
AUDIT REPORT



Empire State Development Corporation
Community Development Block Grant Disaster Assistance Funds
New York, New York

2004-NY-1001

MARCH 25, 2004

OFFICE OF AUDIT
New York/New Jersey Region



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TO: Nelson R. Bregon, General Deputy Assistant Secretary for Community Planning and Development, D

Alexander C. Malloy

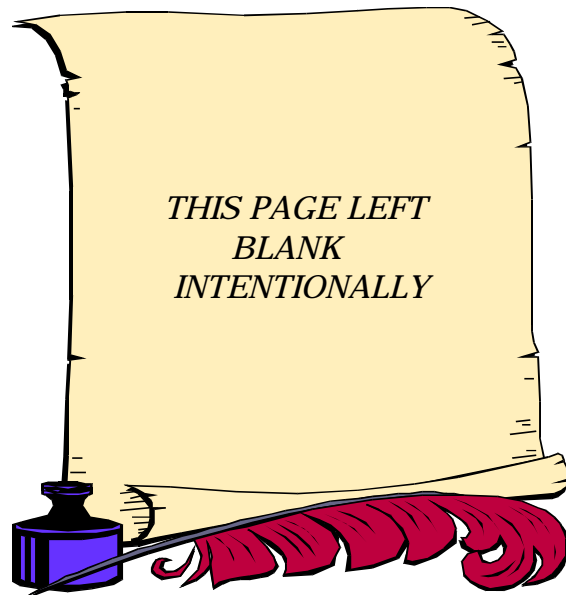
FROM: Alexander C. Malloy, Regional Inspector General for Audit, 2AGA

SUBJECT: Community Development Block Grant Disaster Assistance Funds
Empire State Development Corporation
New York, New York

We have completed an audit of the operations of the Empire State Development Corporation (ESDC) pertaining to its administration of the Community Development Block Grant Disaster Assistance Funds, which were provided to the State of New York as a result of the September 11, 2001 terrorist attacks on the World Trade Center in New York City. The objectives of the current review were to determine whether the ESDC: (1) disbursed the CDBG Disaster Assistance Funds to eligible Small Firm Attraction and Retention Grant (SFARG) and Business Recovery Loan Fund (BRLF) Program applicants in accordance with HUD Approved Action Plans; (2) developed and implemented adequate procedures for monitoring the programs funded with CDBG Disaster Assistance Funds; and (3) has a financial management system that adequately safeguards the funds. The current review covered the period from April 1, 2003 to September 30, 2003. This report contains two findings with recommendations for corrective actions.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. 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 because of this audit.

Should you or your staff have any questions, please contact Garry Clugston, Assistant Regional Inspector General for Audit, at (716) 551-5755, extension 5901.



Executive Summary

We have completed an audit of the operations of the Empire State Development Corporation (ESDC) pertaining to its administration of the Community Development Block Grant (CDBG) Disaster Assistance Funds, which were provided to the State of New York as a result of the terrorist attacks on the World Trade Center in New York City. The objectives of the current review were to determine whether the ESDC: (1) disbursed the CDBG Disaster Assistance Funds to eligible Small Firm Attraction and Retention Grant (SFARG) and Business Recovery Loan Fund (BRLF) Program applicants in accordance with HUD Approved Action Plans; (2) developed and implemented adequate procedures for monitoring the programs funded with CDBG Disaster Assistance Funds; and (3) has a financial management system that adequately safeguards the funds. This is the third and final report that the Office of Inspector General (OIG) will issue on the CDBG Disaster Assistance Funds directly appropriated to ESDC. We have issued an audit report every six months and included a summary of each report's findings in the Inspector General's Semi-Annual Reports to Congress. The prior audit reports on the ESDC were issued on March 25, 2003 and September 30, 2003, and are discussed in the Follow Up On Prior Audits section of this report.

The results of our review disclosed that the ESDC generally disbursed the CDBG Disaster Assistance Funds to eligible applicants in accordance with HUD Approved Action Plans, and has a financial management system that is capable of adequately safeguarding the funds. However, we noted processing deficiencies in its grant programs that need to be resolved to enhance the efficiency of ESDC's administration of the funds. Also, we noted monitoring controls that need to be strengthened so HUD can readily make compliance determinations regarding ESDC's programs. These issues are summarized below and discussed in detail in the two findings in this report.

ESDC disbursements

The ESDC has continued to make substantial progress in developing and implementing programs that address the immediate economic needs of numerous businesses that suffered economic losses and property damages during the September 11, 2001 terrorist attacks. At September 30, 2003, the ESDC had disbursed over \$796 million of the \$1.124 billion in CDBG Disaster Assistance Funds it is administering. The ESDC had disbursed \$36 million in Small Firm Attraction and Retention Grants (SFARG) to 1,095 businesses representing over 19,000 employees, \$173 million in Large Firm Job Creation and Retention Grant Program (JCRP) to 44 large Businesses, and \$543 million in Business Recovery Grants (BRG) to over 14,000 applicants. In addition, the ESDC has implemented several other programs to address the economic needs of the Lower Manhattan area resulting from the terrorist attacks. The ESDC's grant and loan programs have contributed significantly to the revitalization of Lower Manhattan.

The ESDC has made significant progress in improving its management controls and internal audit procedures over the disbursement of the disaster assistance funds. As a result of actions taken by ESDC, including actions to resolve recommendations in prior OIG audit reports, the ESDC identified and recovered \$1.48 million of improper BRG and SFARG grants disbursements.

ESDC Needs to Improve its Procedures for Documenting its Monitoring of CDBG Disaster Assistance Programs

Although the Empire State Development Corporation (ESDC) has developed and begun implementation of procedures for monitoring the CDBG Disaster Assistance programs, we noted that the ESDC needs to improve procedures for documenting its monitoring reviews of the Business Recovery Loan Fund (BRLF) Program and the Job Creation and Retention Program (JCRP). Specifically, we found that the ESDC is not adequately documenting its on-site monitoring of the BRLF lenders; nor maintaining written or computerized documentation detailing their monitoring of the JCRP. Without adequate documentation of the ESDC's monitoring of these programs, HUD's ability to make compliance determinations regarding these programs as required by the alternative procedures published in the Federal Register will be limited. We believe these deficiencies occurred because the ESDC did not follow procedures that required formal written documentation of on-site monitoring visits of BRLF lenders, and because its written monitoring procedures for the JCRP do not require that monitoring reviews be fully documented.

ESDC Needs to Continue Improvements in the SFARG Program Processing

Our review of statistically selected samples of Small Firm Attraction and Retention Grant (SFARG) applications disclosed that the ESDC disbursed two grants totaling \$49,000 to applicants who were mistakenly determined to be eligible. This occurred because ESDC did not properly apply certain program guidelines during the processing of the applications. Specifically, we found that one applicant was ineligible because the program's lease requirement was not met while the other applicant did not meet the program's full time permanent employee requirement. In this regard, we believe that ESDC officials should resolve the deficiencies in this finding along with similar issues discussed in a finding in our prior audit report.

Exit conference

The results of our audit were discussed with ESDC officials during the audit and at an exit conference held on March 10, 2004 at the ESDC's office. The ESDC provided written comments to our draft report on March 18, 2004. We included excerpts of the comments with the findings, and provided the complete text of the comments in Appendix B of this report.

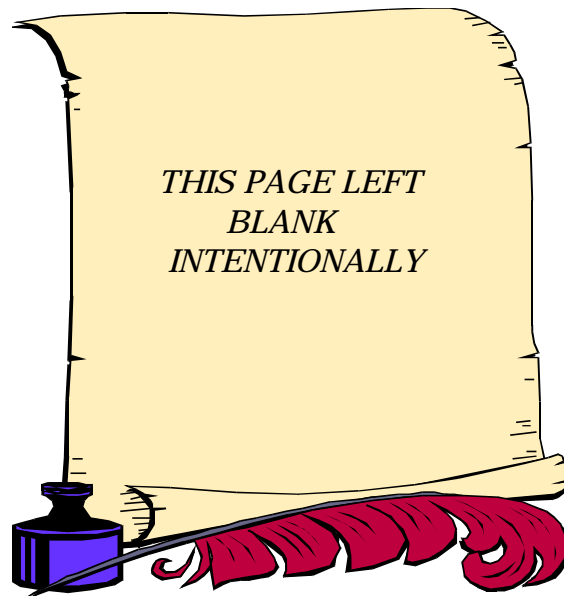


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Abbreviations

BRG	Business Recovery Grant
BRG2	Compensation for Economic Losses to Other Businesses
BRLF	Business Recovery Loan Fund
CDBG	Community Development Block Grant
ESDC	Empire State Development Corporation
HUD	U.S Department of Housing and Urban Development
JCRP	Large Firm Job Creation and Retention Program
LMDC	Lower Manhattan Development Corporation
OIG	Office of the Inspector General

Introduction

The negative economic impact of the September 11, 2001 terrorist attacks on the World Trade Center in lower Manhattan took a devastating toll on New York City affecting a much broader area than just lower Manhattan. Numerous New York City businesses were destroyed, displaced or could not operate because certain infrastructures were destroyed or seriously damaged. In the aftermath of the terrorist attacks, Congress authorized HUD to provide the State of New York with \$3.483 billion of Community Development Block Grant (CDBG) Disaster Assistance Funds. Specifically, on November 5, 2001, the Office of Management and Budget designated \$700 million for CDBG funding for New York City out of the Emergency Response Fund that Congress appropriated.¹ On January 10, 2002, Congress appropriated an additional \$2 billion for CDBG funding, earmarking at least \$500 million to compensate small businesses, nonprofit organizations, and individuals for their economic losses.² Finally, on August 2, 2002, Congress appropriated an additional \$783 million for CDBG funding.³ The Office of the Inspector General (OIG) has been performing an on-going audit of the operations of the Empire State Development Corporation (ESDC) pertaining to its administration of a portion of the CDBG Disaster Assistance Funds. The OIG previously issued audit reports covering the periods from program inception (February 2002) to March 31, 2003. This is the third audit and it covers the period from April 1, 2003 to September 30, 2003.



Congressional funding to the State of New York for New York City

HUD awarded the first congressional appropriation, in the amount of \$700 million, to the State of New York on February 13, 2002 through the Empire State Development Corporation (ESDC) for the properties and businesses damaged by the September 11, 2001 terrorist attacks on the World Trade Center in New York City. The ESDC was designated by the Governor to administer the first CDBG appropriation of \$700 million. The ESDC is governed by a Board of Directors, whose Chairman is Charles A. Gargano and its Executive Vice President and Chief Operating Officer is Kevin S. Corbett. The ESDC's offices are located at 633 Third Avenue, New York, New York. To carry out large-scale economic development activities, ESDC creates various consolidated subsidiaries. In this

¹ 2001 Emergency supplemental Appropriations act for Recovery from and Response to Terrorist Attacks on the United States, Pub. L. 107-38, 115 Stat. 220, (2001).

² The Department of Defense and Emergency Supplemental Appropriations for Recovery From and Response to Terrorist Attacks on the United States Act 2002(Emergency Supplemental Act 2002), Pub. L. 107-117, 115 Stat. 2336 (2002).

³ The 2002 Supplemental Appropriations Act for Recovery From and Response to Terrorist Attacks on the United States, Pub. L. 107-206.

regard, the ESDC's Board of Directors authorized the creation of the Lower Manhattan Development Corporation (LMDC) on November 2001 to assist in the economic recovery and revitalization of Lower Manhattan, with special emphasis on the redevelopment of the areas damaged during the terrorist attacks. LMDC has been designated by the State of New York as the entity to develop programs and distribute the \$2.8 billion appropriated by Congress in the 2002 Emergency Supplemental and the 2002 Supplemental acts previously stated.

The OIG has issued semi-annual reports on the disaster assistance activities carried out by the ESDC since the inception (February 2002) of the disaster assistance programs. This is the third report and it covers the period April 1, 2003 to September 30, 2003. Our audit reports covered all major programs administered with CDBG funds allocated to the ESDC. A separate series of audits of the activities being administrated by the LMDC is currently being conducted. The results of our current audit of LMDC will be provided in a separate audit report.

Approved action plan

The ESDC developed an Action Plan dated January 30, 2002, which described how the \$700 million was to be allocated among various categories. On November 22, 2002, HUD approved the LMDC's Action Plan, which included an additional \$350 million that the LMDC provided to the ESDC's business recovery programs. In March 2003, the ESDC reallocated funds to meet program objectives. On August 6, 2003, HUD approved LMDC's fourth Action Plan that included an additional \$74,500,000 from LMDC to the ESDC's BRG program. The additional funding brought the amount that is being administrated by the ESDC to \$1.124 billion.

The budget and disbursement amounts on September 30, 2003, were as follows:

Program	Budget as of September 30, 2003	Disbursements as of September 30, 2003	Balance as of September 30, 2003
Bridge Loan Program	6,760,000	\$0	\$6,760,000
Business Recovery Loan Fund	\$41,140,000	\$16,285,298	\$24,854,702
Business Recovery Grant Program	\$564,360,000	\$543,993,383	\$20,366,617
Small Firm Attraction & Retention Grants	\$155,000,000	\$36,798,430	\$118,201,570
Grants To Technical Assistance Providers	\$5,000,000	\$2,636,584	\$2,363,416
Large Firm Job Creation & Retention	\$320,000,000	\$173,693,270	\$146,306,730
Compensation For Economic Losses To Other Businesses	\$13,240,000	\$13,240,000	\$0
Business Information	\$5,000,000	\$3,647,153	\$1,352,847
Administration	\$14,000,000	\$6,215,775	\$7,784,225
TOTALS	\$1,124,500,000	\$796,509,893	\$327,990,107

As of September 30, 2003, the ESDC had disbursed funds to recipients primarily in four major programs: Small Firm Attraction and Retention Grants (SFARG); Job Creation and Retention Program (JCRP); Business Recovery Grants (BRG); and Compensation for Economic Losses to Other Businesses (BRG2). During our previous audits, we performed extensive reviews of the JCRP, BRG, and BRG2 Programs. For the current audit period, we concentrated our audit efforts on the SFARG and Business Recovery Loan Fund (BRLF) programs. In addition, we reviewed the ESDC's procedures for the monitoring of the CDBG disaster assistance programs.

Audit Objectives

Our audit objectives were to determine whether the ESDC: (1) disbursed the CDBG funds to eligible Small Firm Attraction and Retention Grant (SFARG) and Business Recovery Loan Fund (BRLF) Program applicants in accordance with HUD Approved Action Plans; (2) developed and implemented adequate procedures for monitoring the

programs funded with CDBG Disaster Assistance Funds; and (3) has a financial management system that adequately safeguards the funds.

Audit scope and methodology

To achieve our audit objectives, we:

- Interviewed ESDC and HUD Officials;
- Analyzed ESDC's computerized data systems;
- Reviewed ESDC program guidelines, policies and monitoring procedures;
- We reviewed 93 SFARG cases which were selected using Statistical Sampling;
- Compared ESDC data to New York State Department of Labor data;
- Confirmed SFARG occupancy data with landlords;
- Performed an analysis of all 270 BRLF cases using Audit Command Language (ACL);
- Reviewed a sample of BRLF case files;
- Observed ESDC monitoring of a community-based lender.

As part of our review of the data within ESDC's grants management system and disbursement database, we analyzed the systems to identify potential control weaknesses. Although, we did not perform a detailed assessment of the reliability of the data within these systems, we did perform a minimal level of testing to determine whether the data was reliable for our purposes.

We performed our on-site work between August 2003 and March 2004. The current review covered the period between April 1, 2003 and September 30, 2003. The audit was conducted in accordance with Generally Accepted Government Auditing Standards.

We provided a copy of this report to the Auditee.

Monitoring Reviews of CDBG Disaster Assistance Programs Should be Fully Documented

Although the Empire State Development Corporation (ESDC) has developed and begun implementation of procedures for monitoring the CDBG Disaster Assistance programs, we noted that the ESDC needs to improve procedures for documenting its monitoring reviews of the Business Recovery Loan Fund (BRLF) Program and the Job Creation and Retention Program (JCRP). Specifically, we found that the ESDC is not adequately documenting its on-site monitoring of the BRLF lenders; nor maintaining written or computerized documentation detailing their monitoring of the JCRP. Without adequate documentation of the ESDC's monitoring of these programs, HUD's ability to make compliance determinations regarding these programs as required by the alternative procedures published in the Federal Register will be limited. We believe these deficiencies occurred because the ESDC did not follow procedures that required formal written documentation of on-site monitoring visits of BRLF lenders, and because its written monitoring procedures for the JCRP do not require that monitoring reviews be fully documented.

Scope

We reviewed the ESDC's monitoring procedures for the following programs: Business Recovery Grant (BRG), Compensation for Economic Losses to Other Businesses (BRG2), Small Firm Attraction and Retention Grant (SFARG), Job Creation and Retention (JCRP), Business Recovery Loan Fund (BRLF), and the Technical Services Assistance Grant. The review included determining whether the ESDC has developed and implemented adequate procedures for monitoring the above-mentioned CDBG disaster assistance programs.

Criteria

The Federal Register Docket No. 4732-N-04, dated May 22, 2002, states that 24 CFR 570.490 (b) is waived and the following provision applies: "The state shall maintain such records as may be necessary to facilitate review and audit by HUD of the State's administration of CDBG funds under Section 570.493. Consistent with applicable statutes, regulations, waivers, alternative requirements, and other Federal requirements, the content of records maintained by the State shall be sufficient to: enable HUD to make the applicable determinations described at Section 570.493; make compliance

determinations for activities carried out directly by the state; and show how activities funded are consistent with the descriptions of activities proposed for funding in the action plan”.

The determinations under 24 CFR Section 570.493 are as follows: (1) whether the state has distributed CDBG funds to units of general local government in a timely manner in conformance to the method of distribution described in its action plan under part 91 of this title; (2) whether the state has carried out its certifications in compliance with the requirements of the Act and this subpart and other applicable laws; and (3) whether the state has made reviews and audits of the units of general local government required by § 570.492.

BRLF Program

Background

The purpose of the WTC Business Recovery Loan Fund (BRLF) Program is to fund participating lenders in order for them to provide low-cost working capital loans on flexible terms to small businesses that currently lack access to suitable credit, particularly those that do not meet SBA credit criteria for disaster loans; and that have been adversely affected by the September 11, 2001 attacks.

Written/Computerized Documentation of on-site monitoring is needed

Our review of the BRLF Program disclosed that the ESDC has written monitoring procedures for this program and has implemented those procedures. However, we found that the ESDC does not adequately document its on-site monitoring of the Business Recovery Loan Fund (BRLF) Program lenders. Specifically, we found that the ESDC conducted periodic on-site monitoring visits at the BRLF Program lenders to ensure compliance with the BRLF Program regulations. However, the ESDC did not adequately document the results of its monitoring reviews. The ESDC only documents its on-sites visits in a schedule, which only shows the dates of the on-site visits, the organizations visited, the ESDC participants, the Lender participants, and comments on any exceptions noted.

According to ESDC officials, besides the schedule, written notes of the ESDC officials and emails/letters to the BRLF Lenders are the only documentation of the ESDC's on-site monitoring visits. The handwritten notes do not provide

details on each of the individual files reviewed by the ESDC during its on-site monitoring reviews. We believe the handwritten notes should be formalized to facilitate a review by HUD. Additionally, the results of the on-site monitoring reviews should be provided in a report that describes what was reviewed, the results of the review, and the conclusions reached. This information is needed for HUD to determine whether funds were awarded and disbursed in accordance with approved action plans. Without adequate documentation of the ESDC's on-site monitoring reviews, HUD's ability to make compliance determinations regarding these programs as required by the alternative procedures published in the Federal Register will be limited. Therefore, we are recommending that HUD require the ESDC to maintain written and/or computerized documentation detailing on-site monitoring of BRLF Program lenders to facilitate reviews and audits by HUD.

JCRP

Background

The Large Firm Job Creation and Retention Grant Program (JCRP) targets businesses in the area of Lower Manhattan south of Canal Street with over 200 full-time employees that require assistance in maintaining, establishing or resuming a presence in Lower Manhattan or elsewhere in New York City. The program also aims to attract companies willing to commit to relocating and/or creating 200 or more jobs in Lower Manhattan.

Adequate Documentation of Monitoring is needed

Our review of the JCRP disclosed that ESDC has monitoring procedures for this program; however, at the time of our review the procedures were not in writing. According to ESDC officials, they monitor the JCRP grantees via the Report of Employment, which is submitted annually to the ESDC. ESDC officials further stated that the employment data from the Report of Employment is tracked in a database and that this monitoring includes comparing employment data submitted in the annual Report of Employment to the employment data required by the JCRP contract.

Our review disclosed that the ESDC received the Report of Employment from the ten JCRP grantees that were required to submit the report by February 1, 2003. We noted that the

ESDC entered the employment data from the Report of Employment into a database; however, the database documentation provided to us did not indicate whether JCRP grantees were in compliance with the JCRP contracts. ESDC Officials advised us that a new database is being developed, which will be used to monitor only JCRP grantees. It should be noted that, if sufficient and adequate information is not maintained in ESDC's database, a determination cannot be made as to whether JCRP grantees are in compliance with the program's requirements. Our review also disclosed that the ESDC contacted the New York State (NYS) Department of Labor (DOL) to verify the employment data submitted in the Report of Employment for the ten JCRP grantees reviewed. However, the contact was not made until after we made inquiries regarding data comparisons. Furthermore, ESDC does not have any documentation showing the results of its comparison of the employment data in the Report of Employment to data filed with the NYS DOL. Documented reports of ESDC's monitoring reviews of JCRP grantees, would enhance HUD's ability to make compliance determinations regarding the JCRP as required by alternative procedures published in the applicable Federal Register. Therefore, we are recommending that HUD require the ESDC to establish adequate monitoring procedures for the JCRP and maintain written and/or computerized documentation detailing the monitoring of this program to facilitate reviews and audits by HUD.



Auditee Comments

The ESDC stated that it understands that the OIG believes that ESDC's documentation of its monitoring of the BRLF Program should be more formal and should include greater detail. ESDC staff has already begun to use checklists and more formal procedures that will achieve this goal and enable HUD to more easily review the extent and outcomes of BRLF monitoring efforts.

Furthermore, the ESDC indicated that it believes that adequate documentation of JCRP monitoring exists. Compliance can easily be determined from viewing the current ESDC employment database. All material and relevant data is captured in the database. ESDC will work to develop a separate JCRP database that may address some of your office's (OIG's) concerns.

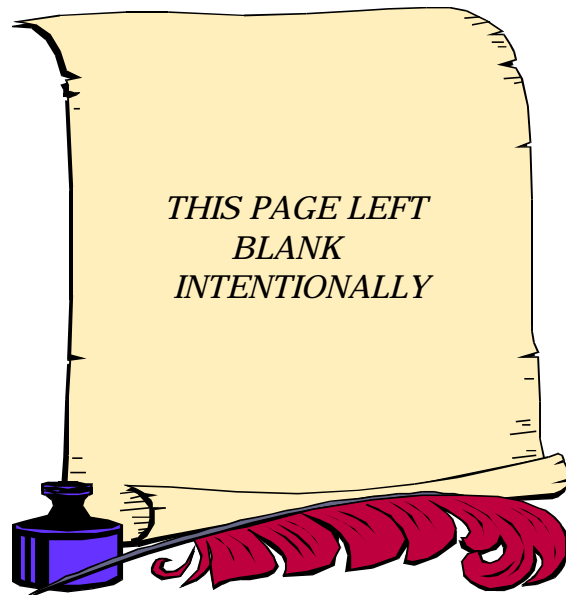
**OIG Evaluation of
Auditee Comments**

We believe that written and/or computerized documentation detailing the monitoring of the JCRP will facilitate reviews and audits by HUD.

Recommendations

We recommend that HUD, the General Deputy Assistant Secretary for Community Planning and Development:

- 1A. Require the ESDC to maintain written or computerized documentation detailing on-site monitoring reviews of BRLF Program lenders to facilitate reviews and audits by HUD.
- 1B. Require the ESDC to maintain written or computerized documentation detailing the monitoring of the JCRP and other CDBG Disaster programs to facilitate reviews and audits by HUD.



Processing Deficiencies of The Small Firm Attraction and Retention Grant Program Should be Resolved

Our review of statistically selected samples of Small Firm Attraction and Retention Grant (SFARG) applications disclosed that the ESDC disbursed two grants totaling \$49,000 to applicants who were mistakenly determined to be eligible. This occurred because ESDC did not properly apply certain program guidelines during the processing of the applicants' applications. Specifically, we found that one applicant was ineligible because the program's lease requirement was not met, while the other applicant did not meet the program's full time permanent employee requirement. As a consequence, two applicants received grants, totaling \$49,000, from the SFARG Program that they were not entitled to receive. In this regard, we believe that ESDC officials should resolve these deficiencies in conjunction with resolving similar issues discussed in a finding in our prior audit report.

Background

The purposes of the Small Firm Attraction and Retention Grant (SFARG) Program is to retain small businesses at risk of leaving downtown Manhattan, to attract new ones, and to assist those businesses located in or close to the World Trade Center on September 11, 2001 that maintained a business in New York City.

The SFARG Program provides grants to qualified businesses, with 200 or fewer employees, that are located or plan to locate in the area of Manhattan south of Canal Street, and commit to remaining in the area for at least five years beyond their current commitment. The grant amount awarded to each business is determined by the number of employees located at the "eligible premises" and the location of the business within the City of New York. Grant payments are made in two installments, the first at the time the application is approved, and the second 18 months after the application date. Total payments are \$3,500 per employee, except for businesses that were in the "Restricted Zone" and remained downtown. Those businesses receive two payments totaling \$5,000 per employee.

The ESDC's amended Action Plan of June 7, 2002 allocated \$105 million for the SFARG Program from the

HUD appropriation of \$700 million. The LMDC Action Plan increased the allocation for the SFARG Program by \$50 million to \$155 million. At September 30, 2003, per the ESDC's Grants Management System, \$36,798,430 of SFARG funds had been expended.

Scope

From the 324 SFARGs with disbursements totaling \$9,514,250 between April 1, 2003 and September 30, 2003, we selected two statistical samples of SFARGs. Our samples were selected using a Stratified Variable Sample method. The sample parameters called for a 95 percent confidence level and a precision range of 5 percent. The first statistical sample consisted of 47 SFARGs, representing disbursements of \$2,874,500 that were disbursed between April 1, 2003 and June 30, 2003. The second statistical sample consisted of 46 SFARGs representing disbursements of \$3,299,000 that were disbursed between July 1, 2003 and September 30, 2003. In total, we selected and tested 93 SFARGs, representing disbursements of \$6,173,500. We reviewed the 93 grants in our sample to determine whether the ESDC followed its processing criteria and SFARG guidelines. We sent confirmations to the landlords to verify the applicants' leases. We independently obtained the data on all 93 SFARGs from the New York State Department of Labor to verify the information to the ESDC grant management system. We interviewed ESDC officials to determine how the ESDC is verifying and monitoring program activity.

Criteria

The SFARG Program guidelines state: "a business shall be eligible for funding under the program if it was operating its business pursuant to a lease for its then current business premises within the Eligible Area and that the lease was to expire, by its terms, on or prior to December 31, 2004, or such lease was to expire after December 31, 2004 and it is relocating its business to another location within the Eligible Area or it was operating its business outside the Eligible Area, or it had not yet commenced its business operations."

OMB Circular A-87 states that governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices. It further provides that to be allowable under a grant program, costs must be necessary

and reasonable for proper and efficient administration of the program and be adequately documented.

Ineligible grant

Ineligible SFARG

For Grant Number 31044, the ESDC disbursed \$24,500 in SFARG funds to an applicant who was not eligible for SFARG assistance. Our review disclosed that the applicant's original lease was cancelled prematurely on April 25, 2003 and a new lease was executed. The new lease term is May 1, 2003 to April 30, 2013. The SFARG program guidelines require that applicants located in the eligible area must have had an existing lease expiring before December 31, 2004. Because the original lease expired after December 31, 2004, the applicant was not eligible for the SFARG program. As a result, the applicant received \$24,500 in SFARG funds for which it was not eligible to receive.

Ineligible SFARG Payment

Ineligible SFARG Payment to an Applicant with Seasonal Employees

For grant number 30686, the ESDC disbursed \$24,500 in SFARG funds to an applicant that was not eligible for assistance because the applicant's business employees only have a temporary work status. The applicant, a tax preparation company, employs temporary seasonal employees during tax season.

The ESDC approved and disbursed a \$24,500 SFARG to the applicant based on information showing that the applicant had a total of fourteen employees. We noted that the applicant's employees are stationed at three different locations within the Borough of Manhattan. However, documentation in the application file and site visits showed that two of the locations were rented on a seasonal basis. In addition, employee data, which we independently obtained from the New York State Department Labor for the first quarter of 2003, showed that the applicant reported only eight employees for the first month, six employees for the second month, and zero employees for the third month. The data for the second quarter of 2003 showed zero employees for all three months.

Criteria

The SFARG Program guidelines state that a full time permanent employee shall mean (i) a full time, permanent employee on the eligible Business' payroll that has worked for a minimum of 35 hours per week for not less than four consecutive weeks. Based on the results of our review the applicant's employees were not permanent employees since they were hired to work on a temporary basis. Inasmuch as the purpose of the SFARG Program is to assist businesses with permanent employees, the grant amount awarded to the applicant is ineligible. As a result, the applicant received \$24,500 in SFARG funds for which it was not eligible to receive.

Auditee Comments


ESDC agrees that the grant recipient for grant Number 31044 is not eligible for assistance under the SFARG Program, and has sent the recipient a letter requesting reimbursement.

Concerning the applicant under Grant Number 30686, ESDC maintains that this applicant remains in compliance with the program's guidelines and is eligible for the SFARG payment. At the time of application, the employees were working full time on the payroll, and were therefore eligible. While additional NYS-45 forms for the 3 subsequent quarters found that the company had 0 employees during those quarters, additional reviews of the application and contact with the applicant confirmed that the company is a tax preparation service and hires full time employees on a seasonal basis. This issue was brought to the SFARG Review Committee and it was confirmed that the guidelines do not preclude employees like this from being eligible. Furthermore, we believe that denying this applicant the SFARG payment would be inconsistent with the program's guidelines. The seasonality of the employment numbers is irrelevant to the company's eligibility.

**OIG Evaluation of
Auditee Comments**

Regarding the applicant under Grant Number 30686, our review indicated that the applicant's employees were not

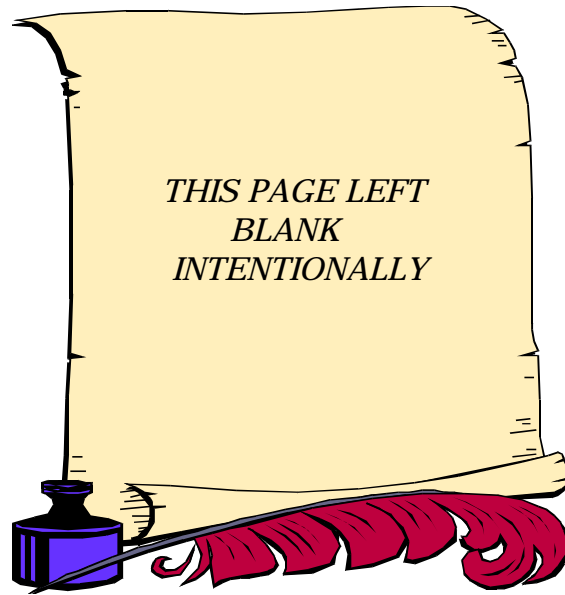
permanent employees since they were hired to work on a temporary basis. Inasmuch as the purpose of the SFARG Program is to assist businesses with permanent employees, we believe that the award of this grant did not meet the purpose of the program.



Recommendations

We recommend that HUD, the General Deputy Assistant Secretary for Community Planning and Development:

- 2A. Ensure that the ESDC reimburses the SFARG Program the amount of \$49,000 from non-federal funds to correct the improper payments made to ineligible applicants for SFARG numbers 31044 and 30686.
- 2B. Instruct the ESDC to improve procedures for verifying the eligibility of the SFARG applicants to ensure that SFARGs are only awarded to eligible applicants.



Management Controls

In planning and performing our audit, we considered the management controls of the Empire State Development Corporation to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. Management controls include the systems for measuring, reporting, and monitoring program performance.

Relevant Management

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

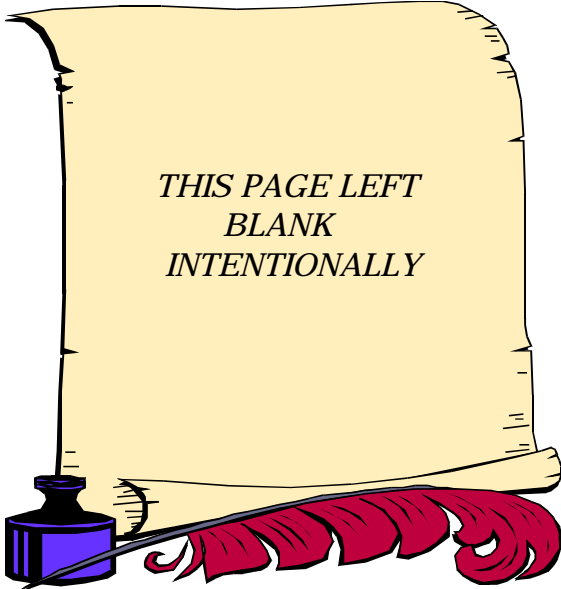
- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss and misuse.
- Validity and Reliability of Data –Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained and fairly disclosed in reports.

We assessed all the relevant controls identified above.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization’s objectives.

Significant Weaknesses

Although the review did not disclose any major significant weaknesses in ESDC's management controls, we found deficiencies in its grant processing and monitoring procedures that warrant corrective actions to improve the efficiency of the grant programs being administered by ESDC. The deficiencies are discussed in the finding section of this report.



Follow Up On Prior Audits

We issued two prior audit reports on the ESDC, under Report Number 2003-NY-1003 on March 25, 2003, and Report Number 2003-NY-1005 on September 30, 2003.

Audit Report 2003-NY-1003 contains four findings. The recommendations and status of each recommendation are as follows:

Finding 1- Recommendations and Resolution Actions Taken

- 1A Instruct the ESDC on whether unresolved overpayments of \$303,700, which we have determined to be technically ineligible, is to be reimbursed to the BRG Program by the ESDC from non-Federal funds.

HUD sustained the recommendation and advised the ESDC to reimburse the BRG Program \$303,700 from non-Federal funds. Of the sustained amount, a total of \$156,333 has been reimbursed and \$50,000 remains due on a repayment agreement for grant number 11363 with a target date for completion of the repayment of September 15, 2004. HUD has established a target date of October 31, 2004 to recapture the remaining \$97,367 in ineligible costs.

- 1B Instruct the ESDC that post reviews of disbursed BRGs should be performed to identify and correct errors with appropriate corrective actions.

HUD agreed with the recommendation. Final Action has been completed.

- 1C Ensure that the ESDC disburses the \$8,173 approved under BRG 30058 to correct the underpayment.

HUD agreed with the recommendation and the underpayment of \$8,173 has been corrected.

- 1D Require the ESDC to analyze tax information as part of its internal audit function, maintain its analysis for HUD review, and report results to HUD-OIG.

HUD agreed with the recommendation. Final Action has been completed.

Finding 2- Recommendations and Resolution Actions Taken

- 2A Obtain and review the results of the audit work that the ESDC's internal audit division is performing on the economic loss documentation issue, and determine whether the audit work is adequate enough to ensure that reported economic loss amounts are supported by proper documentation.

HUD agreed with the recommendation. HUD advised the ESDC to provide a schedule and description, including the results, of the audit work that the ESDC internal audit division is performing on the economic loss documentation issue, so that HUD can

determine whether the audit work is adequate to ensure that reported economic loss amounts are supported by proper documentation. HUD has revised the target date for completion for this recommendation to October 31, 2004.

- 2B Ensure that the ESDC has properly implemented the formulas and procedures that HUD recommended for determining duplication of benefits.

HUD agreed with the recommendation. Final Action has been completed.

- 2C Direct the ESDC to seek reimbursement in coordination with the SBA, of grant funds that were determined to be duplicate benefits.

HUD agreed with the recommendation. Final Action has been completed.

Finding 3-Recommendations and Resolution Actions Taken

- 3A Instruct the ESDC on whether the unresolved payment of \$38,500 to an ineligible recipient, is to be reimbursed to the SFARG Program by the ESDC from non-Federal funds.

HUD agreed with the recommendation. The incorrect payment has been partially resolved through a BRG supplemental grant. A repayment agreement for the remaining \$12,228 has been executed. HUD has revised the target date for completion for this recommendation to February 28, 2005.

- 3B Instruct the ESDC to revise procedures and guidelines for processing SFARG applications to include detailed procedures on how to handle special situations and require adequate documentation of the decision-making process.

HUD believes that ESDC has an adequate procedure in place for addressing special cases in the SFARG Program. This recommendation is closed.

- 3C Require the ESDC to establish procedures to ensure that its grants management system contains the same Employee Identification Number (EIN) that the SFARG recipient files with the New York State Department of Labor.

HUD advised the ESDC to establish and document procedures to ensure that ESDC's grants management system contains the same Employee Identification Number (EIN) as the form the SFARG recipient filed with the New York State Department of Labor. This recommendation is closed.

Finding 4-Recommendations and Resolution Actions Taken

- 4A Instruct the ESDC to reimburse the program with non-Federal funds for the \$12,491 of duplicate payments.

The ineligible amount was sustained. A total of \$9,974.11 has been repaid and the remaining \$2,696.89 will be repaid in accordance with an executed repayment agreement. This recommendation is closed. However, during the current audit, we found a duplicate payment of \$17,302, of which \$7,662 represents ineligible costs to the BRG program. The ESDC was aware of this duplicate payment and sent a letter to the recipient requesting repayment.

- 4B Direct the ESDC to establish controls to ensure that payment records are reviewed prior to disbursement so that duplicate payments do not occur.

HUD agreed with the recommendation. HUD advised ESDC to establish and document controls to ensure that payment records are reviewed prior to disbursement so that duplicate payments do not occur. This recommendation is closed.

- 4C Instruct the ESDC to implement procedures to reconcile disbursements per the ESDC's General Ledger to the grant management system and the disbursement database.

HUD agreed with the recommendation. HUD advised ESDC to implement and document procedures to reconcile disbursements per the ESDC General Ledger to the grant management system and the disbursement database. The ESDC is continuing to work on reconciling its disbursement records.

- 4D Direct the ESDC to ensure that procurements of goods and services are: (a) conducted in a manner that promotes full and open competition, (b) adequately justified, and (c) fully documented.

HUD agreed with the recommendation. HUD advised ESDC to ensure that procurements of goods and services are: (a) conducted in a manner that promotes full and open competition, (b) adequately justified, and (c) fully documented. This recommendation is closed.

- 4E Instruct the ESDC to provide assurance that costs incurred are adequately documented, reviewed and approved prior to payment.

HUD agreed with the recommendation. HUD instructed the ESDC to provide assurance that costs incurred are adequately documented, reviewed and approved prior to payment. This recommendation is closed.

Audit Report 2003-NY-1005 contains three findings. The recommendations and status of each recommendation are as follows.

Finding 1- Recommendations and Resolution Actions Taken

- 1A Ensure that the ESDC has properly recorded and accounted for the reimbursement of the \$27,750 in ineligible SFARG overpayments.

HUD sustained the recommendation and the ineligible amount of \$27,750 has been recovered. This recommendation is closed.

- 1B Instruct the ESDC to improve procedures for verifying the location of the SFARG applicants to ensure that the proper grant amount is awarded.

HUD agreed with the recommendation and stated that the ESDC has developed, distributed and implemented procedures for identifying the location of SFARG applicants. This recommendation is closed.

- 1C Instruct the ESDC to include procedures to verify the accuracy of the information by SFARG applicants on their lease arrangements as part of its internal audit review.

HUD agreed with the recommendation. ESDC has indicated verification of the lease information is now being performed by SFARG application processing personnel on new disbursement applications, in accordance with documented procedures. Lease verification has been subject to sampling by an outside audit firm and will be sampled as deemed appropriate by Internal Audit going forward. This recommendation is closed.

Finding 2- Recommendations and Resolution Actions Taken

- 2A Instruct the ESDC on whether the \$108,885, which we have determined to be ineligible, should be reimbursed to the BRG Program by the ESDC from non-Federal funds. It should be noted that the ESDC recaptured an overpayment of \$100,000 prior to the completion of our audit fieldwork.

HUD agreed with the recommendation. HUD advised the ESDC to obtain documentation from the applicant in order to make a determination as to the eligibility of the \$108,885. The target date for completion for this recommendation is October 31, 2004.

- 2B Ensure that the ESDC disburses the additional \$14 to the underpaid applicant.

HUD agreed with the recommendation and the ESDC has disbursed the \$14 underpayment. This recommendation is closed.

- 2C Instruct the ESDC to reimburse the program with non-Federal funds for the \$34,313 duplicate payment.

HUD agreed with the recommendation and stated that the ESDC has negotiated a repayment plan. The target date for completion for this finding recommendation is March 31, 2007.

- 2D Require the ESDC to continue corrective actions that address the issues identified in the findings of our prior audit, as well as those discussed in this finding.

HUD agreed with the recommendation and advised the ESDC to continue to take corrective actions. This recommendation is closed.

Finding 3-Recommendations and Resolution Actions Taken

- 3A Instruct the ESDC to establish accounting procedures to ensure that costs are correctly classified on drawdown forms and that the \$184,579.97 is correctly classified as Business Information expense.

HUD agreed with the recommendation. The ESDC has correctly classified the costs as a Business Information expense. This recommendation is closed.

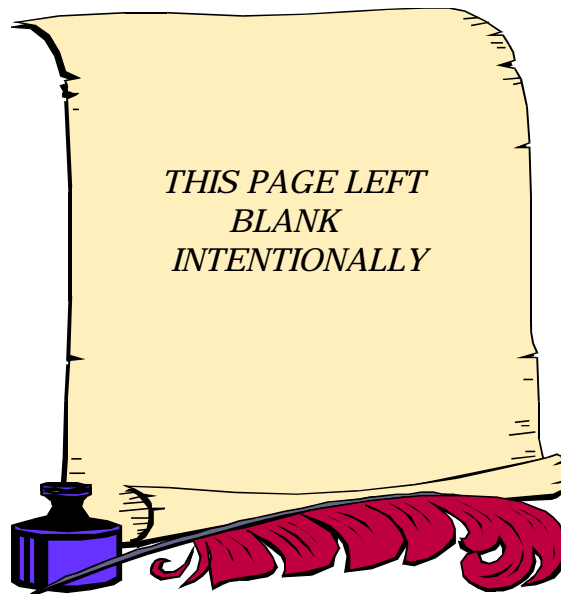
- 3B Direct the ESDC to establish accounting procedures to ensure that indirect costs are based on actual cost data, and that all allocations of indirect costs are reviewed.

HUD agreed with the recommendation. HUD confirmed that the \$2,134.24 understatement of indirect costs was adjusted and additional testing did not disclose any other instances of this issue. This recommendation is closed.

- 3C Instruct the ESDC to implement accounting procedures to ensure that all grant disbursements under the Technical Assistance Service Grant Program are adequately supported with documentation.

HUD agreed with the recommendation. HUD reviewed the ESDC's accounting procedures and is satisfied that the procedures and their implementation to date address the identified area of weakness. This recommendation is closed.

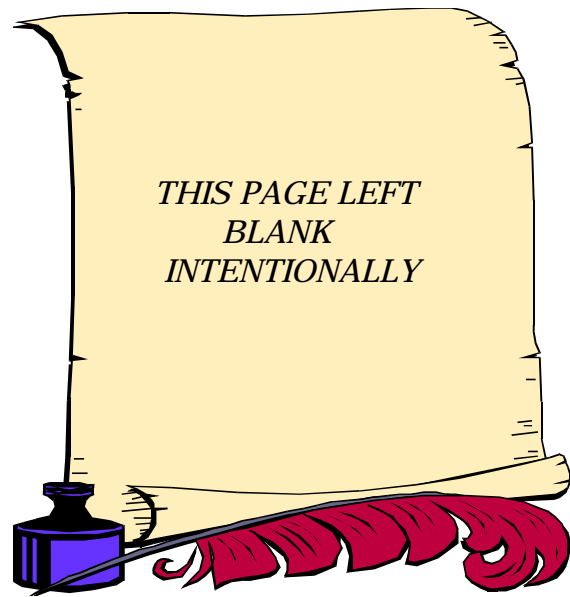
Follow Up On Prior Audits



Schedule of Questioned Costs

<u>Finding</u>	<u>Type of Questioned costs</u> <u>Ineligible 1/</u>
2	\$ 49,000
Total	\$ <u>49,000</u>

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.



Auditee Comments



Kevin S. Corbett
Chief Operating Officer,
Executive Vice-President and
Executive Deputy Commissioner

March 18, 2004

Mr. Alexander C. Malloy
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
26 Federal Plaza – Room 3430
New York, NY 10278-0068

Re: Draft Audit Report
Empire State Development Corporation (“ESDC”)
Community Development Block Grant Disaster Assistance Funds

Dear Mr. Malloy:

Thank you for the opportunity to respond to and comment on the latest Draft Audit Report issued by your office.

Monitoring Reviews of CDBG Disaster Assistance Programs Should be Fully Documented

BRLF Program

Written Computerized Documentation of on-site monitoring is needed.

ESDC understands that the OIG believes that ESDC’s documentation of its monitoring of the BRLF program should be more formal and should include greater detail. ESDC staff has already begun to use checklists and more formal procedures that will achieve this goal and enable HUD to more easily review the extent and outcomes of BRLF monitoring efforts.

JCRP Program

Adequate Documentation of Monitoring is Needed

ESDC believes that adequate documentation of monitoring exists. Compliance can easily be determined from viewing the current ESDC employment database. All material and relevant data

is captured in the database. ESDC will work to develop a separate JCRP database that may address some of your office's concerns.

With regard to the contact with the Department of Labor ("DOL"), ESDC did not initially include such a comparison primarily because DOL statistics include employment for companies throughout New York State. Therefore for companies with multiple locations including ones outside the eligible JCRP area, DOL will report numbers that are not meaningful in evaluating this program.

However, as indicated in the report, at the suggestion of HUD, ESDC did obtain DOL data and now documents the results of the inquiry to DOL in the project file.

Processing Deficiencies of the Small Firm Attraction and Retention Grant Program Should be Resolved

Ineligible SFARG

ESDC agrees that this grant recipient was not eligible for the program and the grant was disbursed due to human error. A recapture letter was sent to the client on 1/28/04 and the file is currently being handled for recapture by Portfolio Management. ESDC believes that this is an isolated incident and the current procedures for ensuring that grants are accurately disbursed to eligible businesses are sufficient.

Ineligible SFARG Payment to an Applicant with Seasonal Employees

ESDC maintains that this applicant remains in compliance with the program's guidelines and is eligible for the SFARG payment. At the time of application, the employees were working full time on payroll, and were therefore eligible. While additional NYS-45 forms for the 3 subsequent quarters found that the company had 0 employees during those quarters, additional review of the application and contact with the applicant confirmed that the company is a tax preparation service and hires full time employees on a seasonal basis. This issue was brought to the SFARG Review Committee and it was confirmed that the guidelines do not preclude employees like this from being eligible. Furthermore, we believe that denying this applicant the SFARG payment would be inconsistent with the program's guidelines. The seasonality of the employment numbers is irrelevant to the company's eligibility. The company has an eligible five-year lease commitment, pays rent throughout the year and is eligible for the program.

Follow up on Prior Audits

Finding 2 Recommendation and Resolution Actions Taken

2A Substantial audit work has been performed on the economic loss issue. We expect to be able to comply with HUD's request to receive, by October 31, 2004, a schedule and description of the audit work, including the results as to whether reported economic losses are supported by proper documentation.

Thank you for your continuing assistance in identifying areas for improvement. Our goal is to administer the HUD Grant funds as expeditiously as possible within the mandate and guidelines established.

Sincerely,

A handwritten signature in black ink, appearing to read 'K. S. Corbett', written in a cursive style.

Kevin S. Corbett
Chief Operating Officer and
Executive Vice President