AUDIT REPORT

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

2003-NY-1005

SEPTEMBER 30, 2003

OFFICE OF AUDIT
New York/New Jersey Region

audit report

Issue Date
September 30, 2003
Audit Case Number
2003-NY-1005

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

Alexander C. Malloy

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

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

We 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 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 Plans, (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 October 1, 2002 to March 31, 2003. This report contains three findings with recommendations for corrective actions.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken, (2) the proposed corrective action and the date to be completed, or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of this audit.

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

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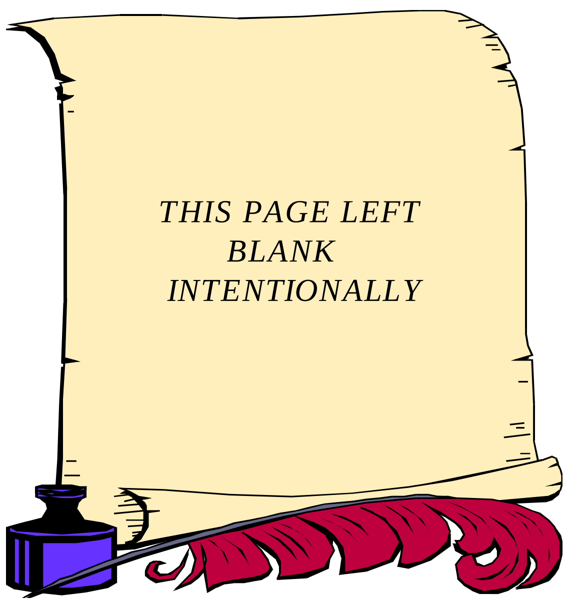
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Executive Summary

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 Plans, (2) disbursed the CDBG disaster funds to applicants for economic loss in a timely manner, and (3) has a financial management system that adequately safeguards the funds. This review is the second in 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 first report on the ESDC was issued March 25, 2003 and is discussed in the Follow Up On Prior Audits section of this report.

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

ESDC disbursements

The ESDC has continued to make substantial progress in developing and implementing programs that address the immediate economic needs of numerous businesses that suffered economic losses and property damages during the September 11, 2001 terrorist attacks. At March 31, 2003, the ESDC had disbursed over $641 million of the $1.05 billion in CDBG Disaster Assistance Funds it is administering. The ESDC had disbursed $26 million in Small Firm Attraction and Retention Grants (SFARG) to 779 businesses representing over 14,000 employees, $110 million in Large Firm Job Creation and Retention Grant Program (JCRP) to 23 large Businesses, and $478 million in Business Recovery Grants (BRG) to over 14,000 applicants.

Processing and monitoring procedures of the SFARG Program need to be improved

Our review of statistically selected samples from the Small Firm Attraction and Retention Grant (SFARG) Program disclosed that overpayments were made to certain grant recipients. Specifically, we found that three out of a sample of 110 applicants had received overpayments totaling $27,750. Also, the review disclosed that lease information in some recipients' applications did not agree with the information that we received from the recipients' landlords. We believe the overpayments occurred because the ESDC did not properly verify the SFARG applicants' location, and that the discrepancies in the lease information occurred because some recipients may have provided incorrect lease information in their grant applications. In this regard, ESDC officials should adequately address these issues during post reviews designed to determine compliance with the program's processing procedures and requirements.

Processing deficiencies in the BRG Program are being addressed

During the current review period, we continued our review of the grants provided under the Business Recovery Grant (BRG) Program by statistically selecting a sample of 308 BRGs, which represent BRG disbursements of $30,065,333. The review identified some of the same issues as reported in the findings of our prior audit report. Specifically, we found overpayments and underpayments of $208,885 and $14 respectively, for a net overpayment of $208,871 and one duplicate payment of $34,313. Also, we found that federal tax information in some recipients' applications did not agree with the information that we received from the Internal Revenue Service. As a consequence, some recipients may have received a grant based on inaccurate tax information. We attribute the over and under grant payments, as well as the duplicate payment to human error, and the federal tax information discrepancies to the possibility that some recipients may have provided incorrect federal tax information in the their grant applications. Regarding the deficiencies, we noted that ESDC and HUD officials are addressing similar issues as part of the actions being taken to resolve the deficiencies discussed in the findings of our prior audit.

Accounting procedures need to be strengthen

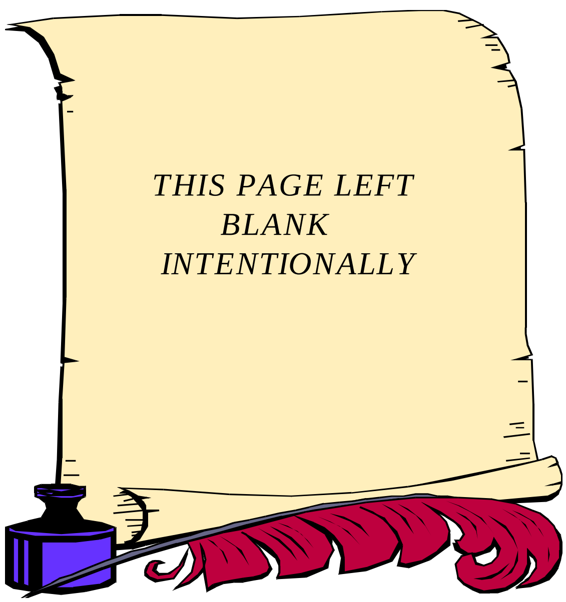
Our review disclosed weaknesses in the ESDC's accounting procedures pertaining to the charging of costs and disbursement of funds. Although some weaknesses resulted from the fast pace required of the ESDC to implement the disaster assistance programs; other weaknesses appear to exist because the ESDC needs to strengthen certain accounting procedures. Specifically, we found that: 1) Business Information expenses of $184,579.79 were misclassified as administrative costs, 2) indirect overhead charges were calculated incorrectly, and 3) a portion of a Technical Assistance Service Grant payment of $80,812.78 lacked adequate supporting documentation. Consequently, weaknesses in the ESDC's accounting procedures caused information on drawdowns to be inaccurately stated, permitted indirect overhead costs to be understated and resulted in disbursements of $55,900 in grant funds without adequate supporting documentation. By strengthening its accounting procedures, the ESDC will enhance its accountability over the receipt and disbursement of Disaster Assistance Funds.

Recommendations

We provided recommendations at the end of each finding that address the causes of deficiencies and weaknesses in the grant programs being administered by the ESDC.

Exit conference

The results of our audit were discussed with ESDC officials during the audit and at an exit conferences held on August 27, 2003 and September 4, 2003 at the ESDC's office. The ESDC provided written comments to our draft report on September 16, 2003. We included excerpts of the comments with the findings, and provided the complete text of the comments in Appendix C of this report.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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
BRG2	Compensation for Economic Losses to Other Business
ESDC	Empire State Development Corporation
LMDC	Lower Manhattan Development Corporation
JCRP	Large Firm Job Creation and Retention Program

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 destroyed or seriously damaged. In the aftermath of the terrorist attacks, Congress authorized HUD to provide the State of New York with $3.483 billion of Community Development Block Grant (CDBG) Disaster Assistance. 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] The Office of the Inspector General (OIG) is performing an on-going audit of the operations of the Empire State Development Corporation (ESDC) pertaining to its administration of the CDBG Disaster Assistance funds. The OIG previously issued an audit report dated March 25, 2003 covering the period from program inception (February 2002) to September 30, 2002.

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

HUD awarded the first congressional appropriation, in the amount of $700 million, to the State of New York on February 13, 2002 through the Empire State Development Corporation (ESDC) for the properties and businesses damaged by the September 11, 2001 terrorist attacks on the World Trade Center in New York City. The ESDC was designated by the Governor to administer the first CDBG appropriation of $700 million. The ESDC is 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 engaged in four principal activities: economic and real estate development; State facility financing; housing portfolio management; and privatization initiatives. To carry out large-scale economic development activities, ESDC creates various consolidated subsidiaries. In this regard, the ESDC's Board of Directors

[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.

authorized the creation of the Lower Manhattan Development Corporation (LMDC) on November 2001 to assist in the economic recovery and revitalization of lower Manhattan, with special emphasis on the redevelopment of the areas damaged during the terrorist attacks. LMDC has been designated by the State of New York as the entity to develop programs and distribute the $2.8 billion appropriated by Congress in the 2002 Emergency Supplemental and the 2002 Supplemental acts previously stated. A separate audit of the activities being administrated by the LMDC is currently being conducted. The results of that audit will be provided in a separate audit report.

Approved action plan

The ESDC developed an Action Plan dated January 30, 2002, which described how the $700 million was to be allocated among various categories. On November 22, 2002, HUD approved the LMDC's Action Plan, which included an additional $350 million that the LMDC provided to the ESDC's business recovery programs. The additional funding brought the amount that is being administrated by the ESDC to $1.05 billion. In March 2003, the ESDC reallocated funds to meet program objectives. The budget at March 31, 2003 was as follows:

Program	Budget as of March 31, 2003	Disbursement as of 3/31/03	Balance as of March 31, 2003
Bridge Loan Program	$6,760,000	$0	$6,760,000
Business Recovery Loan Fund	$41,140,000	$5,772,798	$35,367,202
Business Recovery Grant Program	$489,860,000	$478,084,202	$11,775,798
Small Firm Attraction & Retention Grants	$155,000,000	$26,513,750	$128,486,250
Grants To Technical Assistance Providers	$5,000,000	$1,490,456	$3,509,544
Large Firm Job Creation & Retention	$320,000,000	$110,244,000	$209,756,000
Compensation For Economic Losses To Other Businesses	$13,240,000	$12,732,591	$507,409
Business Information	$5,000,000	$2,241,078	$2,758,922
Administration	$14,000,000	$4,807,285	$9,192,715
TOTALS	**$1,050,000,000**	**$641,886,160**	**$408,113,840**

To achieve the Congressional mandate to provide assistance to individuals and small businesses as quickly as

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possible, the ESDC began implementing its action plan immediately upon approval. As of March 31, 2003, the ESDC had disbursed funds to recipients primarily in four major programs: Small Firm Attraction and Retention Grants; Job Creation and Retention Program; Business Recovery Grants; and Compensation for Economic Losses to Other Businesses. Our audit efforts were concentrated on these grant programs. In addition, we reviewed the ESDC's Grants to Technical Assistance Providers, the Business Information Program, and administrative costs.

Small Firm Attraction and Retention Grant (SFARG) Program

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

From the 496 SFARGs with disbursements totaling $13,674,000 between October 1, 2002 and March 31, 2003, we selected two statistical samples of SFARGs. Our samples were selected using a Stratified Variable Sample method. The sample parameters called for a 95 percent confidence level and a precision range of 5 percent. The first statistical sample consisted of 55 SFARGs, representing disbursements of $4,217,500 that were disbursed between October 1, 2002 and December 31, 2002. The second statistical sample also consisted of 55 SFARGs representing disbursements of $3,840,000, which were disbursed between January 1, 2003 and March 31, 2003. In total, we selected and tested 110 SFARGs, representing disbursements of $8,057,500.

Large Firm Job Creation and Retention Grant Program

JCRP Program

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

The ESDC's amended Action Plan of June 7, 2002 allocated $170 million for the JCRP grants from the $700 million HUD appropriation. The November 22, 2002 LMDC Action Plan increased the allocation for the JCRP grants by $150 million to $320 million. At March 31, 2003, $110,244,000 of JCRP funds had been expended. We reviewed all 23 JCRP grants disbursed as of March 31, 2003. In addition, we reviewed 10 JCRP grants applications where the intended recipients declined to accept the grant.

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 a business must have been located south of 14th Street and employ 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 was less), depending on location. This amount was limited by

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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.

The ESDC initially estimated the total cost for the BRG Program to be $481 million. The funding was 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.

In December 2002, due to an extensive outreach campaign conducted by the ESDC, there was a substantial increase in the number of BRG applications received. A total of 3,447 BRG applications (22 percent of total applications received) were received in the month prior to the program's completion deadline of December 31, 2002. As a result, the number of approved businesses increased from 10,801 to 14,248 requiring $558 million of grant funds. This was substantially more than the $481 million allocated for the BRG Program. To meet this demand, the ESDC reallocated funds from the Business Recovery Loan Program to the BRG Program. The reallocation brought the amount allocated to the BRG Program to $489 million. To provide the appropriate grant amount to all eligible applicants, the ESDC requested an additional $74.5 million from the LMDC. As of our audit ending date of March 31, 2003, the ESDC indicated that 2,166 eligible businesses were awaiting disbursement of BRG funds. Subsequent to our audit period, the LMDC submitted and received approval of a partial action plan, which included $74.5 million for the BRG Program.

Scope

From the 8,401 BRGs with total disbursements of $194,333,965 between October 1, 2002 and March 31, 2003, we selected two statistical samples of BRGs. Our samples were selected using Dollar Unit Sampling. The first statistical sample consisted of 243 BRGs, representing BRG disbursements of $23,828,445 that were disbursed between October 1, 2002 and December 31, 2002; and the second statistical sample consisted of 65 BRGs representing BRG disbursements of $6,236,888, which were disbursed between January 1, 2003 and March 31, 2003. In total, we selected and tested 308 BRGs, representing BRG disbursements of $30,065,333. 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 guidelines. We sent confirmations to BRG recipients requesting verification of the information in the grant files. Also, we requested income tax information for the BRG grant recipients in our sample from the Internal Revenue Service and compared the information received to the federal income tax information in each BRG file.

Compensation for Economic Losses to Other Businesses

BRG2 Program

The Compensation for Economic Losses to Other Business (BRG2) Program has the same program requirements and procedures as the BRG Program**.** However, the BRG2 Program was established to compensate businesses employing more than 500 employees, but fewer than 200 employees in New York City. As a result, we used the same auditing procedures used to review activities of the BRG Program. The ESDC initially estimated the total cost for the BRG2 Program to be $5 million. In March 2003, ESDC reallocated $8,240,000 from the Bridge Loan Program to the BRG2 Program. This brought the total budget for the BRG2 Program to $13,240,000.

From the 78 BRG2s, with total disbursements of $11,303,056 between program inception and March 31, 2003, we statistically sampled BRG2s using a Dollar Unit Sampling method. The statistical sample consisted of 30 BRG2s, representing disbursements of $6,853,461.

Audit scope and methodology

We performed our on-site work between February 2003 and August 2003. The current review covered the period between October 1, 2002 and March 31, 2003. 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.

Processing and Monitoring Procedures of The Small Firm Attraction and Retention Grant Program Need to be Improved

Our review of statistically selected samples of the Small Firm Attraction and Retention Grant (SFARG) Program disclosed that overpayments were made to certain grant recipients. Specifically, we found that three out of a sample of 110 applicants had received overpayments totaling $27,750. Also, the review disclosed that lease information in some recipients' applications did not agree with the information that we received from the recipients' landlords. We believe that the overpayments occurred because the ESDC did not properly verify the SFARG applicants' location, and that the discrepancies in the lease information occurred because some recipients may have provided incorrect lease information in their grant applications. In this regard, ESDC officials should adequately address these issues during post reviews designed to determine compliance with the program's processing procedures and requirements.

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

Scope

Our review of the SFARG Program encompasses all disbursements from October 1, 2002 to March 31, 2003, which were 496 grants totaling $13,674,000. We selected a Stratified Variable Sample of 110 grants, representing disbursements of $8,057,500. We reviewed the 110 grants in our sample to determine whether the ESDC followed its processing criteria and SFARG Program guidelines. We sent confirmations to the landlords to verify the applicants' leases. We independently obtained the data on all 110 SFARGs from the New York State Department of Labor to verify the information in the ESDC grant management system. Furthermore, we interviewed ESDC officials to determine how the ESDC is verifying and monitoring program activity.

Criteria

OMB Circular A-87 provides 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.

Result of our review

We tested 110 SFARGs and found three processing errors that resulted in grant dollars being overpaid to certain recipients. The errors may have occurred because the ESDC staff did not apply the SFARG Program guidelines in an adequate manner. Details pertaining to the results of our test review are provided below:

Overpayments

SFARG overpayments of $27,750

Our review disclosed that the ESDC had overpaid three SFARG applicants a total of $27,750, as follows:

For grant number 24908, the ESDC calculated the grant amount as if the applicant's business was located in the restricted zone. The ESDC made a payment to the applicant for 18 employees at $2,500 totaling $45,000. Our review found that the applicant's address was actually located outside of the restricted zone. Therefore, the applicant was only eligible for a payment of $31,500, (18 employees at $1,750). The applicant was overpaid $13,500.

For grant numbers 19964 and 23844, the ESDC determined the grant amount based on the applicants' original addresses, which were in the restricted zone. Our review determined that at the date the grant applications were submitted, the applicants had moved to a location outside the restricted zone. Therefore, the applicants were not eligible for the per employee amounts that the ESDC used to determine their grant amounts. For grant number 19964, the ESDC made a payment to the applicant for 13 employees at $2,500, totaling $32,500. The applicant was only eligible for a payment of $22,750 (13 employees at $1,750). The applicant was overpaid by $9,750. For grant number 23844, the ESDC made a payment to the applicant for 3 employees at $5,000 totaling $15,000. The applicant was only eligible for a payment of $10,500 (3 employees at $3,500). The applicant was overpaid by $4,500.

The overpayments occurred because staff members of ESDC did not properly verify the SFARG applicants' location. ESDC officials agreed with our determination in all three cases, and requested repayment of the excess grant amount from the applicants. The three SFARG applicants reimbursed the overpayments, which totaled $27,750.

Discrepancies in applicants lease information

To verify lease information provided by applicants, we sent confirmations to landlords for 106 of 110 SFARG applicants in our sample. Three of the responses from landlords identified discrepancies in the information provided to the ESDC by the SFARG applicants. On one of the confirmations, the landlord responded that the term of the lease was incorrectly stated, and that the lease was only for three years, not six years as stated by the applicant. On two of the confirmations, the landlords indicated that the tenants (SFARG applicants) moved out of the premises. Currently, the ESDC has not implemented monitoring procedures to verify that SFARG applicants provided accurate information pertaining to their lease arrangements. Thus, we recommend that adequate verification procedures be implemented.

Auditee Comments

The ESDC disagrees with the heading of the finding and believes a more accurate description of Finding 1 is that processing and monitoring procedures of SFARG are being improved.

The ESDC indicated that adequate procedures are in place for identifying the location of SFARG applicants. All reviewers of grant applications have maps that clearly outline the location of the grant applicant. The applications go through four reviews before disbursement. Also, the ESDC stated that verifying the accuracy of lease information is definitely part of the internal audit department review that began in July. Beginning September 15, 2003, site visits will be conducted on initial review of SFARG applications in lieu of accepting applications at a walk-in center.

OIG Evaluation of Auditee Comments

The title of the finding identifies that there is a need for improvement in the processing and monitoring procedures of the SFARG Program, as discussed in the finding.

Recommendations

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

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

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

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

Processing Deficiencies in The Business Recovery Grant Program are Being Addressed

During the current review period, we continued our review of the grants provided under the Business Recovery Grants (BRG) Program by statistically selecting a sample of 308 BRGs, which represent BRG disbursements of $30,065,333. The review identified some of the same issues as reported in the findings of our prior audit report. Specifically, we found overpayments and underpayments of $208,885, and $14 respectively, for a net overpayment of $208,871 and one duplicate payment of $34,313. Also, we found 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 in determining the amount of each applicant's grant. As a consequence, some recipients 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. Regarding the deficiencies, we noted that HUD and ESDC officials are addressing similar issues as part of the resolution actions taken to resolve deficiencies discussed in the findings of our prior audit.

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 employ 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 amount of an applicant's eligible economic loss. 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 limited by the amount of an applicant's eligible economic loss.

The ESDC initially estimated the total cost for the BRG Program to be $481 million. The funding was 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.

In December 2002, due to an extensive outreach campaign conducted by the ESDC, there was a substantial increase in the number of BRG applications received. A total of 3,447 BRG applications (22 percent of total applications received) were received in the month prior to the program's completion deadline of December 31, 2002. As a result, the number of approved businesses increased from 10,801 to 14,248 requiring $558 million of grant funds. This was substantially more than the $481 million allocated for the BRG Program. To meet this demand, the ESDC reallocated funds from the Business Recovery Loan Program to the BRG Program. The reallocation brought the amount allocated to the BRG Program to $489 million. To provide the appropriate grant amount to all eligible applicants, the ESDC requested an additional $74.5 million from the LMDC. As of our audit ending date of March 31, 2003, the ESDC indicated that 2,166 eligible businesses were awaiting disbursement of BRG funds. Subsequent to our audit period, the LMDC submitted and received approval of a partial action plan, which included $74.5 million for the BRG Program.

Criteria

Title 24 CFR Part 570.489 (d) provides that states shall have fiscal and administrative requirements to ensure that funds received under this part are only spent for reasonable and necessary costs of operating programs under this subpart.

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 the application reflect revenues or expenses, as applicable, related solely to operations derived from the premises indicated in the application; and that the applicant is in compliance with all federal, state and local laws and not delinquent on any tax obligation.

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Monetary errors resulted in overpayments and under-payments

BRG under and overpayments

From the 8,401 BRGs disbursed during the audit period October 1, 2002 to March 31, 2003, we selected two statistical samples. Our samples were selected using Dollar Unit Sampling. In total, we selected and tested 308 BRGs representing BRG disbursements of $30,065,333. Our review of BRGs disclosed that two BRG recipients received more than they were entitled, while one received less than the full entitlement. Specifically, our testing of 308 BRGs totaling $30,065,333, disclosed that ESDC incorrectly computed 3 BRGs resulting in two overpayments of $108,885 and $100,000 and an underpayment of $14.

Details of the review of the samples

Details of the review of the samples

We discussed the errors identified in our statistically selected samples, with ESDC officials. For grant number 19327, the ESDC officials agreed that an incorrect gross revenue amount was used to calculate the grant amount. The ESDC has corrected the gross revenue amount for grant number 19327 in its database, and has approved grant number 31030 in the amount of $14 to provide the applicant with the amount of the underpayment. The ESDC needs to ensure that the additional $14 is disbursed to the applicant.

For grant numbers 16012 and 22456, the BRG recipient received these two BRGs totaling $600,000 for two different locations, however the business had the same tax ID number for each location. In HUD's September 3, 2002 letter to the ESDC, HUD reminded the ESDC that Public Law 107-117, at 115 Stat. 2236, limits payments to businesses for economic loss to $500,000. HUD further stated, "For this purpose, one Federal tax identification number (TIN) equals one $500,000 limit." Therefore, this BRG recipient received an overpayment of $100,000. The ESDC was aware of this overpayment of $100,000 and received a repayment of $100,000 from the grant recipient.

For grant number 26242, the ESDC calculated the grant based on a tax return that was not filed with the IRS. Specifically, the ESDC grant file contained two different tax returns and the ESDC used the tax return initially provided to them by the applicant to calculate the grant.

The grant was calculated by annualizing the operating expenses listed on that tax return. Prior to payment of the grant, the applicant provided the ESDC with a second tax return, which listed no operating expenses. This is the tax return that the applicant filed with the IRS. Since this tax return showed no operating expenses, the ESDC should have calculated the grant using $0 expenses, which would have resulted in no grant payment. Therefore, we have determined that the entire grant amount of $108,885 is ineligible. We spoke with ESDC officials and they agreed that the grant should have been calculated based upon the tax return filed with the IRS. The ESDC is in the process of taking action to resolve the overpayment.

Duplicate BRG Payment

Duplicate BRG payment of $34,313

Our Audit Command Language (ACL) software analysis of all the grant payments in our audit period disclosed a duplicate BRG payment. Specifically, we found that the recipient of grant number 16195 received a payment, dated September 7, 2002 in the amount of $34,313, and on December 4, 2002, received another payment in the amount of $36,170, for the same application. Since the recipient was entitled to and received a grant payment of $36,170, the $34,313 payment represents a duplicate payment. Thus, the $34,313 is an ineligible costs and the ESDC should be instructed to reimburse the program with non-Federal funds for the duplicate payment.

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 307 of the 308 BRG applicants in our samples in order to compare the tax information submitted to the ESDC by the applicants to the tax information provided by the IRS. Our comparison of the tax transcripts disclosed that 6 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 4 of the 6 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. The IRS information on 1 of the 2 remaining applicants showed that the applicant filed a tax return with the IRS with tax information that differed from the tax information on the returns provided to ESDC. For the other BRG applicant, the IRS provided us with a tax transcript for Fiscal Year 2000, but the applicant did not provide the ESDC with a copy of the Fiscal Year 2000 tax return because the applicant stated that the business is new.

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 believes that the design, implementation and administration of this program has been excellent and that the program goals of helping as many businesses as possible in the shortest amount of time, have been met. The "processing deficiencies" cited are minimal. This report notes that improvements have been made since the first report. ESDC will continue to strive to process every application correctly.

OIG Evaluation of Auditee Comments

We agree that the ESDC made significant improvements in the administration of BRG Program since our prior review; however, the finding discusses areas where the ESDC needs to continue its corrective actions.

Recommendations

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

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

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

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

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

Accounting Procedures Need to be Strengthened

Our review disclosed weaknesses in the ESDC ‘s accounting procedures pertaining to the charging of costs and disbursement of funds. Although some weaknesses resulted from the fast pace required of the ESDC to implement the disaster assistance programs; other weaknesses appear to exist because the ESDC needs to strengthen certain accounting procedures. Specifically, we found that: 1) Business Information expenses were misclassified as administrative costs, 2) indirect overhead charges were calculated incorrectly, and 3) a Technical Assistance Services Grant payment lacked adequate supporting documentation. Consequently, weaknesses in the ESDC’s accounting procedures caused information on drawdowns to be inaccurately stated, permitted indirect overhead costs to be understated, and resulted in disbursements of $55,900 in grant funds without adequate supporting documentation. By strengthening its accounting procedures, the ESDC will enhance its accountability over the receipt and disbursement of Disaster Assistance Funds.

Scope and methodology

Our review covered disbursements to grant recipients and administrative costs from October 1, 2002 through March 31, 2003. We used a non-statistical sampling technique for testing applicable accounting transactions. Transactions sampled included expenditures from each major category and type of administrative expense incurred. Also, we tested disbursements to grant recipients under ESDC’s programs including the Technical Assistance Services Grant Program.

Criteria

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.

Results of review

Overall, our test of accounting transactions disclosed that the ESDC has adequate accountability over the receipt and disbursement of Disaster Assistance funds. However, we noted areas where accounting procedures need to be improved. Specifically, we found a misclassification of costs on drawdown documents, incorrect computations of indirect overhead charges, and disbursements without adequate supporting documentation.

Misclassification of costs on HUD drawdown documents

$184,579.79 was misclassified on HUD drawdown document.

Our review disclosed that the ESDC misclassified costs of $184,579.79 on a drawdown request for the CDBG Disaster Assistance funds. The ESDC submitted a voucher on January 7, 2003 for a drawdown of $558,076.31 and listed the amount under the administrative budget line item. Our review disclosed that $184,579.79 of the drawdown was actually for advertising expense costs which should have been listed under the Business Information budget line item. Therefore, the drawdown for Business Information costs was understated by $184,579.97, while the amount for Administrative costs was over stated by the same amount. Apparently, ESDC's and HUD's records did not reflect the correct drawdown information. To avoid this from reoccurring, the ESDC should establish procedures for ensuring that the amounts are properly classified on the drawdown documents prior to executing a drawdown request.

Computations of indirect overhead costs incorrectly computed

Indirect overhead charges understated

We reviewed the ESDC's indirect costs charged to the CDBG Disaster Assistance Grant by testing one of the two drawdowns for overhead charges, which represented $30,295.00 of the $70,539.69 that had been allocated for the period from October 1, 2002 through March 31, 2003. Our review disclosed that the ESDC used budget amounts instead of actual costs for several line items in computing the indirect overhead charges on the January 24, 2003 drawdown. We determined that the actual indirect overhead charge should have been $32,429.24 instead of the $30,295 charged on the drawdown. As a result, the ESDC had understated its indirect overhead charges by $2,134.24. The ESDC needs to establish procedures to ensure indirect costs are based on actual cost data and all allocations of indirect costs are reviewed.

Technical Assistance Services Grant Disbursed without adequate supporting documentation

Background

The Technical Assistance Services Grant Program targets small businesses that were affected by the WTC disaster. The ESDC selected 23 community-based and service organizations to assist in implementing this program. These organizations offer a broad range of technical assistance services to small businesses in Lower Manhattan including financial and technical assistance, accounting and legal assistance for non-profits, training and counseling for women-owned firms, marketing and disaster recovery seminars and other technical assistance targeting a range of small businesses and locations in Lower Manhattan. The budget for the Technical Assistance Services Grant Program is $5,000,000, of which $1,490,456 had been incurred and reimbursed through March 31, 2003. Program participants are provided 25 percent of the grant as an initial advance. Subsequent requests for funds require documentation showing that cumulative costs are in excess of the initial amount advanced and have been applied against that amount before any additional payments are made to a program participant.

Scope

We selected a non-statistical sample of 10 program participants from the 23 organizations in the program. Specifically, we chose all seven participants that submitted cost reimbursement vouchers for costs incurred beyond the initial 25 percent advance, and three program participants that had not submitted payment requisitions for costs incurred in excess of the initial 25 percent advance of the total grant. Out of total disbursements of $1,490,456, in Technical Assistance Services Grants, our sample of disbursements amounted to $765,712.

Grant payment lacked adequate supporting documentation

Our review disclosed that the controls over payments to grant participants for Technical Assistance Services Grants were generally adequate. However, we noted one instance where a payment was made without sufficient documentation to support the costs claimed. Specifically, the payment requisition submitted did not contain documentation supporting program costs amounting to $55,900.78. The participant submitted a payment requisition for $18,342.78, and was paid $18,342.78 in addition to $62,469 of funds that had been previously

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advanced. According to the Grant Agreement, program participants are also required to include supporting documentation for the initial advance of the grant award. Therefore, the payment requisition submitted by the program participant should have contained supporting documentation for program costs amounting to $80,812.78, consisting of the initial advance of $62,469 and the additional program costs of $18,342.78. However, the documentation on file only supported $24,912 of allowable program costs. Thus, $55,900.78 of the $80,812.78 paid to the participant was unsupported. After we informed a member of the ESDC staff of the lack of documentation for these costs, they obtained documentation to support the entire payment of $80,812.78. However, adequate procedures should have been in place to ensure that all costs are adequately supported before any grant funds are disbursed to participants subsequent to the initial advance.

To prevent the deficiencies discussed above from occurring in the future, the ESDC should establish procedures to ensure costs are correctly classified, indirect costs are based on actual cost data, and all disbursements of grant funds are adequately supported.

Auditee Comments

The ESDC believes that adequate accounting procedures are in place. It acknowledges that the events described in the Draft Audit Report did occur. However, ESDC attributes them to human error, not a lack of procedures. These are isolated cases and not reflective of the vast number of correct administrative and program costs that were processed and recorded properly.

OIG Evaluation of Auditee Comments

As discussed in the finding, we believe that the ESDC needs to review its accounting procedures and controls to ensure that costs are correctly classified, indirect costs are based on actual cost data, and all disbursements of grant funds are adequately supported.

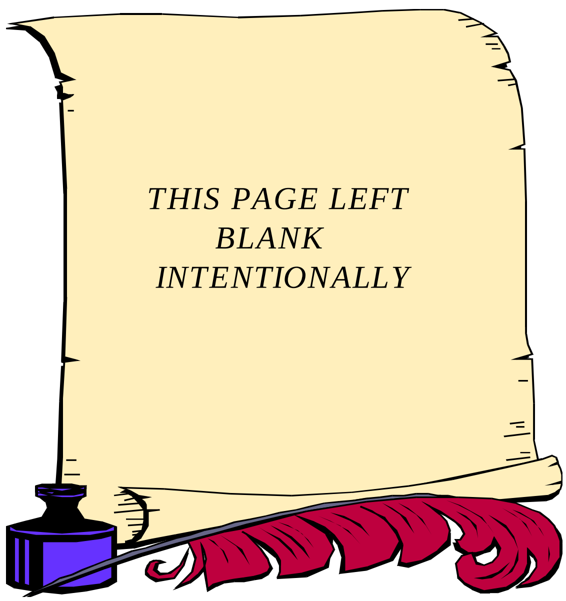
Recommendations

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

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

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

3C. Instruct the ESDC to implement accounting procedures to ensure that all grant disbursements under the Technical Assistance Service Grant Program are adequately supported with documentation.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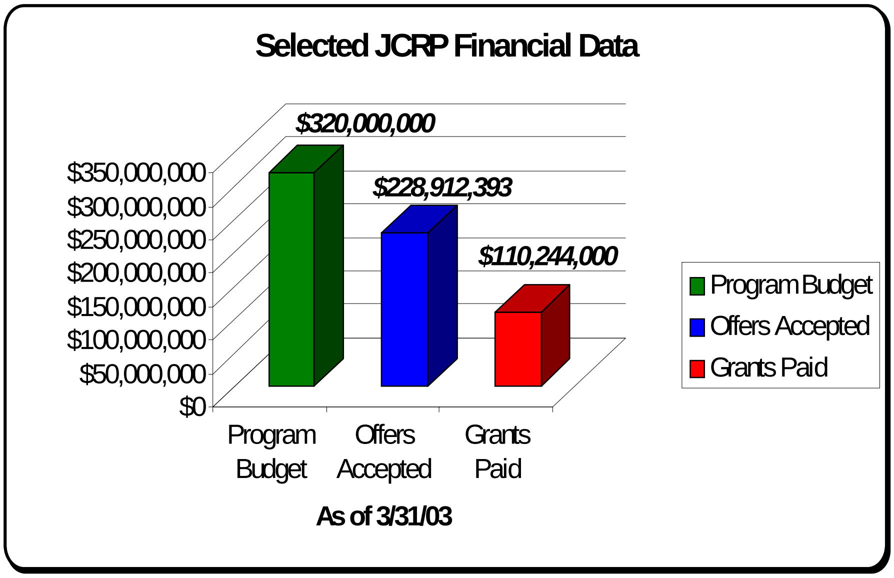
Issues Needing Further Study and Consideration

During our review we noted certain conditions, which we believe warrant further study by HUD management. Specifically, we believe that documentation procedures in the Large Firm Job Creation and Retention Grant Program (JCRP) need to be reviewed. Details pertaining to this issue are provided below:

Program Objective

The Large Firm Job Creation and Retention Program (JCRP) was designed to assist businesses with over 200 employees that agreed to retain or create employment in the area of lower Manhattan south of Canal Street.

HUD approved Action Plans developed by the ESDC and LMDC allocated a combined total of $320,000,000 for the JCRP, with ESDC designated as the Program Administrator. Through March 31, 2003, grant offers accepted by 69 firms amounted to $228,912,393 and awards totaling $110,244,000 had been paid to 23 firms that committed to retaining and/or creating over 32, 000 jobs.



Background

Award of JCRP grants posed a formidable task because ESDC had to quickly develop program guidelines, identify potentially eligible businesses, perform outreach, and develop proposed grant amounts considering the unique circumstances of eligible businesses. Assistance to eligible businesses consisted of discretionary grants decided on an individual case basis based upon such factors as the

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economic value to the City, risk, location, and size of the workforce.

Potential grant amounts developed by ESDC and New York City Economic Development Corporation (EDC) professional staff were submitted to a Review Committee comprised of ESDC and EDC senior staff. This Committee established the final grant amount to be offered. The process involved in developing an initial recommended grant offer to the amount ultimately offered a firm was often lengthy, and involved negotiations.

By design procedures and decisions were not always documented

We found that by design, procedures and decisions made in the award of the JCRP grants were not always documented. For instance, internal JCRP procedures consisted primarily of an outline of the grant award process. Further, key decisions for specific grant amounts awarded were not always fully documented. For instance, we found final awards that were both increased and decreased from the recommended award without documented explanations, and variations in the timing of payments for employment to be created.

HUD should review program design

We believe the lack of documentation occurred because of weaknesses in the design of the Large Firm Job Creation and Retention Grant Program. Due to the sensitivity and the amount of assistance involved in the JCRP, we believe that HUD should review the JCRP to ensure that the program design provides for documentation of all program procedures and decisions. Without said documentation, a complete evaluation of the justification for each award cannot be accomplished.

Auditee Comments

The ESDC states that contrary to the suggestion of the audit, all procedures were fully documented. Both staff recommendations and the final grant offer authorized by the Review Committee were based on the same factors outlined in each project-briefing memo. By design, certain decision-making strategies and reasons for final outcomes were not *always* documented.

The ESDC stated a team consisting of one professional from each of ESDC and the New York City Economic

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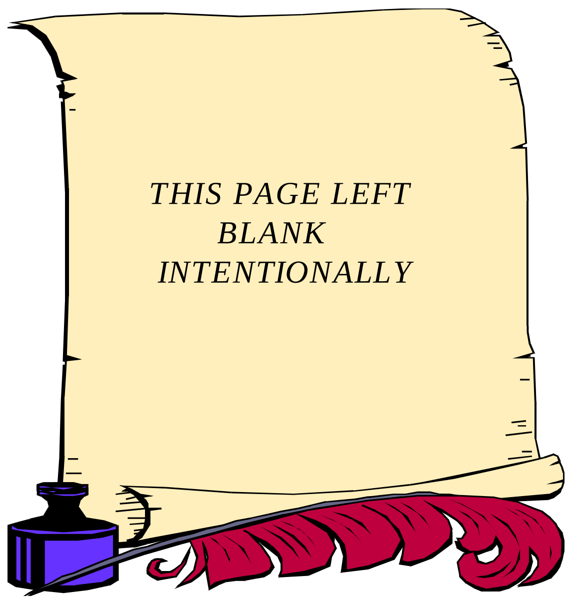
Development Corporation ("EDC") was involved in each step in the process from site visit through final negotiation.

Also, the ESDC indicated that in the rare instance when job growth commitments were awarded up-front, ESDC and EDC fully documented the reasons (for example, a new lease was required to be executed or restrictive business terms were incorporated into the grant offer).

OIG Evaluation of Auditee Comments

Because, certain decision-making strategies and reasons for final outcomes were not *always* documented and variations in the timing of payments for employment to be created occurred, we believe HUD should review the JCRP's program design.

We have revised this section to more correctly reflect EDC 's involvement in the JCRP process.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Management Controls

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

Relevant Management

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

- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss and misuse.

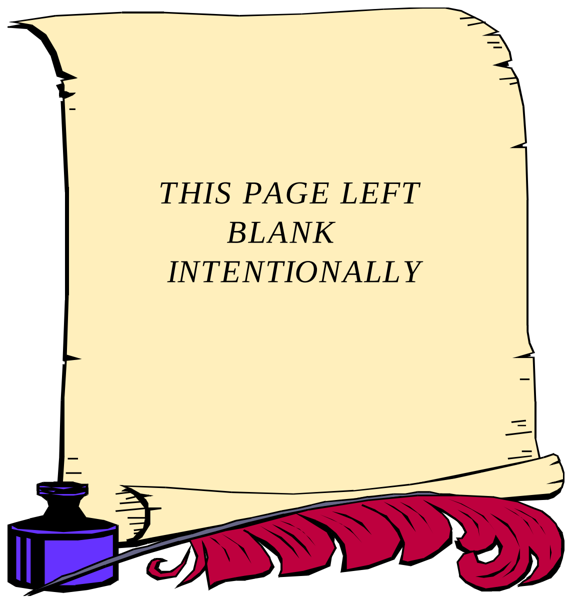
- Validity and Reliability of Data –Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained and fairly disclosed in reports.

We assessed all the relevant controls identified above.

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

Significant Weaknesses

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

We issued Audit Report 2003-NY-1003 on March 25, 2003. The report contains four findings with recommendations. The recommendations and HUD's position on each recommendation are as follows.

Finding 1- Recommendations and Resolution Actions Taken

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

HUD agreed with the recommendation and advised the ESDC to validate and resolve the underpayments and overpayments. HUD also directed the ESDC to reimburse the BRG Program from non-Federal funds with overpayments recovered. The target completion date for this recommendation was August 31, 2003.

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

HUD agreed with the recommendation. HUD also advised the ESDC to develop a system of sampling and testing disbursed BRGs (after disbursement of the funds) to determine if the process was correctly applied and to correct any errors found. According to HUD, acceptable post reviews will use statistically valid audit sampling techniques that maximize dollar coverage and should pursue sampling further if trends in errors are identified. ESDC internal audit department will continue its process of sampling and testing disbursed BRGs to determine that the process was correctly applied. The target completion date for this recommendation is December 31, 2003.

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

HUD agreed with the recommendation. HUD advised the ESDC to disburse the $8,173 approved under BRG ID number 30058 to correct the underpayment from BRG ID number 16370. The target completion date for this recommendation was August 31, 2003.

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

HUD agreed with the recommendation. HUD advised the ESDC to continue analyzing tax information as part of the ESDC internal audit function for discrepancies with Internal Revenue Service filings, maintain analysis documentation for HUD program office review, and report discrepancies, with explanation if available, to the HUD Regional Inspector General for Investigations for New York and New Jersey. ESDC's internal audit department will continue requesting and analyzing tax information received from the IRS as part of its post-disbursement sample testing of BRGs. ESDC has met with and will work with the HUD Regional Inspector General for Investigations for New York and New Jersey to share results and establish appropriate follow-up procedures for discrepancies identified during the verification process. This recommendation is closed.

Finding 2- Recommendations and Resolution Actions Taken

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

HUD agreed with the recommendation. HUD advised the ESDC to provide a schedule and description, including the results, of the audit work that the ESDC internal audit division is performing on the economic loss documentation issue, so that HUD can determine whether the audit work is adequate to ensure that reported economic loss amounts are supported by proper documentation. The ESDC expects economic loss testing to begin in July 2003 and estimates that the process will take at least five months to perform. The ESDC has contracted with an outside firm experienced in evaluating economic loss claims to assist in their efforts. The target date for completion for this finding recommendation is January 31, 2004.

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

HUD agreed with the recommendation. HUD requested that the ESDC provide HUD with a copy of its computer programming documentation being used to implement the duplication of benefits formulas. HUD also requested a description from the ESDC of its understanding of the procedure for determining duplication of benefits. ESDC, HUD, and the U.S. Small Business Administration (SBA) have cooperated and developed a system to determine if a duplication of benefits issue exists for certain grant awards. ESDC provided HUD with the requested programming documentation of the formula developed by these entities that is used in making this determination. This recommendation is closed.

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

HUD agreed with the recommendation. HUD advised the ESDC to seek reimbursement of grant funds that were determined to be duplicate benefits in coordination with the SBA and repay the program account appropriately. HUD stated that as of June 16, 2003, seven grantees were sent letters. Five of these seven grantees remitted the amount requested and the remaining two negotiated repayment plans. This recommendation is closed.

Finding 3-Recommendations and Resolution Actions Taken

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

HUD agreed with the recommendation. The incorrect payment has been partially resolved through a BRG supplemental grant. A repayment agreement for the remaining $12,228 has been executed with a completion date of January 15, 2005.

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

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

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

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

Finding 4-Recommendations and Resolution Actions Taken

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

The ineligible amount was sustained and the $12,491 has been repaid. This recommendation is closed.

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

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

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

HUD agreed with the recommendation. HUD advised ESDC to implement and document procedures to reconcile disbursements per the ESDC General Ledger to the grant management system and the disbursement database. The target date for completion for this finding recommendation was August 31, 2003. We plan to evaluate the resolution actions taken during our next review.

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

HUD agreed with the recommendation. HUD advised ESDC to ensure that procurements of goods and services are: (a) conducted in a manner that promotes full and open competition, (b) adequately justified, and (c) fully documented. Also, HUD asked ESDC to affirm that its procurement manual now fully documents its procurement policies and procedures. The recommendation is closed.

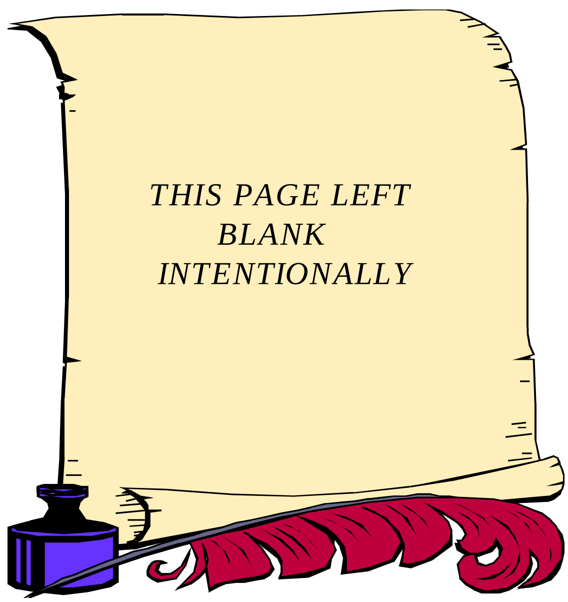
4E Instruct the ESDC to provide assurance that costs incurred are adequately documented, reviewed and approved prior to payment.

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

Schedule of Questioned Costs

Finding	Type of Questioned costs Ineligible 1/
1	$ 27,750
2	243,198
Total	$ 270,948

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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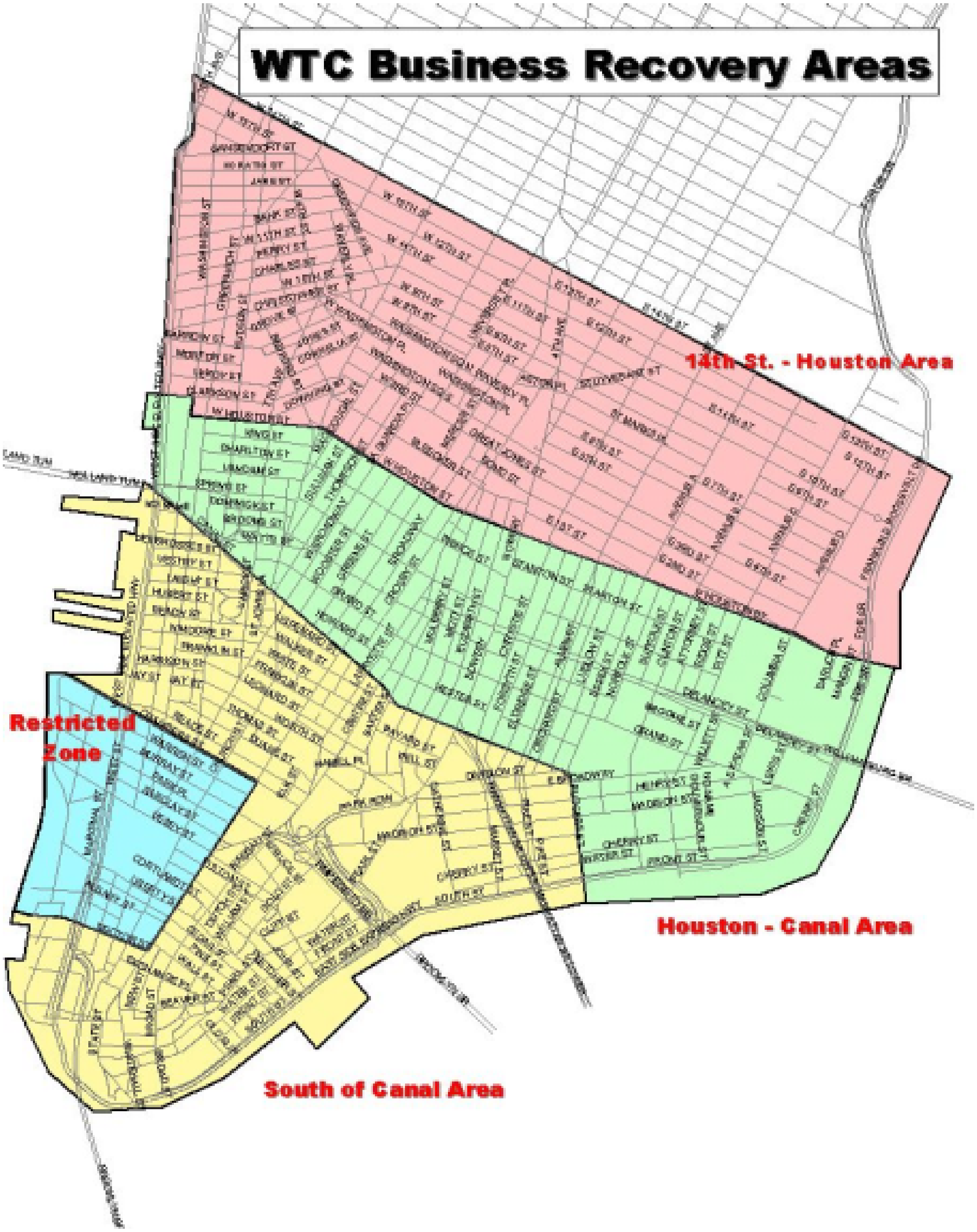
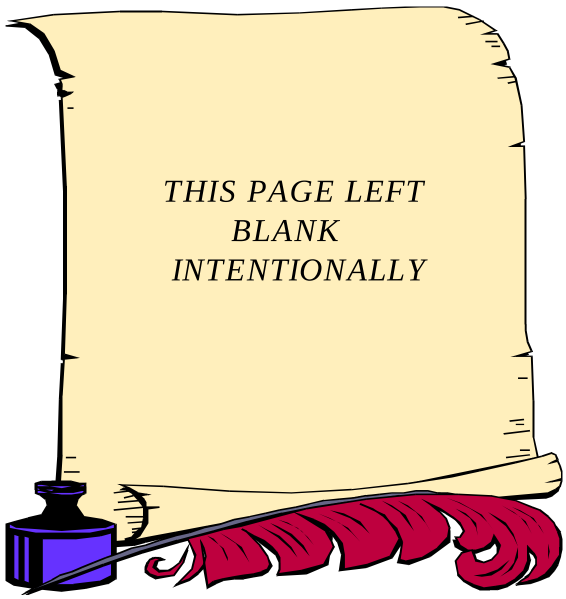
Map Of Eligible Areas

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Auditee Comments

Empire State Development

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

September 16, 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 for the Period 10/1/02 through 3/31/03
Empire State Development Corporation ("ESDC")
Community Development Block Grant Disaster Assistance Funds
Audit Case No. 2003-NY-100

Dear Mr. Malloy:

Thank you for the opportunity to respond to and comment on the Draft Audit Report issued by your office. We believe that throughout the report the general tone and factual evidence support ESDC's belief that the programs have been designed and implemented in a fair, efficient and expeditious manner.

The three findings speak to HUD OIG's continuing review of the BRG and SFARG Program as well as administrative costs and procedures. While we do not take issue with the facts of the individual cases described in the Draft Audit Report, we are concerned that the "headlines" in the Table of Contents for findings one and three overstate the minor problems contained in the body of the report and mislead the reader. A more accurate description of Finding 1 is that processing and monitoring procedures of SFARG are being improved. We would ask you to consider modifying the Table of Contents to more accurately describe the immaterial nature of your findings.

Finding 1. Processing and Monitoring Procedures of the Small Firm Attraction and Retention Grant Program Need to be Improved

a. ESDC has properly accounted for the reimbursement of the $27,750.

b. Adequate procedures are in place for identifying the location of SFARG applicants. All reviewers of grant applications have maps that clearly outline the location of the grant applicant. The applications go through four reviews before disbursement.

c. Verifying the accuracy of lease information is definitely part of the internal audit department review that began in July. Beginning September 15, 2003, site visits will be conducted on initial review of SFARG applications in lieu of accepting applications at a walk-in center.

Finding 2 - Processing Deficiencies in the Business Recovery Grant Program are being Addressed

a. ESDC is working with the applicant to determine whether there is real need to recapture the $108,885.

b. The additional $14 has been disbursed to the grant applicant.

c. ESDC has recovered the $34,313 from the grantee

d. There have been over 21,00 BRG disbursements. ESDC believes that the design, implementation and administration of this program has been excellent and that the program goals of helping as many businesses as possible in the shortest amount of time, have been met. The "processing deficiencies" cited are minimal. This report notes that improvements have been made since the first report. ESDC will continue to strive to process every application correctly.

Finding 3 - Accounting Procedures Need to be Strengthened

ESDC believes that adequate accounting procedures are in place. We acknowledge that the events described in the Draft Audit Report did occur. However, each was the result of human error, not a lack of procedures. These are isolated cases and not reflective of the vast number of correct administrative and program costs that were processed and recorded properly.

Issues Needing Further Study and Consideration

Program Objective

Please note that through March 31, 2003 grant offers were accepted by sixty nine firms, not sixty eight.

Background

Assistance to eligible businesses was based on a number of factors not mentioned in the report, including prior economic development experience of senior management, and quantitative tools such as a

- Pricing Schedule
- Cost Benefit Analysis
- Grant Determination Model

Contrary to the suggestion of the audit, all procedures were fully documented. Both staff recommendations and the final grant offer authorized by the Review Committee were based on the same factors outlined in each project briefing memo. By design, certain decision making strategies and reasons for final outcomes were not *always* documented.

The draft audit report also states that potential grant amounts were recommended by ESDC to the Review Committee. However a team consisting of one professional from each of ESDC and the New York City Economic Development Corporation ("EDC") was involved in each step in the process form site visit through final negotiation.

The report noted that there were "variations in the timing of payments for employment to be created". In the rare instance when job growth commitments were awarded up-front, ESDC and EDC fully documented the reasons (for example, a new lease was required to be executed or restrictive business terms were incorporated into the grant offer).

Nonetheless, ESDC and EDC will consider how they can provide HUD with assurance that our program procedures and decisions are sufficiently clear so that the auditors may evaluate the justification of each grant award, without undermining our ability to negotiate the best deals possible in future transactions.

Management Controls

ESDC completely objects to the use of the term significant weaknesses on page 31 of the draft audit report. The entire draft audit report reflects that the various programs have been designed, implemented and disbursed with an extremely low level of errors. The errors do not reflect a lack of control but human error resulting from the heavy volume of grants and administrative costs processed. Your own statistical samples show an error rate of .3% for SFARG and .7% for BRG. These mistake rates are not statistically material and arguably should not have been included in this report.

Thank you for your attention to these issues.

Sincerely,

Kevin S. Corbett
Chief Operating Officer and
Executive Vice President