The City of New York, Office of Management and Budget, New York, NY

Community Development Block Grant Disaster Recovery Funds, Business Loan and Grant Program

Office of Audit, Region 2
New York – New Jersey

Audit Report Number: 2015-NY-1007
June 12, 2015

To: Marion Mollegen McFadden
Deputy Assistant Secretary for Grant Programs, DG

//SIGNED//

From: Kimberly Greene
Regional Inspector General for Audit, 2AGA

Subject: The City of New York, NY, Did Not Always Disburse Community Development Block Grant Disaster Recovery Funds in Accordance With Federal Regulations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the City of New York, Office of Management and Budget's administration of Community Development Block Grant Disaster Recovery funds for its Business Loan and Grant Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 212-264-4174.

Audit Report Number: 2015-NY-1007
Date: June 12, 2015

The City of New York, NY, Did Not Always Disburse Community Development Block Grant Disaster Recovery Funds in Accordance With Federal Regulations

Highlights

What We Audited and Why

We audited the City of New York, Office of Management and Budget's administration of the Business Loan and Grant Program funded with Community Development Block Grant Disaster Recovery (CDBG-DR) funds provided by the U.S. Department of Housing and Urban Development (HUD) to assist in the disaster recovery and rebuilding efforts resulting from Hurricane Sandy. The objectives of the audit were to determine whether the City (1) disbursed CDBG-DR funds for its Business Loan and Grant Program to assist eligible business owners in accordance with the guidelines established under its HUD-approved action plan, amendments, and applicable Federal requirements and (2) maintained a financial management system that adequately safeguarded funds and prevented misuse.

What We Found

City officials did not always disburse CDBG-DR funds in accordance with guidelines or maintain a financial management system that adequately safeguarded funds and prevented misuse. Specifically, City officials (1) disbursed CDBG-DR funds for unsupported inventory costs, (2) did not identify either the source or application of funds for voucher drawdowns, and (3) did not properly account for duplicate assistance when calculating the unmet need of one applicant. However, they generally approved and denied applications for assistance in accordance with program requirements. The deficiencies resulted from City officials' lack of knowledge of Federal funding regulations and weaknesses in the City's administrative and financial management control system. As a result, City officials could not assure HUD that $241,000 in CDBG- DR funds was adequately safeguarded and disbursed for eligible, reasonable, and necessary expenses and that the funds assisted qualified businesses in compliance with Program requirements.

What We Recommend

We recommend that HUD instruct City officials to provide documentation to support $206,000 in CDBG-DR funds disbursed for inventory purchases and reimburse HUD from non-Federal funds the $35,000 in CDBG-DR funds disbursed for duplicate assistance. Any amounts not supported should be repaid from non-Federal funds.

Table of Contents

Background and Objectives

The U.S. Department of Housing and Urban Development (HUD), Office of Block Grant Assistance, is responsible for the management and oversight of the Community Development Block Grant Disaster Recovery (CDBG-DR) program. The CDBG-DR program provides disaster recovery assistance, which helps cities, counties, and States recover from presidentially declared disasters, especially in low-income areas. The CDBG-DR funding is appropriated by Congress as a special CDBG appropriation in response to a disaster, and the statutory authority for CDBG-DR funding is made through individual supplemental appropriations that address specific disasters. Funding for damages caused by Hurricane Sandy is found in the Disaster Appropriations Act of 2013 (Public Law 113-2). This appropriation has provided the City of New York access to more than $4.2 billion in disaster assistance. These funds are to be used in the most impacted and distressed areas for necessary expenses related to disaster relief, long-term recovery and restoration of infrastructure, and housing and economic revitalization. Each recipient must (1) address a disaster-related impact (direct or indirect) in a presidentially declared county for the covered disaster, (2) be a CDBG-eligible activity, and (3) meet a national objective.

On October 29, 2012, Hurricane Sandy made landfall along the eastern seaboard, impacting more than a dozen States. Over a 48-hour span, the storm caused extensive high winds and rainfall over the metropolitan area of New York City. The effect of these forces caused power outages, damaged homes, and destroyed critical public and private infrastructure.

The table below identifies the three allocations made to the City for CDBG-DR-funded activities.

According to the Federal Register	Allocation amount
March 5, 2013	$1,772,820,000
November 18, 2013	$1,447,000,000
October 16, 2014	$994,056,000
Total funding through October 2014	**$4,213,876,000**

The City received an allocation of $42 million in CDBG-DR funds for the administration of its Business Loan and Grant Program, and approximately $7.9 million of these funds were disbursed as of March 18, 2015.

One purpose of the Program is to assist storm-impacted, low-capital businesses with loans or grants to use toward replenishing working capital or inventory. The Program operates on a first-come, first-served basis and will end when all allocated CDGB-DR funds are used. All activities funded under the Program must meet at least one of the following HUD national objectives:

- Low- and moderate-income-area benefit,

- Low- and moderate-income limited clientele (microenterprises),
- Low- and moderate-income job creation and retention, and
- Urgent need.

Program funds can be used for moveable equipment (when no installation is required), inventory, working capital (such as lease or mortgage payments), marketing costs and quotes, utility bills, business taxes, payroll for staff, insurance (for example, property and liability insurance or worker's compensation), and accounts payable. Program funds are not approved for making improvements to damaged buildings (renovations or repairs), purchasing fixed assets, or repaying government loans.[1]

The City's Office of Management and Budget, in conjunction with the New York City Department of Small Business Services, administers the Business Loan and Grant Program. The New York Business Development Corporation Local Development Company operates the program as a subrecipient to provide the underwriting, awarding, and servicing of loans and grants offered through the program. Additionally, New York City Business Solutions, a component of the Department of Small Business Services, provides intake and application assistance on behalf of the applicant.

The objectives of the audit were to determine whether the City (1) disbursed CDBG-DR funds for its Business Loan and Grant Program to assist eligible business owners in accordance with the guidelines established under its HUD-approved action plan, amendments, and applicable Federal requirements and (2) maintained a financial management system that adequately safeguarded the funds and prevented misuse.

[1]The City's Business Loan and Grant Program Policies and Procedures, Version 2.0, dated December 6, 2013, page 8.

Results of Audit

Finding: The City Did Not Always Disburse CDBG-DR Funds in Accordance With Federal Regulations

City officials generally approved and denied applications for assistance in accordance with established guidelines and program requirements. However, the City did not always disburse CDBG-DR funds for its Business Loan and Grant Program in accordance with guidelines established under its HUD-approved action plan, amendments, and applicable Federal requirements. Specifically, City officials disbursed CDBG-DR funds for unsupported inventory costs and did not identify either the source or application of funds for 8 of 12 voucher drawdowns. Additionally, during a review of applications, we determined that City officials did not properly account for duplicate assistance when calculating the unmet need of one applicant. These deficiencies resulted from City officials' lack of knowledge of Federal funding regulations, weak administrative and financial management controls that led to unsupported and ineligible disbursements, and improper maintenance of HUD-reimbursed vouchers. Therefore, City officials could not assure HUD that $241,000 in CDBG-DR funds was adequately disbursed for eligible expenses and appropriately assisted qualified businesses.

Unsupported Inventory Costs

City officials disbursed CDBG-DR funds for unsupported inventory purchases. On April 23, 2014, without evidence that inventory damage or loss occurred as a direct result of Hurricane Sandy, City officials disbursed $206,000 in CDBG-DR funds to the owner of an undergarment business, via two-party checks, for the purchase of lingerie inventory. However, insurance documentation disclosed that the business was closed for 5 days and suffered a business interruption and not an inventory loss. According to the City's policies and procedures,[2] an eligible loss is defined as a physical loss to moveable equipment or inventory or an economic loss that was incurred as the direct result of Hurricane Sandy. Additionally, regulations at 2 CFR (Code of Federal Regulations) Part 225, appendix A, paragraph (A)(2)(a)(1), states that governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practice. During the course of the audit, we determined that City officials did not have sufficient knowledge of requirements that govern the administration of Federal funding or practice efficient and effective administration of sound management controls. This deficiency resulted in the expenditure of $206,000 in unsupported CDBG-DR funds.

[2] The City's Business Loan and Grant Program Policies and Procedures, Version 2.0, dated December 6, 2013, page 4, provides that "eligible loss" means physical loss to moveable equipment and inventory or economic losses incurred on or after October 27, 2012, and resulting directly or indirectly from Hurricane Sandy.

Source and Application of Federal Funds Not Always Identified

City officials did not always identify the source and application of funds on voucher drawdowns. Of 12 voucher drawdowns reviewed, 4 did not identify the specific funding source (such as grant or loan) and 8 did not show where funds were spent or applied (table 1). Additionally, the total for these eight voucher drawdowns was approximately $1.2 million; however, supporting invoices amounted to $1.36 million. City officials agreed that these totals did not match and stated that due to the flexibility of the Program, awardees were not required to provide a breakout of expenditures or identify the source of funds (loan versus grant). City officials further stated that a particular invoice may have been only partially covered by CDBG-DR funds; thus, a breakout of costs would place an additional burden on a business, especially during disaster recovery. Guidance in 24 CFR 85.20(b)(2) requires grantees and subgrantees to maintain records adequately identifying and reconciling data to the source and application of funds, awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. This reconciliation is necessary to ensure that the same source documentation is not used to make multiple drawdowns of CDBG-DR funds. Further, the source and application of funds are to be properly identified, and the specific supporting documentation should agree with the amount and type of drawdown (grant or loan).

Count	Voucher number	Voucher drawdown amount	Supporting documentation amount	Source of funds (grant or loan) identified	Application of funds identified
1	252342	$550,000	$574,317	No	No
2	255047	$60,000	$65,427		No
3	256158	$210,000	$282,087	No	No
4	256549	$36,688	$37,115		No
5	255672	$40,000	$43,880		No
6	251308	$100,514	$111,927	No	No
7	265585	$29,041	$30,682		No
8	265584	$185,739	$213,074	No	No
	Totals:	**$1,211,982**	**$1,358,509**	**4 instances in which the source of funds was not identified**	**8 instances in which the application of funds was not identified**

Duplicate Assistance Not Properly Accounted for When Calculating Unmet Need

City officials did not account for duplicate assistance when calculating the unmet need of one program applicant. Specifically, they did not deduct $35,000 in duplicate assistance, consisting of a $25,000 loan and a $10,000 grant, from the unmet need calculation for a pharmacy business. The $25,000 loan and $10,000 grant were provided by the New York Business Development Corporation Local Development Company. According to City officials, to calculate the unmet need of the pharmacy business, which had experienced a change in cash flow as a result of the storm, the $35,000 in duplicate assistance was added to the pharmacy's total working capital losses to reflect a positive baseline. Officials further stated that if the $35,000 in duplicate assistance was not included in the pharmacy's working capital loss, the unmet need calculation would not have accurately portrayed the pharmacy's full losses. However, the City's policies and procedures[3] require the deduction of all duplicate assistance from the unmet need calculation. Further, 76 FR (Federal Register) 71064 (November 16, 2011) states that to calculate a CDBG-DR award, all assistance found to be duplicative is subtracted to obtain the maximum potential award amount or the unmet need. Therefore, the $35,000 in duplicate assistance was ineligible.

Approval and Denial of Applications in Accordance With Program Requirements

City officials generally approved and denied business applications for assistance in accordance with Program requirements. We reviewed 10 business applicants, consisting of 1 denied and 9 approved businesses. This review disclosed that in applicants' files, City officials had documented the applicant's core eligibility (such as for-profit or small business), location of loss, damage or interruption the business realized, and Federal debarment verification and that the business was not a private utility. Additionally, all 10 businesses in our sample had provided adequate proof of their loss of inventory or moveable equipment or business interruption. Further, City officials properly documented the applicants' need for inventory, moveable equipment, or working capital and unmet need determination. The business that was denied assistance suffered damages as a result of the storm. However, the denial occurred because one of the two owners left the business and the remaining owner applied for disaster assistance to start a new business in the same location. Appropriately, City officials denied the applicant because the new business did not exist before Hurricane Sandy.

Conclusion

City officials did not always disburse CDBG-DR funds and maintain a financial management system that adequately safeguarded the funds in accordance with Federal regulations. Specifically, they disbursed CDBG-DR funds for unsupported inventory costs, did not identify either the source or application of funds or both for voucher drawdowns, and did not properly account for duplicate assistance. However, City officials generally approved and denied business applications for assistance in accordance with program requirements. The deficiencies were a result of City officials' lack of knowledge of Federal regulations and weaknesses in the City's administrative and financial management controls. These conditions led to questionable disbursements and improper maintenance of HUD-reimbursed vouchers. As a result, City officials could not assure HUD that $241,000 in CDBG-DR funds was disbursed for eligible, reasonable, and necessary expenses and that the funds assisted eligible businesses in compliance with Program requirements.

---

[3] The City's Business Loan and Grant Program Policies and Procedures, Version 2.0, dated December 6, 2013, page 5, provides that "unmet need" means the losses to moveable equipment, inventory, and working capital suffered by the applicant as a direct or indirect result of Hurricane Sandy less all duplicative assistance sources.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs instruct City officials to

1A. Provide documentation to justify the $206,000 in CDBG-DR funds disbursed for unsupported inventory purchases. Any amounts not supported should be repaid from non-Federal funds.

1B. Strengthen controls over disbursements to ensure that supporting records adequately identify the source, application, and use of funds for all financially assisted activities.

1C. Reimburse HUD from non-Federal funds the $35,000 in CDBG-DR funds disbursed for ineligible duplicate assistance.

Scope and Methodology

The review generally covered the period October 29, 2012, through July 31, 2014, and was extended as needed. Audit fieldwork was performed onsite from August 2014 through April 2015 at the City's office located at 255 Greenwich Street, New York, NY.

To accomplish our audit objectives, we

- Reviewed applicable laws, regulations, HUD handbooks, Federal Registers, Code of Federal Regulations requirements, public laws, and the City's policies and procedures for the Business Loan and Grant Program.
- Obtained an understanding of the City's disbursement and financial controls.
- Interviewed officials of the City and the Department of Small Business Services.
- Reviewed the City's action plan and amendments.
- Reviewed the grant agreement between HUD and the City.
- Reviewed the memorandum of understanding between the City and the Department of Small Business Services and the subrecipient agreements between the City and the New York City Economic Development Corporation, the Department of Small Business Services, and the New York Business Development Corporation.
- Evaluated the City's internal controls and reviewed application and disbursement files to identify potential weaknesses related to our objectives.
- Reviewed data in HUD's Disaster Recovery Grant Reporting system.[4]
- Reviewed HUD monitoring reports.
- Reviewed the City's financial statements for the year ending in June 2013.

City officials processed 48 applications during the audit period, October 29, 2012, to July 31, 2014, consisting of 9 denied and 39 approved applications. We selected for review a nonstatistical sample of 10 applications, consisting of 1 denied and 9 approved applications, which represented approximately 21 percent (10/48) of the application universe. City officials disbursed approximately $2.4 million in program funds during the period October 29, 2012, to October 14, 2014. We selected for review a nonstatistical sample of 12 voucher drawdowns

[4] The Disaster Recovery Grant Reporting system was developed by HUD's Office of Community Planning and Development for the CDBG-DR program and other special appropriations. Data from the system are used by HUD staff to review activities funded under these programs and for required quarterly reports to Congress.

totaling approximately $1.4 million, which represented approximately 59 percent ($1.4 million/$2.4 million) of the total disbursement universe. The voucher drawdowns tested consisted of 10 vouchers associated with the 9 approved applications and 2 vouchers related to program administrative costs.

While we used the data obtained from HUD's Disaster Recovery Grant Reporting system for informational purposes, our assessment of the reliability of the data in the system was limited to the data reviewed; therefore, we did not assess the reliability of this system. We performed a minimal level of testing and found the data to be adequate for our purposes.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objectives.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal 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 the use of funds 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 the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- City officials did not have adequate controls over program operations, compliance with laws and regulations, and safeguarding resources when they did not ensure that CDBG-DR funds were disbursed for eligible, reasonable, and necessary expenses and that the funds assisted eligible businesses in compliance with HUD rules and regulations and their own policies and procedures (see finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/
1A		$206,000
1C	$ 35,000	
Totals	**$35,000**	**$206,000**

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.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

The City of New York
Office of Management and Budget
255 Greenwich Street, New York, NY 10007

TO: Karen Campbell-Lawrence

DATE: May 1, 2015

SUBJECT: City of New York Response to HUD OIG Audit of CDBG-DR Business Loan and Grant Program

MEMORANDUM

City of New York's Response to HUD OIG's Draft Audit Report

Set forth below is the City of New York's ("City") response to the HUD Office of Inspector General's ("OIG") Draft Audit Report regarding the OIG's review of the City's Office of Management and Budget's ("OMB") administration of Community Development Block Grant Disaster Recovery ("CDBG-DR") funds for its Hurricane Sandy Business Loan and Grant Program ("HSBLGP"). These remarks were provided in a written draft received by the City on April 17, 2015. The City recognizes the OIG's efforts in this audit and appreciates the opportunity to address the Draft Audit Report in advance of the issuance of the Final Audit Report.

The OIG's Draft Audit Report includes one Finding: **The City Did Not Always Disburse CDBG-DR Funds in Accordance with Federal Regulations.** This Finding is categorized in four parts, which the City will address separately. We ask that the Final Audit Report include a copy of this response and reflect the record as described below.

Comment 1

1. **OIG:** Questionable Inventory Costs

City Response:

The City respectfully disagrees with this finding. The City believes it did disburse CDBG-DR funds properly and that it provided adequate documentation to support the $210,000 and $206,000 working capital expenses paid for with CDBG-DR funding. Furthermore, the City believes its officials have knowledge of Federal regulations and have adequate administrative and financial management controls in place to maintain a financial management system. These controls have adequately safeguarded the funds in accordance with the guidelines established under its HUD-approved Action Plan and subsequent Amendments, as well as all applicable Federal requirements.

1

Auditee Comments

Ref to OIG Evaluation

Comment 1

The OIG's draft report states that the City disbursed CDBG-DR funds for ineligible inventory purchases. This statement implies that inventory purchase is the basis for the business' need. However, for both costs in question, lost inventory was not the basis of an unmet need determination. Rather, the award was issued due to the business' unmet need in working capital due to economic loss. With respect to both businesses, the unmet need in working capital is supported by New York Business Development Corporation--Local Development Corporation's ("NYBDC LDC") underwriting analysis. The underwriting analyses have previously been provided to the OIG. A working capital need with underlying inventory accounts payable are different than if the funds were used for inventory purchases based on a specific finding of inventory unmet need. The City believes that it correctly followed applicable policies and procedures for the $210,000 and $206,000 disbursements to an undergarment business and pharmacy business, respectively.

Both businesses had outstanding accounts payable following Hurricane Sandy. The accounts payable invoices are eligible working capital expenses pursuant to Hurricane Sandy Business Loan and Grant Program Policies and Procedures 2.0 ("Policies and Procedures"), page 8. The Policies and Procedures provide in part as follows:

Eligible Activities/Uses: Funds provided to businesses under this program may be used for […] working capital such as:

a. Lease and/or mortgage payment
b. Marketing costs and quotes
c. Utility bills
d. Business taxes
e. Payroll for staff
f. Insurance (e.g. property insurance, liability insurance, worker's compensation)
g. Accounts Payable
h. Inventory

The City agrees with the OIG that CDBG-DR funds cannot be used for reimbursement for inventory or pre-storm working capital expenses. These two awards were not reimbursement. As discussed during the exit conference on April 23, 2015, the OIG defines reimbursement as a repayment of expenses already paid by a business. In this case, the businesses never paid suppliers for the inventory in question. As a result, the substantiation documentation provided to the City is an accounts payable. Whether the accounts payable occurred pre- or post-storm does not impact eligibility. Both businesses had an eligible working capital need in the form of an accounts payable invoice that was not paid due to the storm and that was still pending payment when they received the award. Neither the Policy and Procedures nor the regulations governing the CDBG-DR funds prohibit issuing payments for accounts payable that contain inventory or that were dated prior to the storm.

Furthermore, the City followed processes to ensure that both the pharmacy and the undergarment businesses' costs were necessary and reasonable. The Policies and Procedures require that a business satisfies core eligibility requirements in order for its expenses to be necessary and reasonable. Both the pharmacy business and undergarment business meet

2

Ref to OIG Evaluation	Auditee Comments

Comment 1

these core eligibility requirements, including that the business had ample proof of loss, damage, and/or interruption, was not debarred by the federal government, and operated prior to the storm. If a business meets the HSBLGP eligibility requirements, and is determined to have an unmet need for working capital via the program's financial analysis, then the company is eligible for a working capital award. In this case, each company was determined to have an unmet need for working capital. Since accounts payable is an eligible working capital expense, the companies supplied information on accounts payable. The accounts payable were for inventory items.

Comment 2

Concerning the $206,000 in unsupported inventory for undergarment business, the OIG also states that the undergarment business did not experience economic losses. The City would like to emphasize that the business did suffer from an economic loss, which is evident in the assessment provided by the program underwriter, NYBDC LDC. The undergarment business suffered from business interruption which is supported by the insurance document and the SBA award letter for the working capital loan the business received for disaster recovery. These two documents are sufficient to prove that the business experienced interruption as a result of Hurricane Sandy. Per the program's Policies and Procedures, proving that the business was interrupted as result of the storm is one allowable method of establishing core eligibility for an award. Once the applicant established that they were eligible for an award, the business was then assessed by the program underwriter, NYBDC LDC, who determined that the business had a working capital need based on their economic losses. Similar to the pharmacy, the undergarment business then substantiated their need for a working capital award by showing the City that they had an outstanding accounts payable bill.

Comment 1

Additionally, the OIG report states that the pharmacy did not report this accounts payable in the business tax returns. However, the pharmacy utilizes a cash basis accounting method. Pursuant to generally accepted accounting principles, cash basis accounting does not report accounts payable on tax returns. Instead, cash basis accounting only records transactions when there is a change in the inflow or outflow of cash. Since the inventory invoice had not been paid, the business was not required to record it in the tax returns. Please refer to Schedule B in the Business Tax Returns for additional details (document previously provided to the OIG during audit, as well as during exit conference and will not be included here due to the sensitive nature of the information shown). Tax returns have no bearing on the company's ability to use accounts payable invoices as a way to substantiate disbursement; tax returns are used to determine the cash flow and working capital deterioration, not for disbursement substantiation. Furthermore, tax returns are used for cash flow and working capital analysis as part of common underwriting procedures.

As a result, the $210,000 payment and the $206,000 were documented, necessary and reasonable working capital expenses.

Comment 3

2. **OIG:** Source and Application of Federal Funds Not Always Identified

City Response:

3

Ref to OIG Evaluation

Auditee Comments

Comment 3

The City respectfully disagrees with this observation. The City believes there are adequate administrative management controls in place and that HUD-reimbursed vouchers were properly maintained.

In compliance with the March 5, 2013 Federal Register Notice, the City tracks and reports program income resulting from CDBG-DR programs. For any award that contains a loan component, the Authorization for Disbursement that NYBDC LDC submits to the City contains a detailed breakout into which portions of the award are classified as loan or a grant. Additionally, the documentation details what portions of the loan/grant are tied to the type of award (moveable equipment, inventory, and working capital). After receiving the estimates of the working capital, inventory, or equipment need at the time of disbursement, NYBDC LDC requests the funds either by matching basis or if there is a specific type of funding for certain purposes. Once the disbursement is processed within the City's Financial Management System, only one lump sum is transferred electronically to NYBDC LDC, even if funds include both a loan and a grant. The lump sum is then sent to the applicant or vendors according to the authorization for disbursement. The City's Financial Management System is not able to include the detailed breakdown of loan/grant funds. However, the City separately maintains such information, as well as the application of the funds. The City no longer disaggregates loans and grants in the CDBG-DR reports to HUD. As discussed at the exit conference, the City did initially submit disaggregated information. However, in working with HUD, the City realized that this detailed information did not need to be reported because the CDBG-DR grant permits the same eligible uses for both loans and grants. As HUD Program ("CPD") stated at the exit conference, HUD CPD does not ask for this level of detail in the DRGR system and does not need this breakdown in the drawdown detail.

As requested during the exit conference on April 23, 2015, we are attaching hereto a breakdown of loan and/or grant amounts for each disbursement. We note that the documentation attached hereto does not include the full details associated with each recipient and total award.

Voucher Number	Recipient	Breakdown of Loan and/or Grant amount provided for each disbursement
252342	[redacted]	Please refer to page 1 of the Exhibit 1 attached
255047	[redacted]	Please refer to page 2 of the Exhibit 1 attached
256158	[redacted]	Please refer to page 3 of the Exhibit 1 attached
256549	[redacted]	Please refer to page 4 of the Exhibit 1 attached
255672	[redacted]	Please refer to page 5 of the Exhibit 1 attached
251308	[redacted]	Please refer to page 6 of the Exhibit 1 attached
265585	[redacted]	Please refer to page 7 of the Exhibit 1 attached
265584	[redacted]	Please refer to page 8 of the Exhibit 1 attached

The OIG report mentions that the invoices used to justify disbursements are worth more than draw requests. The City believes that this mismatch is not problematic and normal in the course of grants. There are two reasons why invoices submitted may be higher than disbursements. First, receipts may be in excess of available funds. The objective and purpose of receipts is for the recipient to demonstrate that the award received was spent on eligible items. A receipt in excess of an award demonstrates that a company had more than enough eligible expenses.

4

Ref to OIG Evaluation

Auditee Comments

Comment 3

Second, a particular invoice may only be partially covered by CDBG-DR funds. Awardees are currently not required to provide additional documentation regarding the breakout of invoices in order to identify the source of funds. While the sum of the invoices provided as part of the drawdown documentation may exceed the disbursed loan/grant amounts, the drawdown funds always match what has been disbursed as demonstrated by the documentation. To require additional documentation showing a breakdown of sources would place additional burden on a business, especially in the context of disaster recovery. Examples are, but not limited to the following:

- Payroll Invoice
  - To further break out whether funds were used to pay personnel, taxes, or additional expenses would require payroll substantiation that a business may or may not be able or willing to provide, therefore there is no requirement to substantiate a payroll invoice other than proof of expense. Payroll is currently an eligible expense for a working capital award.
- Utilities
  - A utility bill may comprise charges for service, fees, and taxes. Tracking which portions of the bill are grant funded is not a requirement of the program. Utilities as a whole are currently an eligible working capital expense; therefore, the partial payment towards this particular invoice is considered eligible with no further breakout or detail.

Comment 4

3. **OIG:** Duplicate Assistance Not Properly Accounted for When Calculating Unmet Need

City Response:

The City respectfully disagrees with this observation. The City believes it did properly account for duplicative assistance when calculating the unmet need of the pharmacy.

NYBDC LDC normalizes the business cash flow as part of the common underwriting procedure it follows, which means adjusting for any grants and loans the business has received after Hurricane Sandy. NYBDC LDC completes this step in order to assess the impact Sandy had on cash flow, without having potentially duplicative funding in the cash flow analysis. This requires NYBDC LDC to either add back (in the case of a Sandy related expenses) or subtract (in the case of Sandy related funding) potentially duplicative assistance. NYBDC LDC makes these adjustments to the cash flow in order to directly compare the company's pre-Sandy financial structure and net cash flow to the company's financial position after the storm. This allows for a clear analysis of the change in net cash flow after the storm.

Many businesses that were cash flow positive before the storm became cash flow negative in the years that followed. In this case, a business is eligible for working capital up to its baseline (positive) year. New York City's Department of Small Business Services ("SBS") will award the business an amount up to the baseline after incorporating an adjustment for duplicative assistance.

5

Ref to OIG Evaluation	Auditee Comments

Comment 4

In the pharmacy's case, it received $35,000 of duplicative grant and loan assistance; therefore NYBDC LDC subtracted these funds in its cash flow analysis. SBS then incorporated this adjustment into its working capital total need by adding $35,000 to the total working capital need.

SBS then subtracts duplicative assistance from the total working capital loss (a sum of cash flow deterioration and working capital change). This step allows SBS to properly account for the business' losses (because NYBDC LDC previously added back and normalized their cash flow chart). If SBS did not add back duplicative funding, then the Applicant's unmet need would not accurately portray their full losses.

The illustrations below demonstrate this process.

Illustration No. 1: Change in cash flow position from 2011 to 2012

	Historic 2010	Historic 2011	Historic 2012	Interim 9/30/13	Projected 12/31/2013	Projected 12/31/2014
Net Profit	($23.0)	($28.0)	($99.0)	($34.0)	($55.0)	($5.0)
-Distributions	$0.0	$0.0	(111.0)	(38.0)	(38.0)	$0.0
-Grant/Ins. Funds Rec'd	0.0	0.0	0.0	(44.0)	(44.0)	0.0
+Depreciation	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
+Interest Expense	7.0	$0.0	$0.0	3.0	4.0	6.0
+ Personal Global CF (A)	104.0	99.0	176.8	0.0	$0.0	$0.0
+ Other Business Global CF	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Total Cash Flow	**$88.0**	**$71.0**	**($33.2)**	**($113.0)**	**($133.0)**	**($1.0)**
Existing Debt Serv. (B)	$10.0	$10.0	$10.0	$20.2	$29.5	$44.1
Proposed Debt Serv. (C)	$0.0	$0.0	$0.0	$0.0	$0.0	$80.3
Total Debt Service	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$29.5**	**$124.4**
Net Excess/ (Deficit) Cash Flow	**$78.0**	**$61.0**	**($43.2)**	**($140.6)**	**($162.5)**	**($123.4)**

The second illustration shows how SBS adds back the duplicative assistance of $35,000; ultimately, telling how it is subtracted (refer to the total need box for "adding back" and A-B Unmet Need for proof of subtraction duplicative assistance).

Illustration No. 2: Duplicative Assistance Add-back

6

Ref to OIG Evaluation	Auditee Comments

Comment 4

	Inventory	Moveable Equipment	Working Capital
TOTAL NEED (A):	235,182.00	56,302.00	=SUM(566700+35000+7452.79)

Sandy Relief Assistance Provider	Type	Purpose *(or eligible use, with receipts)* of funds: Inventory	Unspecified	Mov. Equip.	Unspecified	Working Capital	Unspecified	Other (non-duplicative)	Basis of determination of purpose *(Documentation **Must** be in the file)*
		Counted as Inventory		*Counted as Mov. Equipment*		*Counted as Working Capital*			
Sandy I Loan	Loan						25,000.00		
Sandy I Grant	Grant						10,000.00		
Insurance	Insurance							18,547.57	
National Grid	Grant							50,000.00	
Private bank loan	Loan							175,000.00	
Accion USA	Loan							18,860.00	
NYBAC	Grant							5,000.00	
Sandy 1 Principal and in	Loan							7,452.79	

	Inventory	Moveable Equipment	Working Capital	
TOTAL Duplicative Assistance (B):	-	-	35,000.00	*274,860.36*
[A - B] UNMET NEED (C):	235,182.00	56,302.00	574,152.79	
Already Replaced After Assistance (D):	235,182.00	-		
[C - D] Unmet Need Yet to Replace (E):	-	**56,302.00**	**574,152.79**	TOTAL Unmet Need: 630,454.79

RECOMMENDED AWARD				Total Award:
Grant:	-	56,302.00	574,152.79	**630,454.79**
Loan:	-	-	-	-
Total:	-	**56,302.00**	**574,152.79**	**630,454.79**

Non-HSBLGP Loan Amount: 226,312.79

Estimated Monthly Debt Service: -

<u>Total Working Capital Need</u> for businesses that were positive in the baseline year and become negative in one of the subsequent years (*please see Illustration No.1*) is defined as the sum of the following:

- Working capital duplicative assistance ($35.0 for Sandy 1 loan and grant) *(this figure comes from illustration No. 1, and is part of the grants/insurance received in the cash flow chart).*
- Working Capital Loss ($233.0) *(this figure comes from the Loan and Grant Report, which was provided to the OIG during the Audit and is not included here due to sensitive information contained in the document).*
- Enterprise Loss ($122.0) *(this figure comes from the Loan and Grant Report, which was provided to the OIG during the Audit and is not included here due to sensitive information contained in the document).*
- Working Capital Gap ($211.7) *(this figure comes from the Loan and Grant Report, which was provided to the OIG during the Audit and is not included here due to sensitive information contained in the document).*
- Interest and principal payments ($7.4)[1]

Therefore, the pharmacy's Total Working Capital Need is $609.1 ($35.0 plus $233.0 plus $122.0 plus $211.7 plus $7.4), *(please see the blue Working Capital cell in Illustration No. 2).*

<u>Unmet Need</u> is defined as Total Working Capital Need minus Duplicative Assistance. For the pharmacy:

[1] *After July 1st, 2014 the loan and grant ratios changed, therefore applicants who were approved for a loan received an adjustment to cover the interest and principal payment for the amount that was converted to a grant.*

7

Ref to OIG Evaluation

Auditee Comments

Comment 4

- Total Working Capital Need is $609.1 *(as shown above, this is the sum of working capital duplicative assistance, working capital loss, enterprise loss, working capital gap and interest and principal payments).*
- Working capital duplicative assistance is $35.0 for Sandy 1 loan and grant.

Therefore, the pharmacy's total unmet working capital need is $574.1 ($609.1 minus $35.0).

The Program's Policies and Procedures dictate that a business' total unmet need is found by taking the sum of unmet need in eligible categories, where applicable. In this case, the total unmet need for the pharmacy is the sum of inventory ($56.3) and working capital need ($574.1), which is $630.4 *(please see TOTAL Unmet Need cell in Illustration No. 2).*

As a result subtracting the duplicative assistance in the same eligible category from the total unmet need in working capital, the City's methodology follows 76 FR (Federal Register) 71064 (November 16, 2011) regulation.

4. **OIG:** Approval and Denial of Application in Accordance With Program Requirements

Comment 5

City Response:

The City agrees with your assessment that the approval and denial process of applications was done in accordance with program requirements. The City agrees that it properly documented the applicant's eligibility; verification of loss, including location; substantiation of Federal debarment; confirmation that the business was not a public utility; as well as, demonstration of unmet need.

Conclusion

The City acknowledges recommendations 1A – 1D in the OIG report; however, as reflected in the aforementioned details, we disagree with the recommendation to pay back CDBG-DR funds, as we believe we have adequately demonstrated that these costs were eligible and supported. Furthermore, the City believes there was no incidence of duplicative assistance and believes sufficient measures are in place to safeguard against this occurrence. Since the beginning of the Hurricane Sandy Business Loan and Grant Program, the City has continually strengthened its controls by revising Policies and Procedures as needed and working with HUD CPD to ensure that supporting records fully identify the source, application, and use of funds for all financially assisted activities.

With best regards,

Calvin Johnson

NYC Office of Management and Budget, Assistant Director, CDBG-DR

OIG Evaluation of Auditee Comments

Comment 1 City officials disagreed that the questionable inventory costs were ineligible, stating that they provided proper documentation to support the $210,000 in disbursement made to the pharmacy. The officials contended that lost inventory was not the basis for an unmet need determination but that the award was issued due to the business's unmet need in working capital due to economic loss. Further, City officials stated that the City's policies and procedures required that a business satisfy core eligibility requirements, including proof of loss, damage, or interruption, for its expenses to be necessary and reasonable. Since documentation showed that lost inventory was part of the basis for an unmet need determination for the pharmacy business, City officials provided proof of inventory loss and an explanation that the pharmacy business used a cash basis accounting method, and, therefore, there was no accounts payable balance on its tax returns. As a result, we have removed the questionable inventory costs of $210,000 from the final audit report.

Comment 2 City officials also disagreed that the questionable inventory costs of $206,000 in disbursement made to the undergarment business were unsupported. They contended that the undergarment business suffered economic losses in the form of business interruption, which is supported by the insurance documentation. Our review disclosed that the undergarment business was closed for 5 days due to the lack of power and did not provide evidence of loss of inventory. Since the undergarment business did not have the inventory needs and the award was issued to the business' unmet need in working capital due to economic loss, the $206,000 in inventory costs was unsupported.

Comment 3 City officials disagreed that the source and application of Federal funds were not always identified and stated that this mismatch was not a problem. According to the officials, receipts in excess of an award demonstrated that a company had more than enough eligible expenses. Also, City officials stated that awardees were not required to provide additional documentation regarding the breakout of invoices to identify the source of funds because this requirement would place additional burden on a business, especially in the context of disaster recovery. The City further asserted that DRGR system did not require this level of detail in drawdown. However, the mismatch was a problem because City officials could use the same source documentation to make multiple drawdowns of CDBG-DR funds. In addition, if City officials found that some of the expenses were not supported, it was important to know which source of funds (grant or loan) the business should repay first. Receipts in excess of the award amount are a problem when City officials do not keep records to identify which portions of the expenses were paid with Federal funds.

Our review noted that City officials identified the breakdown of loan and grant amounts for a voucher in their files. However, the breakdown did not identify which portion of the expenses was associated with grant or loan funds and which was paid with Federal funds. According to 24 CFR 85.20(b)(2), grantees and subgrantees are required to maintain records that adequately identify the source and application of funds provided for financially assisted activities. Further, we have reviewed the exhibit documentation provided by City officials since the onsite audit work and found that the documentation identified the breakdown of loan and grant amounts but the breakdown did not identify which portion of the expenses was associated with grant or loan funds. The same documentation was provided during the audit. Therefore, the source and application of Federal funds were not always identified as City officials did not properly maintain and reconcile the HUD-reimbursed vouchers.

Comment 4 City officials disagreed that duplicate assistance was not properly accounted for when calculating unmet need for one business. They stated that when a business had a change in cash flow from the prestorm to poststorm periods, the cash flow of the business was normalized as part of their underwriting procedures, adjusting for any grants and loans the business received after Hurricane Sandy. Therefore, the duplicative assistance of $35,000 was added to the total working capital losses so that the business' unmet need would accurately portray its full losses. According to the City's Business Loan and Grant Program Policies and Procedures, Version 2.0, dated December 6, 2013, page 5, the unmet need means the losses to moveable equipment, inventory, and working capital suffered by the applicant as a direct or indirect result of Hurricane Sandy less all duplicative assistance sources. Further, 76 FR71064 (November 16, 2011) states that to calculate a CDBG-DR award, all assistance found to be duplicative is subtracted to obtain the maximum potential award amount or the unmet need. Therefore, the $35,000 in duplicate assistance was ineligible.

Comment 5 City officials disagreed with the recommendations to pay back CDBG-DR funds because they believed they have provided adequate supporting documentation for eligible expenses in accordance with the City's policies and procedures for the program. City officials also cited their continued efforts to strengthen controls by revising applicable policies and procedures as needed and agreed that applications for assistance were generally approved and denied in accordance with program requirements. During our audit review, we were provided six updated versions of the City's policies and procedures for the program; thus, the officials' continual efforts are evident. It is our intention that this report will assist the officials in fully strengthening controls to assure HUD that the CDBG-DR funds are disbursed for eligible, reasonable, and necessary expenses and that the funds assisted eligible businesses.