counsel drafts the allocation agreements that are signed by the allocatee.

As of the 2011 allocation round, the NMTC Program has made 664 awards allocating \$33 billion of tax credit authority. Of the authority awarded, \$3 billion was provided through the Recovery Act for the calendar year 2008 and 2009 allocation rounds, thereby increasing the allocation authority for those years from \$3.5 billion to \$5 billion each. For NMTC allocations provided through the Recovery Act, the CDFI Fund awarded \$1.5 billion in NMTC allocations to 32 CDEs for the 2008 round and \$1.5 billion to 24 CDEs in the 2009 round. The "New Markets Tax Credit

Program Allocation Process (2008 Round)” and “New Markets Tax Credit Program Allocation Process (2009 Round)” (collectively the NMTC policies and procedures) were used to govern the process by which applicants were evaluated and awarded NMTC allocations for those applicable award rounds.

Finding

CDFI Fund Should Revise Policies and Procedures to Clarify Eligibility Reviews Under the New Markets Tax Credit Program

In accordance with the NMTC policies and procedures, reviews are performed to determine an applicant’s eligibility to be considered for a NMTC allocation award. These reviews are performed to ensure that no more than one application is submitted by an applicant and its affiliates and/or common enterprises and that an applicant who was a previous awardee under a CDFI Fund program complied with the prior award agreement and that undisbursed award funds do not exceed 5 percent of total includable awards outstanding. We found that while CDFI Fund personnel performed eligibility reviews, documentation was not maintained to support all reviews with regard to the allocatees under the 2008 and 2009 Recovery Act allocation rounds. Furthermore, the NMTC policies and procedures do not include a requirement to document the results of eligibility reviews.

Affiliates/Common Enterprises

In order to ensure that all applicants have an equal opportunity to receive an allocation and to maximize the value of limited resources in reviewing applications, the NMTC Program requires that only one application may be submitted by an entity and its common affiliate for each allocation round. According to the NMTC policies and procedures, the NMTC Program Manager or designee works with Legal Counsel to ensure that no more than one application is submitted from an affiliated family of entities and/or a family of entities that may appear to be operated or managed as a common enterprise. If potential affiliates and/or common enterprises are identified, the NMTC Program Manager and Legal Counsel are to conduct additional due diligence which may include analysis of

organizational documents, members of governing and advisory boards, staff, and contractual agreements to determine the relationships of the entities.

We found that NMTC program management did not maintain records supporting whether due diligence was performed on potential affiliates/common enterprises discovered during the eligibility reviews of the 2008 and 2009 Recovery Act allocation rounds. A NMTC Program analyst prepared spreadsheets identifying 20 and 31 possible affiliates/common enterprises during the 2008 and 2009 allocation rounds, respectively.¹⁰ The spreadsheets were forwarded to NMTC program management for additional review; however, NMTC program management could not provide documentation to support that additional due diligence was performed to determine the relationship of the entities. The NMTC Program Manager explained that cursory reviews were performed using keyword searches of data from electronic applications, and in most cases, these cursory reviews would exclude applicants as affiliates. Although no affiliates/common enterprises were identified from the spreadsheet data, the cursory reviews were not documented.

The Government Accountability Office (GAO) established standards for internal control in the federal government. Those standards provide that control activities occur at all levels and functions of the entity and include a wide range of diverse activities to include the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Furthermore, internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The requirement for documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained.¹¹

Currently, the NMTC policies and procedures do not include a requirement that eligibility reviews by NMTC Program staff and due

¹⁰ The 20 and 31 applicants included non-Recovery Act allocatees.

¹¹ GAO/AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government*, (November 1999)

diligence reviews performed by the NMTC Program Manager or designee in conjunction with Legal Counsel be documented.

Other Matters

During our testing of eligibility reviews, we noted other matters which we brought to the attention of the NMTC Program management concerning instances where NMTC staff did not always follow NMTC policies and procedures when reviewing applicants under the 2008 and 2009 allocation rounds. However, we were informed that certain procedures noted below were not practical and did not impact the NMTC allocation process.

Legal Review

In accordance with NMTC policies and procedures, if a NMTC applicant is a prior awardee under a CDFI Fund program, the applicant will be reviewed for compliance with award agreements and for undisbursed funds outstanding. In the case of a previous NMTC allocatee, the applicant will be reviewed to ensure that it has issued and received a certain percentage of QEIs and QEI commitments relating to its prior allocation awards. The CCME staff performs reviews to verify that private investors made QEIs in an applicant that received prior allocations in exchange for the right to claim a NMTC. In cases where an applicant has yet to receive all of the required cash investments, the applicant must obtain investor agreements showing a commitment to provide funds by specified dates. Investor agreements are forwarded to Legal Counsel for review and verification that the investor commitments are valid.

The NMTC policies and procedures applicable to the 2008 and 2009 allocation rounds required that CCME staff forward all QEI documentation to Legal Counsel for review. When we identified that all documentation was not provided to Legal Counsel, we were informed that the intent was to have Legal Counsel review "all" documentation related to those applicants claiming only investor commitments (e.g., investor agreements), not those applicants who received cash investments.

Ineligibility Letters

We also found that NMTC program management did not promptly notify four applicants who failed the QEI issuance requirements in the 2008 and 2009 allocation rounds (two per round) within 5 business days as required in the NMTC policies and procedures. For those applicants, the notification of ineligibility letters were sent 49 to 73 days after the CCME staff determined the applicants' failure to meet QEI issuance requirements. When asked about delay in notifications, CCME officials were not sure as to why the policy stated 5 days, but determined that it was not practical. In addition, we were told that notifying applicants of their ineligibility within 5 days had no impact on the applicant because they had no right to appeal the CDFI Fund's determinations.

Overall, we found that the NMTC policies and procedures need clarification regarding eligibility reviews and documentation requirements. Lack of clearly defined policies and procedures may result in personnel performing tasks contrary to management's policy and program requirements. This could also result in duplication of efforts, omission of key procedures, and confusion among personnel regarding their roles and responsibilities. This may also result in an unqualified CDE being awarded allocation authority.

CDFI Fund management acknowledged our finding and agreed that the NMTC policies and procedures need clarification regarding eligibility reviews.

Recommendation

We recommend that Director of the CDFI Fund do the following:

Ensure that the NMTC Program policies and procedures are revised to include a requirement that due diligence reviews of an applicant's affiliates and/or common enterprises be documented and to clarify the level of documentation necessary for the performance of legal reviews and the timeliness of notifications to ineligible applicants.

Management Response

CDFI Fund management agreed with our recommendation, stating that it will revise the NMTC Program Standard Operating Procedures to include a requirement that due diligence reviews of an applicant's affiliates and/or common enterprises be documented. It will also clarify the level of documentation necessary for the performance of legal reviews and address the timeliness of notifications to ineligible applicants.

OIG Comment

Management's planned action meets the intent of our recommendation.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during this audit. If you wish to discuss this report, you may contact me at (202) 927-5784 or Colleen McElwee, Audit Manager, at (202) 927-5839. Major contributors to this report are provided in Appendix 3.

/s/

Donna Joseph
Audit Director

In January 2010, we initiated an audit of the additional funding provided to the CDFI Fund through the Recovery Act to determine whether an appropriate level of accountability, control, and oversight of the NMTC Program had been established. Specifically, we reviewed the CDFI Fund's process for determining eligibility of potential award recipients' and for allocating new markets tax credits, authorized by the Recovery Act, to applicants under the calendar years 2008 and 2009 award rounds.

In performing our work, we interviewed key CDFI Fund personnel, reviewed laws and regulations governing the New Markets Tax Credit Program, including related Recovery Act provisions, internal policies and procedures, findings reported in GAO's 2004, 2007, and 2010 reports, and 2008 and 2009 guidance for CDFI Fund staff, team leaders and reviewers. We also reviewed CDFI's process for identifying affiliates/common enterprises and for notifying ineligible applicants from the population of all 2008 and 2009 round applicants.

We tested the CDFI Fund's eligibility assessments of applicants and their documentation of the process. We applied statistical sampling to select a random sample of 30 applications for testing from the universe of 56 Recovery Act awardees from the 2008 and 2009 rounds. We determined our sample size based on a 90 percent confidence level, an expected error rate of 37 percent, and 10 percent sample precision. As a result, we tested \$1.845 billion (61 percent) of the \$3 billion of Recovery Act funds that had been awarded.

We conducted our fieldwork at the CDFI Fund in Washington, D.C., from March 2010 through December 2011.

Our audit was conducted in accordance with generally accepted government auditing standards for performance audits. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix 2
Management Response

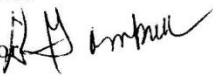


DEPARTMENT OF THE TREASURY
COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND
601 THIRTEENTH STREET, NW, SUITE 200 SOUTH
WASHINGTON, DC 20005

MEMORANDUM

DATE: July 27, 2012

TO: Donna Joseph, Director, Grants and Financial Assistance Audits
Office of Inspector General

FROM: Donna Gambrell, Director 

SUBJECT: Draft Audit Report: The Community Development Financial Institutions
Fund Should Revise Policies and Procedures to Clarify Eligibility
Reviews Under the New Markets Tax Credit Program

In response to a memo from the Office of Inspector General (OIG) dated July 2012 regarding findings that the Community Development Financial Institutions (CDFI) Fund's New Markets Tax Credit (NMTC) Program needs to revise policies and procedures to clarify eligibility reviews under the NMTC Program, please find our comments below. These comments are in accordance with Treasury Directive 40-01, *Responsibilities of and to the Inspector General*.

Notice of Finding: The CDFI Fund should revise policies and procedures to clarify eligibility reviews under the NMTC Program

Recommendation: Ensure that the NMTC Program policies and procedures are revised to include a requirement that due diligence reviews of an applicant's affiliates and/or common enterprises be documented and to clarify the level of documentation necessary for the performance of legal reviews and the timeliness of notifications to ineligible applicants..

Management Response: The CDFI Fund agrees with this recommendation.

PCA: The CDFI Fund will revise the NMTC Program Standard Operating Procedures to include a requirement that due diligence reviews of an applicant's affiliates and/or common enterprises be documented and to clarify the level of documentation necessary for the performance of legal reviews and the timeliness of notifications to ineligible applicants..

PCA Due Date: December 31, 2012

Point of Contact for PCA: Bob Ibanez

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