AUDIT REPORT

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

2003-NY-1003

MARCH 25, 2003

OFFICE OF AUDIT
New York/New Jersey Region

Issue Date March 25, 2003	
Audit Case Number 2003-NY-1003	

TO: Nelson R. Bregon, Deputy Assistant Secretary for Grant Programs, DG

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 are performing an on-going 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 funds to eligible applicants in accordance with the HUD Approved Action Plan, (2) disbursed the CDBG disaster funds to applicants in a timely manner, and (3) has a financial management system that adequately safeguards the funds. The current review covered the period from inception (February 2002) to September 30, 2002. This report contains four 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 you staff have any questions, please contact Garry Clugston, Assistant Regional Inspector General for Audit, at (716) 551-5755, extension 5901.

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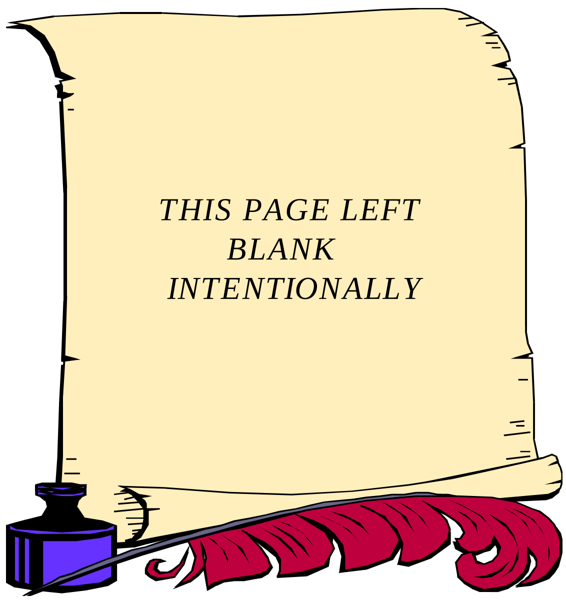
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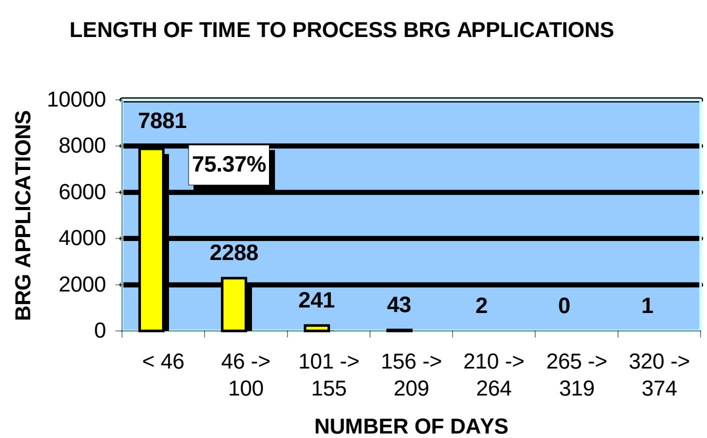
Executive Summary

We are performing an on-going 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 funds to eligible applicants in accordance with the HUD Approved Action Plan, (2) disbursed the CDBG disaster funds to applicants in a timely manner, and (3) has a financial management system that adequately safeguards the funds. This review is the first of a series of reviews that the Office of Inspector General (OIG) plans to conduct during our on-going audit of the CDBG Disaster Assistance Funds. Currently, we plan to issue an audit report every six months and include the results of each review in the Inspector General's Semi-Annual Reports to Congress.

The results of our review disclosed that ESDC generally disbursed the CDBG Disaster Assistance Funds to eligible applicants in accordance with the HUD Approved Action Plan in a timely manner; and has a financial management system that is capable of adequately safeguarding the funds. However, we noted processing deficiencies and discrepancies in its grant programs that either need to be addressed, resolved, or improved to enhance the efficiency of ESDC's administration of the funds. Also, we noted administrative and accounting controls that need to be strengthened to prevent duplicate payments and other related administrative deficiencies from occurring. These issues are summarized below and discussed in detail in the four findings in this report.

ESDC successfully planned, developed, and implemented programs

Under tight time constraints and staff shortages, the ESDC was able to successfully plan, develop, and implement programs that addressed the immediate economic needs of numerous small businesses that suffered economic losses and property damage during the September 11, 2001 terrorist attacks. At September 30, 2002, the ESDC had disbursed \$13 million in Small Firm Attraction and Retention Grants (SFARG) to 280 businesses, and \$277 million in Business Recovery Grants (BRG) to over 10,000 applicants. The ESDC processed 75% of BRG applications within 45 days of receipt of the applications as requested by Congress.



However, despite this accomplishment, there are still areas where the ESDC can improve its operations.

Processing deficiencies in the BRG program

Our review of statistically selected samples of Business Recovery Grants (BRG) disclosed that over and under payments were made to certain grant recipients. Specifically, we found overpayments and underpayments of $311,327, and $19,234 respectively, for a net overpayment of $292,093. Also, the review disclosed that federal tax information in some recipients' applications did not agree with the information that we received from the Internal Revenue Service. This information is very important because it is used to determine the amount of each applicant's grant. As a consequence, some recipients did not receive the proper grant amount while others may have received a grant based on inaccurate tax information. We attribute the over and under grant payments to human error, and the federal tax information discrepancies on the possibility that some recipients may have provided incorrect federal tax information in their grant applications. ESDC officials must adequately address these issues during post reviews designed to determine whether the program's processing procedures and requirements were met.

Resolution of Interim Report concerns not completed

Our assessments of ESDC's management controls over the Business Recovery Grant (BRG) program disclosed indications of two major application-processing weaknesses, which we discussed in our Interim Report to HUD, dated May 22, 2002. Further audit work disclosed that the resolution of these two weaknesses has not been completed. First, we found that early Business Recovery Grant (BRG) applications did not provide any details showing how the amounts of the applicants' estimated economic losses were determined. Second, the ESDC may have awarded CDBG disaster grants to applicants who had received Small Business Administration (SBA) Disaster loans for the same purpose. Consequently, applicants' estimated economic loss amounts were not supported with acceptable documentation; and the ESDC may have provided duplicate benefits to BRG recipients, which is a violation of Title 42, U.S.C. Chapter 68 Section 5155 (a). We attribute these deficiencies to the fact that the ESDC was under a congressional mandate to design and implement procedures that would allow the disbursement of

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grant funds to an approved applicant within 45 days from the receipt of the applicant's application. Apparently, processing procedures were compromised that would have: 1) required documentation to support estimated economic loss amounts, and 2) prevented a duplication of benefits between the BRG program and other federal disaster assistance programs.

SFARG program procedures need improvement

Our review disclosed that Empire State Development Corporation's (ESDC) procedures and guidelines for processing Small Firm Attraction and Retention Grant (SFARG) applications do not contain adequate criteria for handling special situation applications and do not require adequate support for decisions made while processing applications. Consequently, applications involving special situations could be receiving inconsistent consideration from different grant processors, thereby reducing assurances that SFARGs are being awarded consistently. Additionally, we found that the ESDC disbursed a $38,500 grant to an ineligible applicant. We believe these deficiencies occurred because ESDC's program guidelines do not contain procedures that ensure that all applications from eligible businesses are consistently processed, and adequately documented. Thus, improvements are needed to enhance efficiency in the administration of the program as required by OMB Circular A-87.

Weaknesses in accountability and administrative controls

The ESDC needs to eliminate weaknesses in the controls of the overall Disaster Assistance program that pertain to the accountability of grant funds and the procurement of administrative services. Although some weaknesses may have resulted from the fast pace that the ESDC was required to implement the disaster assistance programs; we noted that certain weaknesses occurred and existed because the ESDC has not established and implemented needed controls and procedures to properly: 1) account for all grant funds disbursed, 2) document procurement actions, and 3) review supporting documentation pertaining to administrative expenses. As a consequence, we found a weakness in the program's accounting system that allows duplicate grant payments to be made to grant recipients. Also, we found procurement actions that were not fully documented, and indications that supporting documentation for administrative expenses is not being properly reviewed. By strengthening its administrative and accounting controls, the ESDC will enhance program efficiency and compliance with federal requirements, which provides, in part, that a State shall have fiscal and administrative requirements for expending and accounting for all funds received.

Exit conference

The results of our audit were discussed with ESDC officials during the audit and at an exit conference held on February 24, 2003 at the ESDC's office. The ESDC provided written comments to our draft report. We included excerpts of the comments with the finding, and provided the complete text of the comments in Appendix D of this report.

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Appendices

Abbreviations

HUD	U.S Department of Housing and Urban Development
OIG	Office of the Inspector General
SFARG	Small Firm Attraction and Retention Grant
BRG	Business Recovery Grant
ESDC	Empire State Development Corporation
LMDC	Lower Manhattan Development Corporation

Introduction

The September 11, 2001 terrorist attacks on the World Trade Center in lower Manhattan took a devastating toll on New York City. The negative economic impact of the terrorist attacks affected a much broader area than just lower Manhattan, as numerous New York City businesses were destroyed, displaced or could not operate because certain infrastructures were either destroyed or seriously damaged. In the aftermath of the terrorist attacks, Congress authorized HUD to provide the State of New York $3.483 billion of Community Development Block Grant Disaster Assistance. 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 had 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]

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

The first congressional appropriation, in the amount of $700 million, was awarded by HUD 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 administered 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. Created in 1968, ESDC is a corporate governmental agency of the State of New York, and is currently engaged in housing and economic development, as well as in special projects throughout New York State. To carry out large-scale economic development activities, ESDC creates various consolidated subsidiaries. In this regard, the ESDC's board of directors authorized the creation of the

[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.

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 functions as a joint city-state development corporation with a 16-member board of directors that is appointed by the Governor and the Mayor. 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.

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. The additional funding brought the amount that is being administrated by the ESDC to $1.05 billion, which has been allocated as follows:

Program	EDSC Action Plan	LMDC Action Plan	TOTAL	Drawn downs as of 9/30/02
Bridge Loan Program	$15,000,000	0	$15,000,000	0
WTC Business Recovery Loan Fund	$50,000,000	0	$50,000,000	0
WTC Business Recovery Grant Program	$331,000,000	$150,000,000	$481,000,000	$310,519,261
Small Firm Attraction & Retention Grants	$105,000,000	$50,000,000	$155,000,000	$13,914,000
Grants To technical Assistance Providers	$5,000,000	0	$5,000,000	$842,360
Large Firm Job Creation & Retention	$170,000,000	$150,000,000	$320,000,000	0
Compensation for Economic Losses to Other Business	$5,000,000	0	$5,000,000	$2,740,521
Business Information	$5,000,000	0	$5,000,000	0
Administration	$14,000,000	0	$14,000,000	$2,502,858
TOTALS	$700,000,000	$350,000,000	$1,050,000,000	$330,519,000

In order to achieve the Congressional mandate to provide assistance to individuals and small businesses as quickly as possible, the ESDC began implementing its action plan immediately upon its approval. At September 30, 2002, the ESDC had primarily disbursed funds to recipients of Business Recovery Grants and Small Firm Attraction and

Retention Grants. Thus, our audit efforts were concentrated on these grant programs and administrative costs.

World Trade Center Disaster Business Recovery Grants

BRG program

The World Trade Center (WTC) Disaster Business Recovery Grant (BRG) program provides grants to businesses to compensate them for economic losses resulting from the September 11th terrorist attacks. To qualify the business must have been located south of 14 th Street and employed fewer than 500 employees. (See Appendix B for eligible areas) Initially, the program provided assistance in an amount up to 10 days of gross revenue, or up to $300,000 per business (whichever is less), depending on location. This amount was limited by the applicant's eligible economic loss amount. However, on August 28, 2002, the ESDC revised the program to provide assistance in an amount up to 25 days of gross revenue, or up to $300,000 per business (whichever is less) depending on location. This amount is also limited by the applicant's eligible economic loss amount. See below charts for eligible areas (locations) and assistance levels:

Effective at Program Inception

AREA	DAYS OF ECONOMIC LOSS	PERCENT OF ANNUAL GROSS REVENUES OR EXPENSES	MAXIMUM GRANT AMOUNT
14 St. -- Houston Area	2	0.8%	$50,000
Houston -- Canal Area	3	1.2%	$100,000
South of Canal Area	5	2.0%	$150,000
Restricted Zone	10	4.0%	$300,000

REVISED AUGUST 28, 2002

AREA	DAYS OF ECONOMIC LOSS	PERCENT OF ANNUAL GROSS REVENUES OR EXPENSES	MAXIMUM GRANT AMOUNT
14 St. -- Houston Area	3	1.2%	$50,000
Houston -- Canal Area	5	2.0%	$100,000
South of Canal Area	7	2.8%	$150,000
Restricted Zone	25	10.0%	$300,000

The ESDC estimated the total cost for the BRG program to be $481 million. The funding is comprised of $331 million from the $700 million of CDBG funds provided to New York State through the ESDC, and $150 million from the $2 billion of CDBG funds provided to New York State through the LMDC.

Scope

From the 10,456 BRGs disbursed between program inception (February 2002) and September 30, 2002, we selected two statistical samples. Our samples were selected using Dollar Unit Sampling. The first statistical sample consisted of 170 BRGs, representing BRG disbursements of $18,277,269 that were disbursed between program inception and April 30, 2002. The second statistical sample consisted of 269 BRGs representing BRG disbursements of $27,759,169, which were disbursed between May 1, 2002 and September 30, 2002. In total, we selected and tested 439 BRGs, representing BRG disbursements of $46,036,438. We reviewed the files of the grants that were in our samples to determine whether the ESDC followed its processing criteria and the BRG program's guidelines. We sent confirmations to BRG recipients requesting verification of the information in the grant files. We requested the income tax information on 439 BRGs from the Internal Revenue Service and compared it to the federal income tax information in each BRG file. In addition, we independently obtained computer data from the Small Business Administration (SBA) on the disaster loan assistance that they provided for the September 11th terrorist attacks. Using Audit Command Language (ACL), we matched SBA's computer data to the ESDC's disaster recovery database to identify those BRG recipients that had received SBA disaster loan assistance.

SFARG program

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

The SFARG program provides grants to qualifying 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 $700 million HUD appropriation. The November 22, 2002 LMDC Action Plan increased the allocation for the SFARG program by $50 million to $155 million. At September 30, 2002, per the ESDC's Grants Management System, $12,942,250 of SFARG funds had been expended.

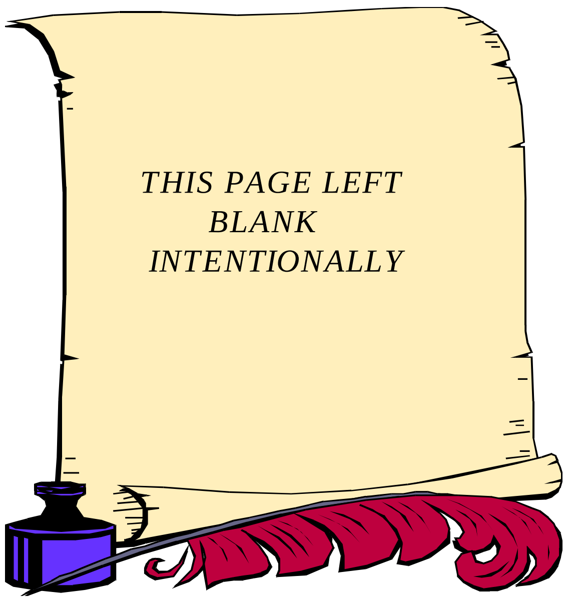
Our review of the SFARG program encompasses all grants disbursed at September 30, 2002, which were 280 grants totaling $12,942,250. Using Audit Command Language (ACL), we selected a stratified variable sample. The sample parameters called for a 95 percent confidence level and a precision range of 5 percent. Our stratified variable sample consisted of 121 cases representing disbursements of $9,879,250.

Audit scope and methodology

We performed our on-site work between April 2002 and February 2003. The current review covered the period between inception (February 2002) and September 30, 2002.

The on-going audit is being conducted in accordance with Generally Accepted Government Auditing Standards.

We provided a copy of this report to the Auditee.



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Processing Deficiencies in the Business Recovery Grant Program Need to be Addressed

Our review of statistically selected samples of Business Recovery Grants (BRG) disclosed that over and underpayments were made to certain grant recipients. Specifically, we found overpayments and underpayments of $311,327, and $19,234 respectively, for a net overpayment of $292,093. Also, the review disclosed that federal tax information in some recipients' applications did not agree with the information that we received from the Internal Revenue Service. This information is very important because it is used to determine the amount of each applicant's grant. As a consequence, some recipients did not receive the proper grant amount while others may have received a grant based on inaccurate tax information. We attribute the over and under grant payments to human error, and the federal tax information discrepancies to the possibility that some recipients may have provided incorrect federal tax information in their grant applications. ESDC officials must adequately address these issues during post reviews designed to determine compliance with the program's processing procedures and requirements.

Background

WTC Disaster Business Recovery Grant (BRG) Program

The World Trade Center (WTC) Disaster Business Recovery Grant (BRG) program provides grants to businesses to compensate them for economic losses resulting from the September 11th terrorist attacks. To qualify the business must have been located south of 14 Street and employed fewer than 500 employees. (See Appendix B for eligible areas) Initially, the program provided assistance in an amount up to 10 days of gross revenue, or up to $300,000 per business, (whichever is less) depending on location. This amount was limited by the applicant's eligible economic loss amount. However, on August 28, 2002, the ESDC revised the program to provide assistance in an amount up to 25 days of gross revenue, or up to $300,000 per business (whichever is less), depending on location and this amount is limited by the applicant's eligible economic loss amount.

The ESDC estimated the total cost of the BRG program to be $481 million. The funding is comprised of $331 million from the $700 million of CDBG funds that were provided to New York State and administered by the ESDC and $150 million from the 2 billion of CDBG funds provided to New

York State and administered by the Lower Manhattan Development Corporation (LMDC).

Scope and methodology

From the 10,456 BRGs disbursed between program inception (February 2002) and September 30, 2002, we selected two statistical samples. Our samples were selected using Dollar Unit Sampling. The first statistical sample consisted of 170 BRGs, representing BRG disbursements of $18,277,269 that were disbursed between program inception and April 30, 2002. The second statistical sample consisted of 269 BRGs, representing BRG disbursements of $27,759,169, which were disbursed between May 1, 2002 and September 30, 2002. In total, we selected and tested 439 BRGs, representing BRG disbursements of $46,036,438. We reviewed the files of the grants that were in our sample to determine whether the ESDC followed its processing criteria and the BRG program's guidelines. We sent confirmations to the BRG recipients requesting verification of the data in the grant files. We requested the applicable federal tax information on 439 BRGs from the Internal Revenue Service and compared the information to the federal tax information in each BRG file. In addition, we independently obtained computer data from the Small Business Administration (SBA) on the disaster loan assistance that they provided as a result of the September 11th terrorist attacks. Using Audit Command Language (ACL), we matched SBA's computer data to ESDC's disaster recovery database to identify those BRG recipients that also received SBA disaster loan assistance.

Criteria

Title 24 CFR Part 570.501 (b) provides that the recipient (grantee) is responsible for ensuring that CDBG funds are used in accordance with all applicable program requirements.

The BRG program requirements are provided in the HUD approved New York State Action Plan dated January 30, 2002, and amended June 7, 2002, as well as, the program's guidelines that are provided to applicants. In the BRG application, applicants certify that all statements in the application, including all attachments hereto and any affidavits, certifications or supplemental information provided herewith, are true and accurate. The applicants further certify that the tax returns provided with their application reflect revenues or expenses, as applicable, related solely to operations derived from the premises indicated in the application and the applicant is in compliance with all federal, state and local laws, and is not delinquent on any tax obligation.

Over and under payments of BRGs

Monetary errors resulted in $277,527 of overpayments and $19,234 of under-payments

Our review of BRGs disclosed that some BRG recipients received more than they were entitled to receive while others received less than their entitlement. Specifically, our testing of 439 BRGs totaling $46,036,438, disclosed that ESDC incorrectly computed nine BRGs resulting in monetary errors in which grant recipients received either an overpayment or an underpayment. The monetary errors resulted in overpayments of $277,527 and underpayments of $19,234, as shown below:

GRANT ID	UNDER-PAYMENT AMOUNT	OVER-PAYMENT AMOUNT	CAUSE
April 30th Statistical Sample			
5998	($779)	$0	1
8477	$0	$3,554	1
9069	$0	$4,073	2
9104	($10,000)	$0	3
9687	($282)	$0	1
9926	$0	$22,533	5
11363	$0	$150,000	2
Subtotal	($11,061)	$180,160	
September 30th Statistical Sample			
16228	$0	$97,367	1
16370	($8,173)	$0	4
Subtotal	($8,173.)	$97,367	
TOTAL	**($19,234)**	**$277,527**	
Error on Supplemental Grant 9926	$0	$33,800	5
GRAND TOTAL	**($19,234)**	**$311,327**	

The causes of the monetary errors are explained below:

1 The ESDC used incorrect revenue amount.
2 The ESDC calculated grant using wrong business zone.
3 The ESDC calculated grant using the business' 2001 federal tax return instead of the business' 2000 federal tax return.
4 The ESDC calculated grant using a 2000 SEC Report instead of requesting that the applicant business provide a 2000 federal tax return.

> The ESDC calculated grant without obtaining the required copy of NYC tax return and a CPA letter. Subsequently, the ESDC obtained copy of the NYC tax return showing correct NYC gross revenue.

See Appendix C for more details.

Evaluation of the results of the statistical samples

Statistical evaluation of the results our review

In consultation with a statistician, we evaluated the results of our sample testing and projected those results over the entire population of BRGs. Using the results of our dollar unit sample of 439 BRGs, representing BRG disbursements of $46,036,438, which was drawn from a population of 10,456 BRGs with a value of $277,343,142, we estimated that the population contains overpayments of $1,125,121 and underpayments of $77,433 for a net overpayment of $1,047,688. Our sample was selected using a 95 percent confidence level and 2 percent materiality level. Pertaining to the estimated number of unidentified BRGs with monetary errors, we believe this issue must be addressed by the ESDC in consultation with HUD to determine the level of post reviews that should be performed to identify and correct the errors with appropriate action.

Details of the review of the samples

Details of the review of the samples

Regarding the errors identified in our statistically selected sample, we discussed them with ESDC officials. For grant numbers 5998, 8477, 9687, and 16228, the ESDC officials agreed that an incorrect gross revenue amount was used to calculate the grant amount. The ESDC has corrected the gross revenue amounts for grants numbered 5998, 8477, and 9687 in its database, and has corrected the monetary errors for those three grants through its supplemental BRG program, therefore, no further corrective action is necessary. For Grant number 16228, the ESDC sent a written letter to the Applicant requesting repayment of the $97,367. 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 also the costs must be adequately documented. As a result, we consider the $97,367 overpayment to be unnecessary in accordance with OMB Circular A-87 and an ineligible cost to the BRG program. Thus, HUD must determine whether the ESDC is to reimburse the BRG program from non-Federal funds.

For grants numbers 9069 and 11363, the ESDC used the wrong zone to calculate these two grants. The ESDC has entered the correct zone into its database and has corrected the monetary errors for grant number 9069 through its supplemental BRG's program. For grant number 11363, the ESDC has executed a note payable between the ESDC and the BRG recipient in the amount of $150,000. The overpayment of $150,000 is technically ineligible. In this regard, HUD has to determine whether the ESDC properly handled this overpayment, or whether ESDC should be instructed to reimburse the BRG program from non-Federal funds.

Regarding grant number 9104, the ESDC calculated the grant using information from a 2001 federal tax return instead of the required 2000 federal tax return. ESDC officials agreed with our calculations and entered the correct tax information into its database and corrected the monetary error through its supplemental BRG program; therefore, no further corrective action is necessary for this grant.

Concerning grant number 16370, the ESDC incorrectly calculated this grant using the gross revenue amount from the Applicant's 2000 SEC Report instead of the required 2000 federal tax return. ESDC Officials agreed with our calculations and entered the correct gross revenue amount into its database. Additionally, the ESDC approved an additional grant in the amount of $8,173 to provide the applicant with the amount of the underpayment. The ESDC should disburse the additional $8,173 to the applicant.

For grant number 9926, the ESDC calculated the grant without obtaining the required copy of the applicant's New York City tax return and a Certified Public Accountant letter stating revenues generated by business locations, therefore we were unable to determine if the ESDC used the correct gross revenue amount to calculate this grant. Subsequent to discussions with ESDC officials, they obtained the required documents, and we determined that the ESDC did not use the correct gross revenue amount.

Apparently, the ESDC computed the initial grant amount incorrectly, which produced an overpayment of $22,533. The ESDC has corrected the gross revenue amount for the grant in its database. In addition, before we learned of the error, the ESDC had provided this grant recipient a supplemental BRG based on the incorrect gross revenue amount. The supplemental grant, which was grant number 16509, was not part of our statistically selected sample and therefore, not part of our statistical projections. However, the ESDC made an additional overpayment of $33,800 to the applicant. The ESDC has sent a letter to the BRG recipient requesting repayment of the $56,333 ($22,533 of the original grant and $33,800 of the supplemental grant). The overpayments of $56,333 represent an ineligible cost pursuant to OMB Circular A-87. Thus, HUD must determine whether the ESDC is to reimburse the BRG program from non-Federal funds. In this regard, a determination needs to be made on unresolved overpayments of $303,700 (See Appendix C), since the ESDC has resolved $7,627 (for grants numbered 8477 and 9069) out of the total overpayments of $311,327.

Discrepancies between Income Tax information in BRG applications and information provided by the IRS

Discrepancies noted in Income Tax data

We requested tax transcripts from the IRS for the applicable 439 BRG applicants in our samples in order to compare the tax information submitted to the ESDC by the applicants to tax information provided by the IRS. Our comparison disclosed that 13 applications contained tax information that did not agree with the tax information on tax transcripts provided by the IRS. Specifically, the IRS information showed that 10 of the 13 applicants did not file a tax return for the applicable tax year, even though the applicant provided the ESDC with a copy of a federal tax return. Also, the IRS information on the remaining three applicants showed that the applicants filed a tax return with the IRS with tax information that differed from the tax information on the returns they provided to the ESDC. The results of our review indicate that 2.8 percent of the grant funds in our statistically selected sample had discrepancies between the income tax information provided in applications and the tax information provided by the IRS. Appling the 2.8 percent to the entire universe of BRGs, we estimate that approximately $7.76 million in grant disbursements have discrepancies between the income tax data in grant applications and the tax information maintained by the IRS.

Officials of ESDC's internal audit division have informed us that they are also statistically sampling and testing BRGs disbursed. Their review also includes comparing the tax information submitted to ESDC by applicants to the tax information submitted to the IRS. As a result, we are recommending that HUD require the ESDC to continue to analyze tax information as part of its internal audit function and report the results to HUD-OIG.

Auditee Comments

The ESDC disagrees with the term "processing deficiencies," which would lead the reader to conclude that there are procedural problems with ESDC's processing of BRG's. In the body of the report, HUD attributed the over and underpayments to human error rather than inadequate or deficient procedures. Also, the ESDC stated that the inability of the IRS to provide a transcript of a grantee's tax return for 10 out of 469 grantees should not be characterized as an ESDC "processing deficiency". This observed condition is independent of ESDC's processing of BRGs.

The ESDC further stated that under "Criteria," it is important to point out that the interpretation of "the plan and guidelines to mean that to be eligible a business must have filed a federal tax return for the tax period prior to" September 11, 2001 is an erroneous interpretation. In fact, several exceptions to this requirement are set forth in the guidelines, and include certain new businesses and contract- based businesses. Also, the ESDC disagrees with the conclusion that because the IRS reported having no record of a tax return, the business did not file a tax return. In testing conducted by ESDC's internal Audit Department, many different reasons were found that could account for the inability of the IRS to provide a return upon an initial request.

OIG Evaluation of Auditee Comments

Processing deficiencies are those conditions that adversely affect the processing and awarding of grant funds; as such human error and discrepancies in tax information are in our

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opinion processing deficiencies. Human error and discrepancies in information are conditions that impact the BRG program and are matters that need to be addressed by the ESDC and HUD.

Concerning the discrepancies in tax information, we have revised the criteria section to more clearly state the applicant's certifications relating to tax information.

Our statistical analysis was used to project the amount of grant disbursements that pertain to discrepancies between the income tax data in their grant applications and the tax information maintained by the IRS. Our analysis did not consider the causes of the discrepancies, but was based on the fact that a discrepancy exists between the tax information in the application and the IRS tax transcripts in 13 BRGs in our statistical sample. Therefore, our statistical projection that approximately $7.76 million in grant disbursements have discrepancies in the tax information is valid.

Recommendations

We recommend that the Deputy Assistant Secretary for Grant Programs:

1A Instruct the ESDC on whether unresolved overpayments of $303,700 (See Appendix C), which we have determined to be ineligible, are to be reimbursed to the BRG program by the ESDC from non-Federal funds.

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

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

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

Details on Economic Loss Amounts and the Duplication of Benefits Issues Need to be Resolved

Our assessments of ESDC's management controls over the Business Recovery Grant (BRG) program disclosed indications of two major application-processing weaknesses, which we discussed in our Interim Report to HUD, dated May 22, 2002. Further audit work disclosed that resolution of these two weaknesses has not been completed. First, we found that early Business Recovery Grant (BRG) applications did not provide any details showing how the amounts of the applicants' estimated economic losses were determined. Second, the ESDC may have awarded CDBG disaster grants to applicants who have received Small Business Administration (SBA) Disaster loans for the same purpose. Consequently, applicants' estimated economic loss amounts were not supported with acceptable documentation; and the ESDC may have provided duplicate benefits to BRG recipients, which is a violation of Title 42, U.S.C. Chapter 68 Section 5155 (a). These conditions exist because application processing controls did not: 1) require documentation to support estimated economic loss amounts, and 2) prevent duplication of benefits between the BRG program and other federal disaster assistance programs. We attribute these deficiencies to the fact that the ESDC was under a congressional mandate to design and implement procedures that would allow the disbursement of grant funds to an approved applicant within 45 days from the receipt of an applicant's application.

Details on estimated economic losses were not obtained

Details of economic loss not obtained

In our May 22, 2002 Interim Report, we reported that the ESDC did not require BRG applicants to provide any details on how their economic loss amounts were derived. Therefore, we recommended that the ESDC obtain from all BRG applicants the details as to how their economic loss amounts were determined. On May 20, 2002, ESDC changed its BRG application to include a request for the details of an applicant's estimated economic loss amount.

ESDC agreed to initiate verification survey

HUD's Management Decision regarding our Interim Report indicated that the ESDC agreed to initiate a verification survey of a sample of businesses that received a BRG prior to May 20, 2002. This verification survey was to obtain the details of economic loss amounts for a sample of businesses, and was to be completed by December 31, 2002. According to ESDC officials, ESDC determined that the verification survey was not productive and decided not to complete the survey. These officials also stated that approximately 75% of the BRGs that did not have the details for their economic loss amount would be submitting the details with an August 29, 2002 supplemental BRG application. ESDC officials also stated that the ESDC will audit economic loss amounts using statistical sampling and other sampling methods to ensure that the numbers submitted are supported by proper documentation.

Applications in sample did not contain details of economic loss

Out of our two statistical samples totaling 439 BRGs, we found that 271 applications did not have the details of the applicant's economic loss amount. As a result, we cannot be assured that the ESDC is obtaining the details from applicants to support the amounts of their estimated economic losses. Therefore, HUD should obtain and review the work performed by the ESDC for economic loss amounts and determine whether the work is adequate to ensure that economic loss amounts are supported by proper documentation.

Duplication of benefits between BRG program and SBA loans

Criteria

Federal Register: January 28, 2002 (Volume 67, Number 18) Docket No. FR-4732-N-01 and Federal Register: February 7, 2002 (Volume 67 Number 26) Docket No. FR-4732-C-02 provide that "The CDBG funds appropriated under the Emergency Response Fund may not be used to provide funds for the same specific uses as disaster loans made available by the Small Business Administration (SBA), in compliance with 15 U.S.C. 636(b)(1)(A). If the needs for assistance are more than the SBA disaster loan amount, CDBG disaster assistance may be used to fund such additional need. New York State should encourage the use of SBA physical damage and economic injury disaster loans; they offer low interest rates and favorable terms."

Title 42 U.S.C. Chapter 68 Section 5155 (a) provides that "The President, in consultation with the head of each Federal agency administering any program providing financial assistance to persons, business concerns, or other entities suffering losses as a result of a major disaster or emergency, shall assure that no such person, business concern, or other entity will receive such assistance with respect to any part of such loss as to which he has received financial assistance under any other program or from insurance or any other source. This section shall not prohibit the provision of Federal assistance to a person who is or may be entitled to receive benefits for the same purposes from another source if such person has not received such other benefits by the time of application for Federal assistance and if such person agrees to repay all duplicative assistance to the agency providing the Federal assistance. The agency which provided the duplicative assistance shall collect such duplicative assistance from the recipient."

Lack of procedures to account for SBA Disaster Loans

Our audit determined that the ESDC did not have procedures in place to account for SBA Physical Damage Disaster Loans and Economic Injury Damage Loans (EIDL) applied for, approved, and/or received by BRG applicants. Initially, the ESDC asked BRG applicants to list grants, loans, and insurance applied for, approved, and/or received; however, the ESDC only considered insurance proceeds and grants received from the NYC Economic Development Corporation (EDC) and the WTC Retail Recovery Grant (RRG) program in calculating BRG assistance. The ESDC did not have an established policy or procedure for accounting for loans received from SBA. That is, the ESDC did not deduct SBA loan amounts from the BRG applicant's estimated economic loss amount when calculating the amount of BRG grant assistance an applicant was entitled to receive. As a result, the ESDC expended CDBG funds that may be a duplication of benefits with SBA Physical Damage Disaster Loans and EIDL.

Interim Report states the potential for duplication of benefits exists

In our May 22, 2002 Interim Report, we reported that ESDC may be awarding Business Recovery Grants to applicants that have already received SBA Disaster Assistance Loans. Since these applicants may not be eligible to receive both the SBA loans and the Business Recovery Grants, there exists a potential for duplication of benefits. As a result, we recommended that HUD make a determination as to whether or not a duplication of benefits could exist if the benefits provided by the Business Recovery Grants and the SBA loans are in excess of an

Applicant's net economic loss. HUD agreed that there is a potential for a duplication of benefits between Business Recovery Grants and SBA Disaster Loans. As such, HUD in consultation with the SBA and the ESDC, developed procedures and formulas for ESDC to use in making determinations of duplications of benefits.

Procedures and formulas for determining duplication of benefits

According to ESDC officials, the ESDC has implemented HUD's procedures and the formulas for determining duplication of benefits. Additionally, ESDC officials have advised us that they have identified about 40 grants in which a duplication of benefits has occurred. The ESDC has not completed its analysis of duplications of benefits and it has not decided on the method for repayment of the duplication of benefits. The ESDC needs to properly implement and complete HUD's procedures and formulas for duplication of benefits. Also, the ESDC needs to make a determination regarding the method of repayment for duplication of benefits. This determination may include consultation with SBA officials to devise a plan of action for resolving the duplication of benefits issue that exists between the BRG program and SBA's disaster loan assistance program.

Auditee Comments

The ESDC stated that the statement "Interim Report concerns not resolved" gives the incorrect impression that ESDC has neglected to address these two important issues. In fact, work on these two issues has been ongoing and evolving as new information and circumstances arose since they were first reported in May/June. Further the ESDC indicated that HUD statistics would be more enlightening if an indication were given as to how many of the 271 BRG's missing detailed economic loss analyses were later received with supplemental grant applications. The ESDC stated that their records show that 84% of businesses that applied for an original BRG have also submitted a supplemental application, thereby providing detail on economic loss.

The ESDC stated the use of the phrase "processing procedures were compromised" is extremely misleading since it suggests a willful decision on ESDC's part to ignore proper mandated processing procedures. However, it was agreed with HUD from the outset that ESDC would not be able to obtain documentation to support economic loss amounts and at the same time meet the congressional mandate of disbursing funds in 45 days.

The ESDC indicated that the application included language to borrowers & applicants which stated that if the applicant received a SBA disaster loan they may be required to use the BRG funds to pay off or reduce the outstanding balance on the SBA disaster loan.

OIG Evaluation of Auditee Comments

We changed the side caption in the Executive Summary to read, "Resolution of Interim Report concerns not completed" to indicate that the process is on going. While we are aware of the ESDC's efforts to resolve the Interim Report issues, they were not resolved at the completion date of our review. The results of our analysis for the review period ending September 30, 2002 showed that out of the 439 BRG applications in our statistical sample, 271 did not have details on the applicant's economic loss amount. As a result, we cannot be assured that the ESDC is obtaining the details from applicants to support the amounts of their estimated economic losses.

Our concern with the duplication of benefits between the BRG program and SBA loans is that the ESDC did not have procedures in place to account for SBA Physical Damage Disaster Loans and Economic Injury Damage Loans (EIDL) applied for, approved, and/or received by BRG applicants. Language in the application concerning duplication of benefits between BRG and SBA loans is not adequate to identify and account for loans received from SBA. The ESDC needs to properly implement and complete HUD's procedures and formulas for duplication of benefits and to make a determination regarding the method of repayment for duplication of benefits.

Recommendations

We recommend that the Deputy Assistant Secretary for Grant Programs:

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.

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

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

Processing Procedures of the SFARG Program Need to be Improved

Our review disclosed that Empire State Development Corporation's (ESDC) procedures and guidelines for processing Small Firm Attraction and Retention Grant (SFARG) applications do not contain adequate criteria for handling special situation applications and do not require adequate support for decisions made while processing applications. Consequently, applications involving special situations could be receiving inconsistent consideration from different grant processors, thereby reducing assurances that SFARGs are being awarded consistently. Additionally, we found that ESDC disbursed a $38,500 grant to an ineligible applicant. We attribute these deficiencies to the ESDC's program guidelines not having procedures that ensure that all applications from eligible businesses are consistently processed, and adequately documented. Thus, improvements are needed to enhance efficiency in the administration of the program, as required by OMB Circular A-87.

Background

The purposes of the Small Firm Attraction and Retention Grant (SFARG) Program are 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 program provides grants to at-risk establishments with 200 or fewer employees that commit to remaining for at least five years in the area of Manhattan south of Canal Street beyond their current commitment. It also provides grants to small firms that were located in or near the World Trade Center that commit to remaining in New York City for at least five years. 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.

The ESDC's amended Action Plan of June 7, 2002 allocated $105 million for the SFARG program from the $700 million HUD appropriation. The November 22, 2002 LMDC Action Plan increased the allocation for the SFARG program by $50 million to $155 million. At September 30, 2002, per the ESDC's Grants Management System, $12,942,250 of SFARG funds had been expended.

Scope

Our review of the SFARG program encompasses all disbursements through September 30, 2002, which were 280 grants totaling $12,942,250. We selected a Stratified Variable Sample of 121 grants, representing disbursements of $9,879,250. We reviewed the 121 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 280 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

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 also the costs must be adequately documented.

We tested 121 SFARGs and found one error that resulted in grant dollars being disbursed to an ineligible recipient. However, we noted instances where SFARG guidelines were not adequate to address applicants with special circumstances. Details pertaining to the results of our test review are provided below:

Ineligible grant

Ineligible SFARG

The ESDC disbursed $38,500 in SFARG funds to an applicant who was not eligible for SFARG assistance. Our review indicated that the location of the applicant's business was not in an eligible area of the SFARG program. However, the ESDC processed the grant as if the business was located in an eligible SFARG area. As a result, the business received $38,500 in SFARG funds for which it was not eligible to receive. ESDC officials stated that they are considering adding another independent internal review of grant processing to prevent a re-occurrence of this in the future.

SFARG processing procedures need to be improved

Processing procedures need improvement

The ESDC's procedures do not adequately state the process to be followed for those SFARG applications with special situations. For example, several grants in our sample involved businesses located in the eligible area, however, most of these businesses' employees may actually work outside the eligible area or even outside of the City of New York. Several other grants involved instances where applicants had no written lease and/or were on a month-to-month lease. Additionally, we noted instances where the landlord and tenant have an identity of interest relationship. The ESDC procedures do not adequately address how special situations such as these should be handled.

ESDC officials agreed that the aforementioned are potential problem areas and are not accounted for in the guidelines. The ESDC should develop detailed procedures on how to best handle these and other special situation grants. Such procedures should increase assurances that all SFARGs are being awarded consistently.

SFARG files did not always contain adequate documentation

In addition, we found that some grant files did not contain adequate documentation to explain how the grant was calculated. For example, several grants in our sample contained a big variance between the number of employees used for grant computation versus the number of employees reported on the New York State Department of Labor NYS-45 form. While we recognize that there can be numerous legitimate reasons for the variance, we believe that the SFARG files should have been better documented to explain how the ESDC determined the number of employees used in the grant computation process.

Also, ESDC officials advised us that they conducted a match with the NYS Department of Labor to verify the number of employees for each SFARG grant recipient. However, as of the date of our review, the ESDC had not analyzed the results of their independent verification.

We independently obtained employee data from the NYS Department of Labor to determine whether the information in EDSC's grant database for all 280 SFARGs, paid through September 30, 2002, was correct. The data from the NYS Department of Labor show that at least 34 of the 280 grant recipients had no employee data under the Employee Identification Number (EIN) provided in the SFARG application. Since 10 of these 34 were in our sample of 121, we attempted to determine the reason(s) for the discrepancies involving the 10 grants. We found that 6 of the 10 had filed their return with the NYS Department of Labor under a different EIN than the one contained in the ESDC's grants management system. The ESDC is inputting into the grants management system the EIN from the SFARG applications. However, in some instances, the recipient actually files with the NYS Department of Labor under a different EIN. This occurs because some applicants have multiple affiliated companies with separate EINs. Since the ESDC plans on comparing the employee data from the SFARG applications with the NYS Department of Labor data, the ESDC needs to establish a procedure to ensure that its grants management system contains the EIN that the SFARG applicants used in filing with the NYS Department of Labor.

Auditee Comments

The ESDC disagrees with the reports statement "that the ESDC failed to include in the program's guidelines procedures that ensure all applications from eligible businesses are processed consistently, timely, and adequately documented." Officials of the ESDC indicated that they find this conclusion misleading since ESDC's program guidelines did establish procedures that generally resulted in consistent, timely and adequately documented processing of SFARG applications. Consequently, the finding's criticism that ESDC's guidelines were deficient because they did not provide "adequate criteria" for handling "special situations" was inappropriate since procedures are normally written to cover the majority of transactions processed. It would be unreasonable to expect procedures developed at the inception of the program to anticipate the numerous special situations that might be encountered. Instead, ESDC Officals say they have continuously evaluated the program and periodically revised the guidelines and procedures as necessary.

Further the ESDC states that the procedures and processing of "SFARG applications with special situations" has improved significantly since the conclusion of the time period covered in this report.

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The ESDC stated that with respect to timeliness, the Executive Summary criticized ESDC for "not always" meeting the processing objective of 45 days. Rather than use the unreasonable standard of "not always," especially for such a complex program as SFARG, a more balance perspective would indicate that ESDC achieved the 45 day timeliness objective 71% of the time.

The ESDC stated without having knowledge of the identity of the 34 grant recipients that did not have employee data under the Employee Identification Number (EIN) provided in the SFARG application, they cannot determine the exact reason for this discrepancy. It is possible that some of the 34 grant recipients outsource their human resource functions to an independent entity under an Employee Service Agreement. In this special situation, the employees of the applicant would be reported to DOL under the EIN of the entity providing the employment service agreement. Under these and similar special circumstances, ESDC will enter into its grant management database the EIN that the SFARG applicant uses to report to DOL, as well as the EIN of related entities or employee service companies. As needed, additional notations will be entered into the database to clarify these situations.

The ESDC indicated Grant Reviewers will provide more detailed written notes to the file, which will clearly explain the process followed and reasoning behind their determination of the number of eligible employees for each grant award.

OIG Evaluation of Auditee Comments

The ESDC incorrectly construes the audit report as implying that ESDC should have had specific and exact procedures at program inception to anticipate every conceivable special situation application that might be encountered. However, the finding merely states that the ESDC should have guidelines that included *procedures* for handling special situations to ensure consistency, etc. Specifically, the finding states that "ESDC procedures do not adequately state the *process* to be followed for those SFARG applications with special situations." This does not imply that the ESDC should have a procedure for *every* conceivable circumstance, but only recommends that ESDC provide procedures on how to consistently *handle* (i.e. approval process) special situations that may arise. Therefore, we conclude that the SFARG guidelines do require revision as stated in recommendation 3B.

We have removed the section on “Not all SFARGs were processed within 45 days” based on consultation with HUD that the 45 day processing requirement was not applicable to the SFARG program.

We will provide the ESDC with a list of the 34 grant recipients with employee data problems. Our recommendation is that ESDC establishes a procedure to ensure that its grants management systems contain the same EIN that the SFARG recipient files with the New York State Department of Labor so this problem can be avoided in the future.

Recommendations

We recommend that the Deputy Assistant Secretary for Grant Programs:

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.

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.

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.

Administrative and Accounting Controls Need to be Strengthened

The ESDC needs to eliminate control weaknesses over its Disaster Assistance program pertaining to accountability of grant funds and procurement of administrative services. Although some weaknesses resulted from the fast pace required of the ESDC to implement the disaster assistance programs; other weaknesses existed because the ESDC has not established and implemented needed controls and procedures to properly: 1) account for all grant funds disbursed, 2) document all procurement actions, and 3) review all supporting documentation pertaining to administrative expenses. Consequently, weaknesses in the ESDC's accounting and administrative control systems have allowed duplicate payments to be made to grant recipients. Moreover, procurement actions were not always fully documented, and supporting documentation for administrative expenses was not always properly reviewed. By strengthening its administrative and accounting controls, the ESDC will enhance program efficiency and compliance with federal requirements, which provides, in part, that a State shall have fiscal and administrative requirements for expending and accounting for all funds received.

Scope and methodology

Our review covered disbursements to grant recipients and administrative costs from program inception (February, 2002) through September 30, 2002. At September 30, 2002, 10,456 program participants had received Business Recovery Grants under the Disaster Assistance program, and the ESDC had incurred about $2.5 million of administrative costs. Using Audit Command Language (ACL) computer software, we analyzed the two databases that the ESDC is using to account for and record the grant disbursements to grant recipients. The analysis disclosed that some recipients received a duplicate grant payment.

Regarding administrative activities and costs, we selected a non-statistical sample of 63 transactions amounting to $307,291. The sample was selected from an administrative cost universe of appropriately $2.5 million. Testing of the sample items included reviews to determine the reasonableness of the costs and their applicability to the Disaster Assistance program.

Criteria

OMB Title 24 CFR 85.20 (b) (3) provides the requirements for internal controls. Effective control and accountability must be maintained for all grant and sub-grant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Title 24 CFR, Part 570.489 (d) provides in part that a State shall have fiscal and administrative requirements for expending and accounting for all funds received under the subpart. The requirements must be available for Federal inspection and must: (i) Be sufficiently specific to ensure that funds received are used in compliance with all applicable statutory and regulatory provisions; and (ii) Ensure that funds received are only spent for reasonable and necessary costs of operating programs.

OMB Circular A-87 states that to be allowable under Federal awards, costs, be necessary and reasonable for proper and efficient performance and administration of Federal awards.

Weaknesses in controls over the accountability of grant funds

Accountability of funds

The ESDC utilizes two databases to account for the amounts disbursed to grant recipients, one is the grants management system, which is the system that also contains the eligibility data on recipients, and the other is the disbursement database. During analysis of the two databases, we identified 22 instances where grant payments per the disbursement database did not agree with the payment amounts stated in the grants management system. Furthermore, we noted that neither database contains complete and accurate information of all disbursements to grant recipients. Specifically, we noted that the grants management system does not permit the recording of a second payment into the amount paid field. Therefore, some additional payments, reimbursements of grants funds or other adjustments to some initial grant payments may not have been recorded in the grants management system. Additionally, we noted that the disbursement database included wire transfers of grant payments that had been cancelled. For proper accountability, the ESDC should implement controls and procedures to ensure that the two databases are maintained in complete agreement, or can be readily reconciled to agree. In conjunction with the above, we noted that disbursement data in the grants management system is not reconciled to corresponding disbursement data in the Disaster Assistance

Program's General Ledger's cash account. Because the disbursements per the General Ledger were not reconciled to either database, the ESDC lacked adequate controls to ensure that the financial information reported in its performance reports is accurate.

Duplicate grant payments

Duplicate grant payments to grant recipients

Of the 22 instances where grant payments per the disbursement database did not agree with disbursement data in the grants management system, four represented duplicate payments totaling $12,491 that were disbursed to four Business Recovery Grants (BRG) recipients, as follows:

Grant ID Number	Amount of Duplicate Payment
6586	$ 3,690
72074	4,315
13285	2,455
16382	2,031
TOTAL	**$12,491**

The duplicate payments occurred either because two payment request forms were prepared, the same form was processed twice, or two BRG applications were submitted for the same business. In this regard, we found that the ESDC had not implemented controls to: (1) ensure that duplicate payment request forms are not prepared, (2) ensure that payment request forms are not used twice, and (3) prevent the submission and processing of two applications from the same business. However, once the duplicate payments were brought to the attention of ESDC officials, they took action to recover the overpayments.

It should be noted that the duplicate payments cause the grants management system to be understated by at least $12,491, which was not recorded in the system since only one disbursement could be recorded in its database for each unique grant ID number. The lack of reconciliation between the disbursement database, the grants management system, and the ESDC's General Ledger accounts has significantly reduced ESDC's ability to detect duplicate grant payments and other disbursement discrepancies. Regarding this issue, ESDC officials stated that they would establish procedures to ensure that controls are in place to prevent the disbursement of duplicate payments.

Administrative matters need to be addressed

Administrative activities

The review showed that administrative activities and related costs incurred for the Disaster Assistance program, were generally in compliance with applicable guidelines and regulations. Moreover, based on a comparison of amounts drawn down to date, the ESDC appears to be achieving program progress at a pace exceeding that at which administration funds have been expended. However, our review identified administrative matters that need to be addressed by the ESDC. They are discussed in the two sections below.

A. Procurements actions were not fully documented

Procurement Actions

The HUD Management Review Report dated July 31, 2002, stated that ESDC's procurement transactions related to temporary personnel agencies were not clearly documented to support that open and free competition had been achieved, or that nonstandard procedures were authorized in the face of pressing needs. Accordingly, HUD recommended that the ESDC review its procurement policies for compliance with 24 CFR 570.489(g) and 24 CFR Part 85.36. In addition, HUD recommended that all documentation for every procurement action, including correspondence related to procurement transactions, be included in the relevant activity file and be reviewed for completeness and compliance prior to formal contract award.

Criteria

Title 24 CFR, Part 570.489 (g) provides that when procuring property or services to be paid for in whole or in part with CDBG funds, the state shall follow its procurement policies and procedures. The state shall establish requirements for procurement policies and procedures for units of general and local governments, based on full and open competition. Methods of procurement (e.g., small purchase, sealed bids/formal advertising, competitive proposals, and noncompetitive proposals) and their applicability shall be specified by the state.

Temporary staff hired without proper procurement

Our review disclosed that services being provided to the ESDC by employees of temporary personnel agencies were procured without the use of formal advertising and without the benefit of binding contracts. Justifying the procurements, ESDC officials contend that the procurements were processed to address the urgent need of hiring skilled staff without delay and to provide immediate assistance and responses to WTC disaster grant applicants. Further, they contend that the staff hired from temporary employment agencies had provided prior services to the ESDC.

However, we found that ESDC's current procurement procedures are vague and lack sufficient details to address instances when contracts are awarded for the purchase of goods or services where formal advertising is not conducted. Moreover, the ESDC procedures do not adequately address situations where services may be procured without the execution of a binding contract, such as may be the case where an urgent need outweighs the benefits of formal contracting.

Contract and procurement procedures should be modified.

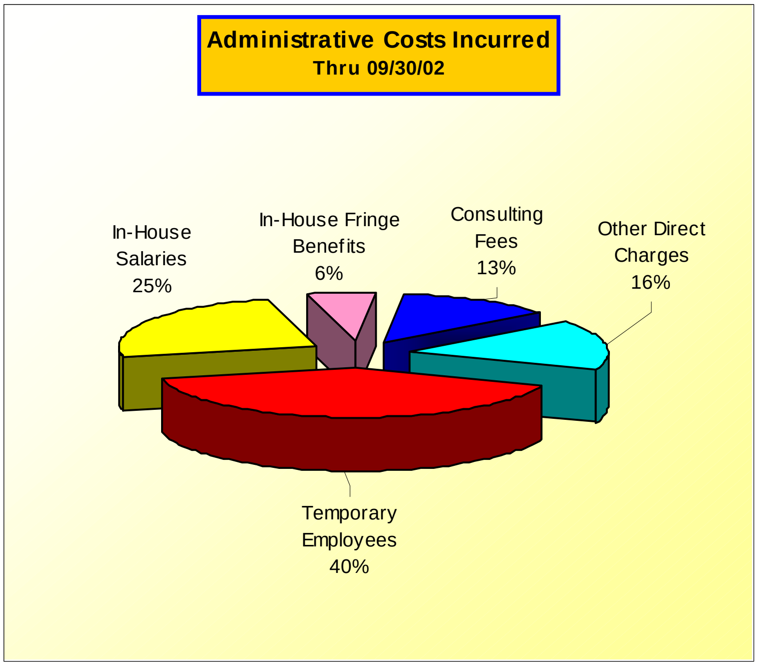
Based on the results of our review, we do not believe that the ESDC has adequately addressed the concerns raised by HUD regarding its own procurement procedures. The current procurement procedures do not adequately address the manner in which it is procuring services from employment agencies.

Consequently, the ESDC should modify its internal procurement policies and procedures as needed to address instances where formal advertising for contracting purposes is not considered necessary, and for instances where the execution of formal binding contracts is deemed impractical, untimely, or inefficient.

B. <u>Administrative costs not adequately reviewed</u>

Administrative costs controls not adequate

To test cash disbursement controls over payments of administrative costs, we selected a non-statistical sample of transactions for detailed testing. The sample consisted of 63 transactions involving costs of $307,291, which contained expenditures from each major cost classification incurred. The sample transactions were selected from a universe of administrative costs of approximately $2.5 million at September 30, 2002. As such, the $307,291 sample represented about 12% of all administrative costs incurred at September 30, 2002. The following graph shows the various types of administrative costs incurred through September 30, 2002, and the percentage of administrative costs charged by major cost category.



Our transaction testing showed that the ESDC generally has adequate controls over payments of in-house administrative costs. However, controls over the reviews of supporting documentation from vendors, such as employment agencies need to be improved to ensure that vendor invoices and claims are adequately reviewed for accuracy and eligibility prior to payment.

Documentation not carefully reviewed prior to payment.

Specifically, included in our sample for testing administrative transactions were payments to employment agencies associated with payroll claims for 60 temporary employees. The review showed that nine of the employees were paid based on summary billings from a vendor that did not provide detailed time sheets. Claims for the remaining 51 employees had detailed time sheets that provided days and hours the employees worked. However, for 13 of the 51 employees, the ESDC was billed for hours that did not agree with the hours logged on the time sheets. Thus, this indicates that the supporting documentation for

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the temporary employment service billings was not carefully reviewed prior to payment.

Although the dollar amounts associated with the aforementioned errors were minor, the significance of the errors is noteworthy. Not only are the errors related to costs incurred for services provided by temporary employment agencies, which comprise about 40 percent of the total costs incurred for administrative activities to date (as shown on the prior page), but the frequency of the undetected errors indicates that the grantee may not be adequately reviewing vendor billings. Consequently, it is possible that costs incurred related to other vendor claims may be incorrect and ineligible or unsupported costs may have been paid. Thus, to prevent the deficiencies cited from recurring in the future, the ESDC should establish controls to ensure that adequate reviews of documentation supporting payment claims are conducted prior to payment.

Auditee Comments

Concerning Finding 4, the ESDC acknowledges that at the time this audit was conducted improvements were needed in the reconciliation and control areas. This was primarily due to the fact that these programs were developed on an emergency basis and time did not permit a comprehensive analysis of new policies and procedures. However, these areas of concern were addressed with HUD OIG staff as they were uncovered and procedures have been established to provide reconciliations of all disbursements data, and additional controls have been activated to help avoid future duplicate payments.

The ESDC stated that the Draft Audit Report does not appreciate the emergency nature of the situation that faced ESDC when confronted with the planning, design and implementation of these grant programs. In no way did time permit ESDC to go through a formal bidding process to obtain temporary staffing assistance.

The ESDC acknowledged that not having a formal contract with the temporary agency was an oversight. However, the ESDC stated that the statement “Contract and procurement procedures should be modified,” is incorrect. The ESDC contends that its procurement procedures do not warrant modification based on the finding related to the procurement of temporary services. One technical exception involving one contract should not require modification of ESDC's procurement procedures. However, ESDC agrees that its procurement procedures need to be "more completely *documented* in its procurement manual" and ESDC is in the process of doing so.

The ESDC officials indicated that they believe recommendation 4A to be unnecessary because the Draft Audit Report acknowledges that ESDC took action to recover the $12,491 in duplicate payments. For recommendations 4B through 4E, these recommendations have already been implemented.

OIG Evaluation of Auditee Comments

We disagree with the ESDC's comment that the Draft Audit Report does not appreciate the emergency nature of the situation that ESDC faced when confronted with the planning, design, and implementation of these grant programs. To the contrary, our report specifically provides the position of ESDC regarding the urgent need ESDC faced in hiring skilled staff to provide immediate assistance and responses to the WTC disaster grant applicants. Further, the finding focused on control and procedure issues, and did not question costs incurred relating to the temporary personnel services provided. The issue stated in the finding was not whether ESDC's procurement of temporary personnel services was exempt from advertising requirements or that the procurement method utilized was not justified. The issue raised was that the procurements in question were not fully documented and that internal procedures should be modified to address instances where formal advertising for contracting purposes is not considered necessary, or for instances where the execution of formal binding contracts are deemed impractical, untimely, or inefficient.

While disputing the fact that its current procedures are vague and lack sufficient details to address instances when contracts are awarded for the purchase of goods and services where formal advertising is not conducted, the ESDC further states that the practices that ESDC follows may not be "sufficiently explained in its written procurement manual". It is precisely the latter issue, that procurement practices followed by ESDC may not be sufficiently explained in its written procurement manual, that supports the concern raised in the finding that procurement procedures are vague and lack sufficient details to address instances when contracts are awarded for the purchase of goods or services where formal advertising is not conducted. We disagree the ESDC's position, and based on the facts outlined in the draft audit finding, it is our position that the procurement procedures should be modified to fully document the processes needed to address instances where formal advertising for contracting purposes is not considered necessary, and for instances where the execution of formal binding contracts are deemed impractical, untimely or inefficient.

Since at the date of our audit the $12,491 in duplicate payments had not been repaid, recommendation 4A is still necessary.

Recommendations

We recommend that the Deputy Assistant Secretary for Grant Programs:

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

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

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

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.

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

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

Based on our review, we believe the following items are significant weaknesses:

The ESDC made over and underpayments to BRG recipients, (Program Operations, Compliance with Laws and Regulations and Safeguarding Resources – See Finding 1).

The ESDC did not implement procedures to obtain the data on estimated economic losses and to detect potential duplication of benefits, (Program Operations – See Finding 2).

The SFARG program's guidelines do not ensure that all applications are processed consistently, (Program Operations and Safeguarding Resources – See Finding 3).

The ESDC had weaknesses in its controls over the accountability of grants funds and the procurement of administrative services, (Program Operations, Compliance with Laws and Regulations and Safeguarding Resources – See Finding 4).

Follow Up On Prior Audits

We issued an Interim Report 2002-NY-1802 on May 22, 2002. The report contains three recommendations, which are still open. The recommendations are addressed in detail in Finding 2. The recommendations and HUD's position on each recommendation are as follows:

1A. Consult with appropriate SBA officials and determine whether duplication of benefits could exist if the benefits provided by a Business Recovery Grant and a SBA loan are in excess of the amount of an applicant's net economic loss. This may necessitate a legal interpretation of the alternative requirements pertaining to duplication of benefits. If you determine that duplicate benefits could exist, notify Empire State of the determination and direct that its processing procedures be revised to request applicants to provide appropriate details on SBA assistance.

HUD agreed with the recommendation and advised Empire State to implement procedures to determine if duplicate benefits existed. ESDC implemented the procedures, but has not completed its analysis.

1B. Ensure that Empire State is complying with Congressional intent and the Federal Register notices dated January 28, and February 7, 2002 regarding the reduction of CDBG disaster grants by any other public benefits that an applicant may have received.

HUD agreed with the recommendation and Empire State is in the process of implementing procedures to reduce the amount of Business Recovery Grants by the applicable amounts of other public assistance.

1C. Require Empire State to obtain from the applicants who have already received a Business Recovery Grant, the details as to how the amount of the estimated economic loss was determined.

HUD agreed with this recommendation. Empire State officials indicate that detailed economic loss data for approximately 75 percent of the applicants that previously received Business Recovery Grants were obtained when those applicants applied for additional funds from the Supplemental Grant Business Recovery Grant program. Empire State officials indicated that procedures would be established to verify the amount of economic loss through statistical and other sampling techniques. However, the testing methodology and time frames for accomplishing these tasks have not been developed or submitted to HUD for approval.

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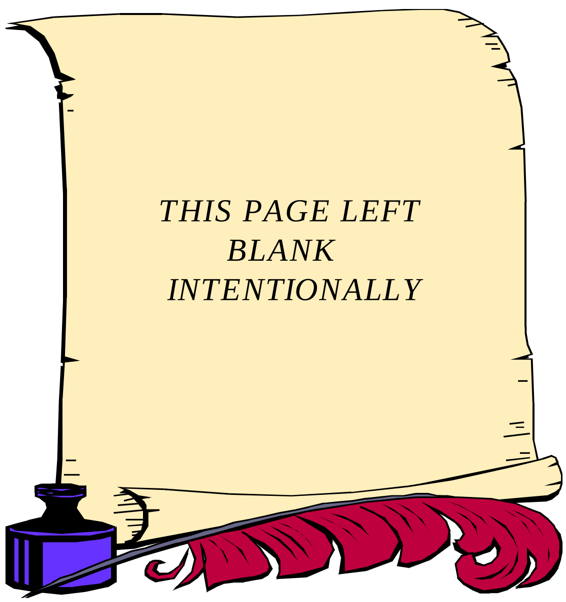
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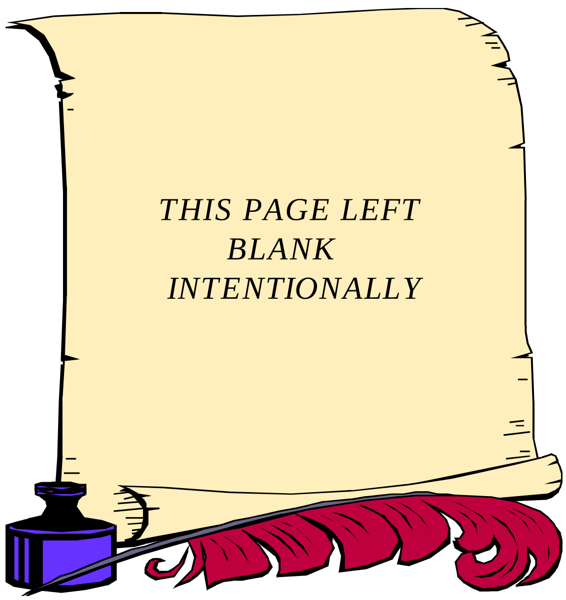
Schedule of Questioned Costs

Finding	Type of Questioned costs Ineligible 1/
1	$ 303,700
3	38,500
4	12,491
	$ 354,691

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.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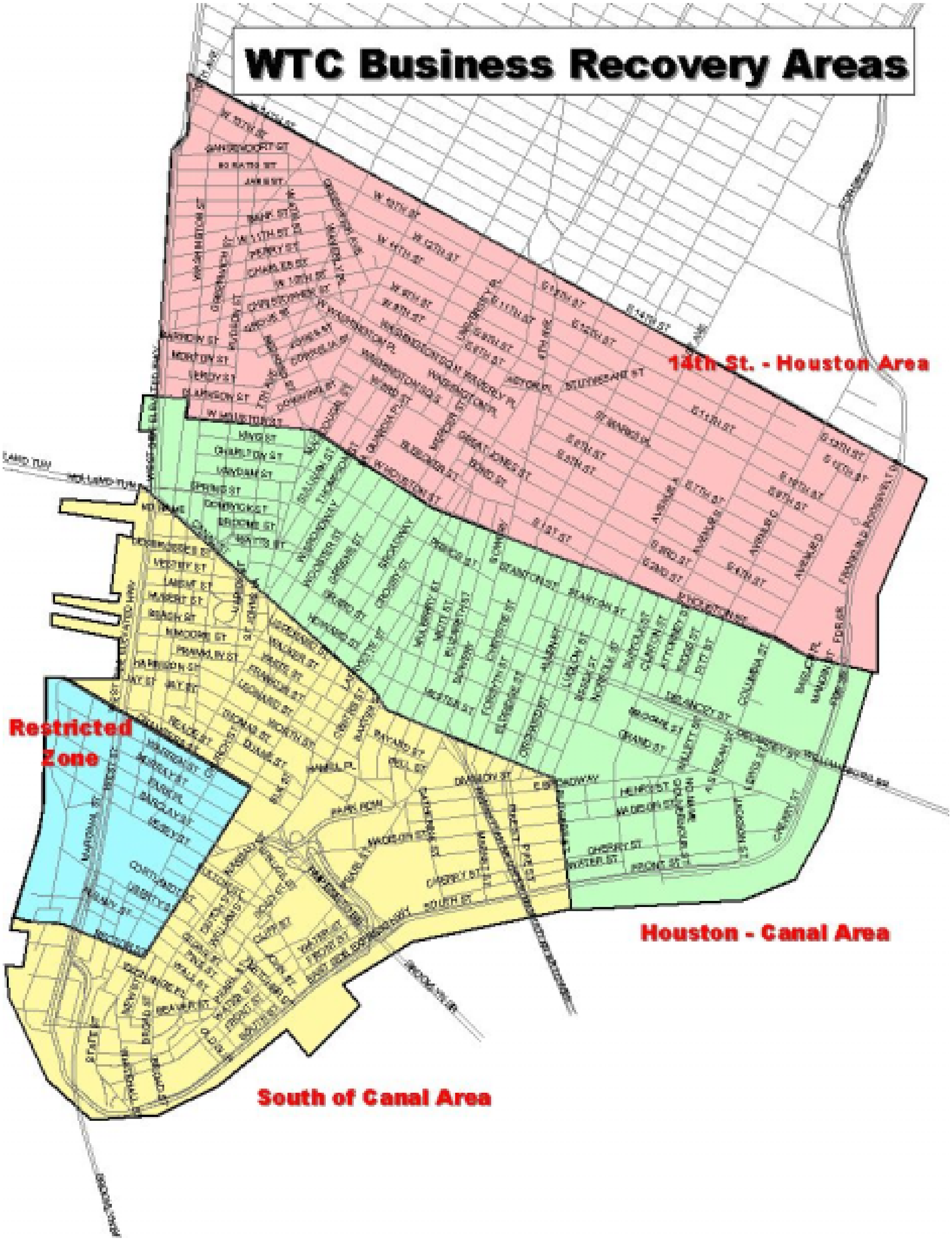
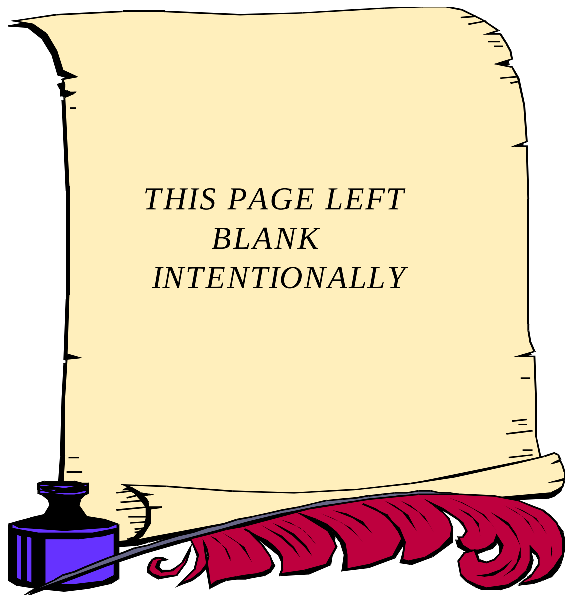
Map of BRG Eligible Areas

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Schedule of BRG Over and Under Payments

GRANT ID	ESDC's BRG CALCULATION: Revenue Amount	Zone	% of Revenue	Initial Grant Calculation	BRG PAID AMOUNT	OIG'S BRG CALCULATION: Revenue Amount	Zone	% of Revenue	Initial Grant Calculation	BRG AMOUNT	AMOUNT QUESTIONED: UNDER-PAYMENT AMOUNT	OVER-PAYMENT AMOUNT	INELIGIBLE COST	REASON
	April 30th Statistical Sample Errors													
5998	$4,367,010	South of Canal	0.02	$87,340	$87,340	$4,405,945	South of Canal	0.02	$88,118.90	$88,118.90	($779)	$0	$0	1
8477	$2,554,186	Houston - Canal	0.012	$30,650	$30,650	$2,257,962	Houston - Canal	0.012	$27,095.54	$27,095.54	$0	$3,554	$0	1
9069	$1,018,560	Houston - Canal	0.012	$12,223	$12,222	$1,018,560	14 St - Houston	0.008	$8,148.48	$8,148.48	$0	$4,073	$0	2
9104	$7,317,882	South of Canal	0.02	$146,358	$118,500	$9,805,820	South of Canal	0.02	$196,116.40	$128,500.00	($10,000)	$0	$0	3
9687	$5,625,432	Restricted Zone	0.04	$225,017	$225,017	$5,632,464	Restricted Zone	0.04	$225,298.56	$225,298.56	($282)	$0	$0	1
9926	$1,643,829	Restricted Zone	0.04	$65,753	$65,753	$1,080,492	Restricted Zone	0.04	$43,219.68	$43,219.68	$0	$22,533	$22,533	5
11363	$12,360,346	Restricted Zone	0.04	$494,414	$300,000	$12,360,346	South of Canal	0.02	$247,206.92	$150,000.00	$0	$150,000	$150,000	2
	Subtotal of April 30th Statistical Sample Errors										($11,061)	$180,160	$172,533	
	September 30th Statistical Sample Errors													
16228	$2,084,204	Restricted Zone	0.1	$208,420	$199,102	$1,110,528	Restricted Zone	0.1	$111,052.80	$101,734.80	$0	$97,367	$97,367	1
16370	$2,918,276	Restricted Zone	0.1	$291,828	$291,827	$8,517,266	Restricted Zone	0.1	$851,726.60	$300,000.00	($8,173)	$0	$0	4
	Subtotal of September 30th Statistical Sample Errors										($8,173)	$97,367	$97,367	
									Subtotal		($19,234)	$277,527	$269,900	
	Error on Supplemental Grant for BRG # 9926													
16509	$1,643,829	Restricted Zone	0.1	$164,383	$98,629	$1,080,492	Restricted Zone	0.1	$108,049.20	$64,829.52	$0	$33,800	$33,800	5
									Total		($19,234)	$311,327	$303,700	

1 ESDC used incorrect revenue amount.

2 ESDC calculated grant using wrong business zone area.

3 ESDC calculated grant using the business' 2001 federal tax return instead of the business' 2000 federal tax return.

4 ESDC calculated grant using a 2000 SEC report instead of requesting that the applicant business provide a 2000 federal tax return or 2000 tax transcript from the IRS.

5 ESDC calculated grant without obtaining the required copy of NYC tax return and CPA letter. Subsequently, ESDC obtained copy of NYC tax return showing correct NYC gross revenue.

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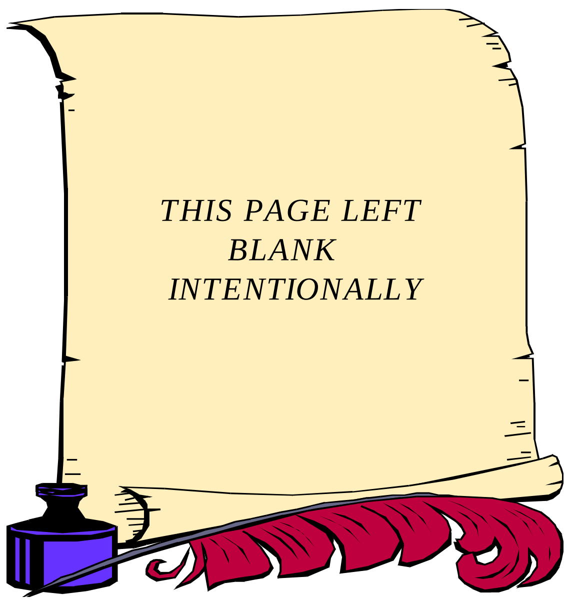
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Auditee Comments

Empire State Development

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

March 10, 2003

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 Draft Audit Report issued by your office. In the wake of the September 11 terrorist attacks, Empire State Development Corporation was charged with planning, developing and implementing programs designed to assist businesses impacted by this unprecedented disaster. Due to the extreme and tragic nature of the disaster, and the condition of the economy, all parties, including Congress, HUD and ESDC agreed that time was of the essence in getting as much assistance in the hands of devastated businesses as soon as possible.

The Executive Summary briefly acknowledges ESDC's successful planning, development and implementation of the grant programs. We are concerned, however, that the overall tone of the Draft Audit Report does not completely, fairly or accurately reflect the extent to which ESDC has successfully, and within extreme parameters, fulfilled the goals and objectives of the Community Development Block Grant It is not so much that we disagree with the findings of fact, but rather with the lack of context and perspective in which they are presented. We feel strongly that the Draft Audit Report, especially the Executive Summary, should be amended before it is published to address the concerns described below:

1. ***Executive Summary***
   Page iv
   "Processing Deficiencies in BRG Program" – We disagree with the term "processing deficiencies," which would lead the reader to conclude that there are procedural problems with ESDC's processing of BRG's. In the body of the report, HUD attributed the over and underpayments to human error rather than inadequate or deficient procedures.

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Page iv
The inability of the IRS to provide a transcript of a grantee's tax return for 10 out of 469 grantees should not be characterized as an ESDC "processing deficiency". This observed condition is independent of ESDC's processing of BRGs. By design, in order to expedite payments, ESDC's grant processing did not involve obtaining an IRS tax transcript prior to making grants.

Page iv
"Interim Report concerns not resolved" - this section of the report gives the incorrect impression that ESDC has neglected to address these two important issues. In fact, work on these two issues has been ongoing and evolving as new information and circumstances arose since they were first reported in May/June. As described later in the Findings section of this response, some 84% of the original BRG recipients have now supplied detailed economic loss analyses. In fact, over 90% of all BRG recipients have supplied this detailed informtion. Similarly, ESDC has been working on an ongoing basis with HUD and SBA to implement controls to address the duplicate benefits issue. The Executive Summary of the report gives no indication that these two issues were largely addressed, even if still not completely resolved. Therefore, a more accurate caption would read "Significant progress on Interim Report concerns"

Page v
"Apparently, processing procedures were compromised. ." The use of the phrase "processing procedures were compromised" is extremely misleading since it suggests a willful decision on ESDC's part to ignore proper mandated processing procedures. However, it was agreed with HUD from the outset that ESDC would not be able to obtain documentation to support economic loss amounts and at the same time meet the congressional mandate of disbursing funds in 45 days. In order to get funds out in 45 days, ESDC, with HUD's approval, had no choice but to forgo having grantees provide documentation to support their economic losses as part of the grant application process. Consequently, for HUD to report that ESDC "compromised" processing procedures is very misleading.

Page v
Similarly, we find that the statement "...applicants' estimated economic loss amounts were not supported with acceptable documentation;" unfairly criticizes ESDC. HUD approved a program design whereby ESDC would accept a certification, rather than require supporting documentation. The certification was later modified to require a "detailed listing" of losses, which ESDC implemented. The agreed upon "acceptable documentation," i.e., certifications and subsequently redefined to mean "a detailed listing of losses" was routinely and properly obtained by ESDC as part of its normal application process approved by HUD.

Page v
"SFARG program procedures need improvement" This section of the Executive Summary reported that ESDC "failed"

"...to include in the program's guidelines procedures that ensure all applications from eligible businesses are processed consistently, timely and adequately documented."

We find this conclusion misleading since ESDC's program guidelines *did* establish procedures that generally resulted in consistent, timely and adequately documented processing of SFARG applications. Consequently, the finding's criticism that ESDC's guidelines were deficient because they did not provide "adequate criteria" for handling "special situations" was inappropriate since procedures are normally written to cover the majority of transactions processed. It would be unreasonable to expect procedures developed at the inception of the program to anticipate the numerous special situations that might be encountered. Instead, we have continuously evaluated the program and periodically revised the guidelines and procedures as necessary.

Page v
With respect to timeliness, the Executive Summary criticized ESDC for "not always" meeting the processing objective of 45 days. Rather than use the unreasonable standard of "not always," especially for such a complex program as SFARG, a more balance perspective would indicate that ESDC achieved the 45 day timeliness objective 71% of the time.

Page v
"Weaknesses in accountability and administrative controls" - In this section, the HUD audit report concluded that:

> "...the ESDC has not established and implemented needed controls and procedures to properly: 1) account for all grant funds disbursed, 2) document procurement actions, and 3) review supporting documentation pertaining to administrative expenses."

HUD's stated conclusion that ESDC has not established controls and procedures to properly perform the three referenced activities is incorrect and misleading. Weaknesses identified by HUD in these areas need to be presented in proper perspective, consistent with HUD's conclusion that ESDC "...has a financial management system that is capable of adequately safeguarding the funds."

In addition to these comments on the Executive Summary, we have the additional comments on the Findings contained in the body of the report.

Finding 1 Processing Deficiencies in the Business Recovery Grant Program Need to be Addressed

On Page 8 under "Criteria," it is important to point out that the interpretation of "the plan and guidelines to mean that to be eligible a business must have filed a federal tax return for the tax period prior to" September 11, 2001 is an erroneous interpretation. In fact, several exceptions to this requirement are set forth in the guidelines, and include certain new businesses and contract-based businesses.

On Page 10 under "Statistical Evaluation of the results of our review," we believe there should be a favorable conclusion on the extremely low error rate in dollar terms (0.41%)

On Page 10 under "Details of the Review of Samples," we do not understand the reference to OMB A-87. It appears that the overpayment of $97,367 was the result of human error. The OMB A-87 language refers to sound management practices. This error does not appear to be attributable to a lack of sound management practices.

On Page 12 under "Discrepancies Noted in Income Tax Data," we disagree with the conclusion that because the IRS reported having no record of a tax return, the business did not file a tax return. In testing conducted by ESDC's Internal Audit Department, many different reasons were found that could account for the inability of the IRS to provide a return upon an initial request. Such reasons include incorrect IRS files, incorrect tax ID numbers, parent/subsidiary arrangements, incorrect fiscal year dates, and other valid reasons. HUD's belief that all "no record' responses indicate a failure to file is an incorrect assumption, which renders the statistical inference- that $8.04 million in grant disbursements had discrepancies – incorrect as well.

With regard to the Recommendations under this finding, ESDC has already recovered $37,500 of the $303,700 in over payments, has a repayment agreement for $112,500 and is still attempting to recover the balance. The additional underpaid amount of $8,173 to one grantee has already been disbursed.

Finding 2 Details on Economic Loss Amounts and the Duplication of Benefits Issues Need to be Resolved

On Page 16 under "Applications in Sample did not contain details of economic loss." HUD statistics would be more enlightening if an indication were given as to how many of the 271 BRG's missing detailed economic loss analyses were later received with supplemental grant applications. Our records show that 84% of businesses that applied for an original BRG have also submitted a supplemental application, thereby providing detail on economic loss. Hence we believe we have sufficient economic loss documentation on substantially all of the BRG's.

Regarding the "Lack of procedures to account for SBA Disaster Loans," it is important to note that at the outset of the BRG Program, HUD program staff instructed us to insert the following statement into the February 8, 2002 version of the application:

> **NOTE to SBA Borrowers & Applicants**: Grant assistance provided under this Program may not be used for the same specific uses as disaster loans made by the Small Business Administration. In accordance with the SBA disaster loan authorization and agreement, grant applicants that have received an SBA disaster loan as a result of the WTC Disaster must advise SBA of their application for assistance under this Program and if approved may be required to use these funds to pay off or reduce the outstanding balance on the SBA disaster loan.

Over time, the approach to the Duplication of Benefits issue has evolved, and we continue to work with HUD and SBA to resolve the matter.

Finding 3 Processing Procedures of the SFARG Program Need to be Improved

On Page 22 under "Ineligible Grant," of the 121 grants reviewed in the audit, it was determined that only one grant (totaling $38,500) was disbursed to an ineligible applicant. This mistake was caused by human error during the application intake review process. During this review, the original business location of the applicant (on 9/11/01) was incorrectly identified to be located in the October 23rd Zone. Under that assumption, the applicant was eligible for the grant.

Prior to and independent of this audit, ESDC had identified this situation and is in the process of seeking repayment of the grant proceeds from the applicant.

In order to avoid future similar occurrences, each SFARG application reviewer is asked to independently verify the correct zone for the applicant's business location(s).

On Page 23 under "Processing Procedures need improvement," the procedures and processing of "SFARG applications with special situations" has improved significantly since the conclusion of the time period covered in this report.

Since SFARG was a newly implemented program, it was not feasible that the Program Guidelines as initially written could address many of the special circumstances encountered in the applications received.

In order to process all SFARG applications (especially those with special situations) in a consistent and fair manner, ESDC staff (including representatives from ESDC's Legal Department, Walk In Center, Loans and Grants Department, etc.) meet periodically to review "special situation" applications and develop appropriate policy. New policies are then recorded as appropriate in the program Guidelines and the Intake Review Procedures document.

On Page 23, under "SFARG files did not always contain adequate documentation," a majority of the SFARG applications are submitted and reviewed in person with a Grant Intake Reviewer

Since there are many reasons why an employee may not be eligible for the SFARG grant calculation, during this meeting the Grant Intake Reviewer assesses the eligibility of each employee listed on the NYS Department of Labor (DOL) NYS-45 form.

Grant Reviewers will provide more detailed written notes to the file, which will clearly explain the process followed and reasoning behind their determination of the number of eligible employees for each grant award.

The report states that HUD independently obtained information from the DOL to determine whether the information in ESDC's database for all 280 SFARG grants paid through September 30, 2002, was correct. The report indicated that 34 of the 280 grant recipients did not have employee data under the Employee Identification Number (EIN) provided in the SFARG application.

Without having knowledge of the identity of the 34 grant recipients, we cannot determine the exact reason for this discrepancy. It is possible that some of the 34 grant recipients outsource their human resource functions to an independent entity under an Employee Service Agreement. In this special situation, the employees of the applicant would be reported to DOL under the EIN of the entity providing the employment service agreement.

Under these and similar special circumstances, ESDC will enter into its grant management database the EIN that the SFARG applicant uses to report to DOL, as well as the EIN of related entities or employee service companies. As needed, additional notations will be entered into the database to clarify these situations.

On Page 24 under "Not all SFARGs were processed within 45 days," the report indicates that more than 70 percent of the SFARG applications were processed within the recommended 45 days upon receipt of a completed application.

Many of the delays occurred during the first few months of the Program with respect to applications received from entities that had fewer than 10 employees. These applications were accepted and deemed "complete" in anticipation that the ongoing Public Comment Period for the related Action Plan would result in an amendment deeming these entities eligible.

This process lasted longer than 45 days, but once these applications were deemed eligible, ESDC processed these applications in a timely manner. The average processing time for the period June 1 through December 24 was as follows:

June 1 – August 31	30 days
September 1 – November 30	27 days
December 1 – February 24, 2003	31 days

With regard to the Recommendations under this finding, ESDC is endeavoring to recover the $38,500 from the ineligible grant recipient, as indicated earlier, and believes that it has already taken steps to implement all of the other recommendations.

Finding 4 Administrative and Accounting controls Need to be Strengthened

On Page 28 under "Weaknesses in controls over the accountability of funds" and on Page 29 under "Duplicate grant payments," ESDC acknowledges that at the time this audit was conducted improvements were needed in the reconciliation and control areas. This was primarily due to the fact that these programs were developed on an emergency basis and time did not permit a comprehensive analysis of the new policies and procedures. However, these areas of concern were addressed with HUD IG staff as they were uncovered and procedures have been established to provide reconciliations of all disbursements data and additional controls have been activated to help avoid future duplicate payments.

On Pages 30 and 31 under "Procurement actions were not fully documented," ESDC believes that the Draft Audit Report does not appreciate the emergency nature of the situation that faced ESDC when confronted with the planning, design and implementation of these grant programs. In no way did time permit ESDC to go through a formal bidding process to obtain temporary staffing assistance.

HUD's finding regarding failure to advertise was unwarranted, since ESDC's procurement actions *were* consistent with State Procurement Guidelines on advertising. On September 18, 2001, ESDC issued a memo based on Office of the NY State Comptroller's Bulletin G-199 that stipulated that "all contracts deemed necessary to address the disaster recovery" were eligible for exemption from advanced advertising. ESDC's procurement of temporary personnel services properly fell within these NY State guidelines, therefore no finding was warranted with respect to not advertising.

ESDC acknowledged that not having a formal contract with the temporary agency was an oversight. However, the origins of this exception must be understood in perspective. ESDC's previous use of this temporary agency was on a much smaller scale and in full compliance with ESDC's "Non-Contractual Payment Procedures" which on page 39 specifically exempted recurring "temporary personnel services" from written contracts. However, this exemption was intended to apply to recurring expenses. Given the increased scope of the temporary agency work for the 9/11 project, this procurement should no longer have been treated as "*recurring* temporary personnel services" and a formal contract should have been prepared. ESDC's procuring staff did not recognize this technicality

HUD's statement that "ESDC's current procurement procedures are vague and lack sufficient details to address instances when contracts are awarded for the purchase of goods and services where formal advertising is not conducted" is not true.

While the practices that ESDC follows may not be "sufficiently explained in its written procurement manual," ESDC does follow very clear and specific procurement practices that are consistent with NY State Procurement Guidelines. With respect to formal advertising, State guidelines require that ESDC advertise significant contracts unless an advertising exemption is approved. This policy is very clear and consistently followed by ESDC.

The caption on Page 31 "Contract and procurement procedures should be modified," is incorrect. ESDC's procurement procedures do not warrant modification based on the finding related to the procurement of temporary services. One technical exception involving one contract should not require modification of ESDC's procurement procedures. However, ESDC agrees that its procurement procedures need to be "more completely *documented* in its procurement manual" and ESDC is in the process of doing so. The finding is one of *more fully documenting* existing and adequate policies and procedures that are practiced by ESDC. HUD should present the finding as such.

On Page 31 under "Administrative Costs not adequately reviewed," after this item was brought to our attention by HUD IG staff, we met with Human Resources to emphasize the need to match all time records and to have details of hours worked for all temporary employees. Based on review of additional invoices, this appears to have been an isolated instance and sufficient policies and procedures are in place to review all Administrative Costs.

With regard to the Recommendations under this finding, we believe finding 4A to be unnecessary because on Page 29 the Draft Audit Report acknowledges that ESDC took action to recover the $12,491 in duplicate payments. For findings 4B through 4E these recommendations have already been implemented.

Thank you for your 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,

Kevin S. Corbett
Chief Operating Officer and
Executive Vice President

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