The State of New Jersey, Trenton, NJ

Community Development Block Grant Disaster Recovery-Funded Grants and Forgivable Loans to Small Businesses Program

Office of Audit, Region 3
Philadelphia, PA

Audit Report Number: 2015-PH-1004
July 20, 2015

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

//signed//

From: David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia Region, 3AGA

Subject: The State of New Jersey Awarded Disaster Funds to Eligible Businesses for Eligible Expenses in Accordance With HUD and Federal Requirements

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 State of New Jersey's Community Development Block Grant Disaster Recovery-funded Grants and Forgivable Loans to Small Businesses 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 215-430-6730.

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The State of New Jersey Awarded Disaster Funds to Eligible Businesses for Eligible Expenses in Accordance With HUD and Federal Requirements

Highlights

What We Audited and Why

We audited the State of New Jersey's Community Development Block Grant Disaster Recovery-funded Grants and Forgivable Loans to Small Businesses program. We conducted the audit because the program was one of the largest funded economic revitalization programs in the State's action plan and because the State had disbursed more than 37 percent of the funds allocated for the program as of September 2014. Our objective was to determine whether the State awarded grants and loans to eligible businesses in accordance with U.S. Department of Housing and Urban Development (HUD) and Federal requirements.

What We Found

The State awarded disaster funds to eligible small businesses for eligible expenses in accordance with applicable HUD and Federal requirements. The State's written policies and procedures were comprehensive in nature, and it adequately documented eligibility for the businesses and expenses reviewed.

What We Recommend

This report contains no recommendations.

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Background and Objective

On October 29, 2012, Hurricane Sandy made landfall near Atlantic City, NJ. The storm caused unprecedented damage to New Jersey's housing, business, infrastructure, health, social service, and environmental sectors. On October 30, 2012, President Obama declared all 21 New Jersey counties major disaster areas. The U.S. Department of Housing and Urban Development (HUD) identified the following nine counties as New Jersey's most impacted areas: Atlantic, Bergen, Cape May, Essex, Hudson, Middlesex, Monmouth, Ocean, and Union.

Through the Disaster Relief Appropriations Act of 2013,[1] Congress made available $16 billion in Community Development Block Grant funds for necessary expenses related to disaster relief, long-term recovery, restoration of infrastructure and housing, and economic revitalization. In accordance with the Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1974, these disaster relief funds were to be used in the most impacted and distressed areas affected by Hurricane Sandy and other declared major disaster events that occurred during calendar years 2011, 2012, and 2013.

On March 5, 2013, HUD issued a Federal Register notice,[2] which advised the public of the initial allocation of $5.4 billion in Block Grant funds appropriated by the Disaster Relief Appropriations Act for the purpose of assisting recovery in the most impacted and distressed areas declared a major disaster due to Hurricane Sandy.[3] HUD awarded the State of New Jersey $1.8 billion from this initial allocation of funds. On April 29, 2013, HUD approved the State's action plan. The action plan identified the purpose of the State's allocation, including criteria for eligibility, and how its uses addressed long-term recovery needs. On May 13, 2013, HUD approved a grant agreement that obligated more than $1 billion in funding from the $1.8 billion allocation. The Disaster Relief Act required the State to spend obligated funds within 2 years of the date of obligation.

The governor of New Jersey designated the State's Department of Community Affairs as the responsible entity for administrating its Disaster Recovery grant. The Department of Community Affairs entered into a subrecipient agreement with the State's Economic Development Authority to administer the Grants and Forgivable Loans to Small Businesses program. The Economic Development Authority is a component unit of the State government.

The State established the Grants and Forgivable Loans to Small Businesses program for the purpose of economic revitalization. While the State initially planned to provide grants and forgivable loans, it had only made grants under the program as of September 2014. The program

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[1] Public Law 113-2, dated January 29, 2013
[2] 78 FR 14330, dated March 5, 2013
[3] Areas impacted by Hurricane Sandy included New York City, New York State, New Jersey, Connecticut, Rhode Island, and Maryland.

provided grants of up to $50,000 to eligible small businesses that sustained physical damage from Hurricane Sandy. Eligible uses of funds included costs related to rehabilitation, new construction, equipment, inventory, mitigation, refinancing, flood insurance, and working capital. If an eligible business had more than one location, it could receive up to $50,000 per impacted location but no more than $250,000 total.

The State initially allocated $260 million to the program. However, on January 8, 2014, HUD approved a substantial amendment to the State's action plan, which allowed the State to reduce the amount allocated to $100 million. The State requested the change because its analysis of the demand for the program showed that $100 million was sufficient to address the remaining needs. As of September 2014, the State had incurred total costs of $52.5 million related to the program, which included $41.3 million in grant funds awarded to small businesses. The other program costs included administrative and delivery costs of $11.2 million.

The Federal Register notice[4] allowed preaward costs to be reimbursable as long as the costs were incurred after the date of the storm. In addition, HUD Community Planning and Development Notices 13-05, dated July 30, 2013, and 14-017, dated November 14, 2014, allowed grantees to reimburse businesses for costs incurred after the date of the storm but before the date of the State's grant agreement.

Our objective was to determine whether the State awarded grants and loans to eligible businesses in accordance with HUD and Federal requirements.

[4] 78 FR 14342, dated March 5, 2013

Results of Audit

Finding: The State Awarded Disaster Funds to Eligible Businesses for Eligible Expenses in Accordance With HUD and Federal Requirements

The State developed and implemented comprehensive written policies and procedures for its Grants and Forgivable Loans to Small Businesses program and adequately maintained documentation to demonstrate eligibility for the businesses and expenses reviewed.

The State Developed Comprehensive Policies and Procedures

The State developed comprehensive written policies and procedures that complied with applicable HUD and Federal requirements. It established baseline eligibility requirements for both businesses and expenses. For example, each applicant was required to (1) be a small business that sustained a minimum of $5,000 in physical damages, not including perishable or consumable inventory; (2) be registered to do business in the State and up to date on all State tax filings; (3) be financially feasible; (4) demonstrate a need for assistance based on projected revenue and expenses; and (5) meet a national objective, such as providing benefit to low- and moderate-income families or meeting an urgent need. Further, the State's policies required funds to be used for eligible expenses, which included costs related to rehabilitation, new construction, equipment and inventory obtained after the date of the storm, mitigation, refinancing, flood insurance, and working capital. To demonstrate eligibility, the State's policy required extensive documentation, including tax returns, bank statements, canceled checks, invoices, receipts, and payroll records. The State's policy also required it to check for duplication of benefits, using documentation related to insurance settlements and other disaster funding.

The State Followed Its Policies and Procedures

The State followed its policies and procedures for the five applicant files reviewed. It awarded the 5 applicants $409,989 in grant funds, and the related files contained more than 300 pages of documentation on average. For each of the five files reviewed, the State awarded and disbursed disaster funds to an eligible small business for eligible expenses in accordance with applicable requirements.

Conclusion

The State developed policies and procedures for its program that were comprehensive in nature and complied with applicable HUD and Federal requirements. It followed its policies and procedures and adequately maintained documentation to demonstrate eligibility for the businesses and expenses reviewed.

Scope and Methodology

We conducted the audit from October 2014 through April 2015 at the State's office located at 36 West State Street, Trenton, NJ, and our office located in Philadelphia, PA. The audit covered the period May 2013 through September 2014.

To accomplish our objective, we reviewed

- Relevant background information;
- Applicable regulations, HUD notices, and the State's policies and procedures;
- The Disaster Relief Appropriations Act, Public Law 113-2;
- The State's Block Grant Disaster Recovery action plan as approved by HUD on April 29, 2013, along with aproved action plan amendments;
- The funding agreement between HUD and the State, dated May 13, 2013;
- The subrecipient agreement between the State's Department of Community Affairs and its Economic Development Authority, dated May 21, 2013, along with an amendedment, dated August 8, 2014;
- Organizational charts for the State's Department of Community Affairs and its Economic Development Authority;
- Applicants' file information from the State's computer data system, which included hundreds of pages of documentation assocated with each applicant;
- A State monitoring report, issued August 2014; and
- HUD mangagement reviews, dated September 13, 2013, June 10, 2014, and January 8, 2015.

We conducted interviews with responsible employees of the State and HUD staff located in Fort Worth, TX.

To achieve our audit objective, we relied in part on computer-processed data. We used the data to select a sample of approved applications that were awarded grants for review. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes.

As of September 2014, the State had awarded \$41.3 million and disbursed \$33.5 million in grant funds related to 839 approved applications. The amount of the awards for the 839 businesses ranged from \$3,412 to \$250,000. After sorting the businesses by the amount of award in descending order, we selected every 15th approved application until we had chosen 5 businesses for review. The five businesses selected for review were awarded \$409,989 in grant funds, with individual awards that ranged from \$50,000 to \$150,000. The files for the businesses were comprehensive in nature, with more than 300 pages of documentation on average to demonstrate the eligibility of the business and expenses.

We reviewed the State's Stronger New Jersey Business Grant Program Guidelines and Procedures (dated March 24, 2014), including policy clarifications (with various dates). We also reviewed its Stronger New Jersey Business Grant Review Guide (dated June 5, 2014). The State's process for approving a grant involved at least nine critical areas. The following paragraphs explain examples of the documentation the State maintained to demonstrate its compliance with the nine critical areas reviewed.

1. Threshold eligibility: Documentation in the files demonstrated that each business (1) was operational on October 29, 2012 (using tax returns), (2) had $5,000 in physical damages from Hurricane Sandy (using contractor estimates, insurance payments or claim reports, invoices and canceled checks, and photographs of the damage), (3) met the annual revenue and liquid asset thresholds (using tax returns and bank statements), (4) had a valid Federal employee identification number, (5) was not debarred, (6) was registered to do business in the State and was in good standing, and (7) was up to date on all State tax filings.

2. Business eligibility: The files contained business tax returns to show that the business was not a home-based business, a casino or gambling facility, a privately owned recreational facility, or a municipal facility. In addition, the files contained photographs of the business location and evidence that that the State reviewed the business' Web site and performed Google searches on the business name and owners.

3. Business needs and eligible assistance: The files contained documentation on projected revenue and expenditures based on prior tax returns, along with additional documentation and explanations provided by the businesses when requested by the State.

4. Use of funds: The files contained documentation supporting the expense category and showing that the expenses were incurred from the date of the storm forward. The documentation included payroll records, canceled checks, bank statements, credit card statements, and wire transfers. The five businesses reviewed used the grant funds for working capital.

5. Other disaster funding: The files contained applications (for the State's program) from each business in which it self-reported whether it had received insurance settlements or funding from the U.S. Small Business Administration (SBA). The files showed that the State also reviewed tax returns to determine whether there were insurance expenses and the nature of the expenses. For SBA, the files contained a spreadsheet provided by the agency, which showed whether the businesses had applied for, been approved for, and received SBA assistance. For assistance from the Federal Emergency Management Agency (FEMA), the files contained screenshots and printouts from FEMA's Web site showing whether the addresses and buildings associated with the business had flood insurance (current or expired) and had any relevant claims. In cases in which the State's review of the application, tax returns, SBA spreadsheet, and FEMA Web site indicated possible assistance, the State obtained source documents. For example, files contained e-

mails from the insurance companies (and copies of policy documents) and copies of the SBA loan documents.

6. Duplication of benefits calculation: The files showed that the State appropriately reduced the amount of eligible funds when there was a duplication of benefits. Examples of duplication of benefits included business interruption insurance proceeds, contents insurance proceeds, and other working capital assistance.

7. Underwriting: The files showed that the State had determined that the business had demonstrated the need for assistance, the project costs were reasonable and realistic for recovery, and the business was financially feasible and appeared likely to have sufficient capital to recover. To support the underwriting analysis and calculations, the files contained the prior year tax returns and other documents.

8. National objective: The State funded the five businesses as an urgent need. The files contained documentation to demonstrate that the businesses were located in two of the nine counties most impacted by Hurricane Sandy.

9. Cost reasonableness: The files showed that the State had performed an analysis to determine whether the costs incurred by the businesses were fair and reasonable. For example, to review the reasonableness of rents, the State compared them to rents of similar businesses in the area. Further, the State was able to provide proof of payments to show that the costs had been paid by the businesses. This proof included receipts and payroll records.

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 findings and conclusions based on our audit objective.

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 objective:

- 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.

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

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.

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Appendix

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

State of New Jersey
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Governor

KIM GUADAGNO
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JOHN J. HOFFMAN
Acting Attorney General

June 30, 2015

Via Electronic Mail and Overnight Delivery

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U.S. Department of Housing and Urban Development
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Wanamaker Building
100 Penn Square East, Suite 10250
Philadelphia, PA 19107
Email: dkasperowicz@hudoig.gov

Re: Audit of New Jersey's Grants and Forgivable Loans to Small Businesses Program

Dear Mr. Kasperowicz:

The State of New Jersey is in receipt of and has reviewed the Department of Housing and Urban Development, Office of the Inspector General's ("OIG") recent audit report concerning the Community Development Block Grant – Disaster Recovery ("CDBG-DR") funded Grants and Forgivable Loans to Small Businesses Program ("Small Business Grants Program"). We thank OIG for its diligence in conducting a professional and thorough audit of this vital economic revitalization program and also for including the State throughout the process. We are pleased by OIG's conclusion that the State appropriately used disaster recovery funds to assist eligible small businesses through the Small Business Grants Program.

Superstorm Sandy, the largest and most devastating natural disaster in New Jersey's history, left thousands of New Jersey small businesses with debilitating property damage and economic losses. As the State began to rebuild, it was clear that many small businesses had lasting unmet needs. To satisfy these unmet needs and to help stabilize vulnerable communities following the storm, the State established the Small Business Grants Program to distribute CDBG-DR grants of up to $50,000 per location[1] to eligible New Jersey-based small businesses. Grant recipients received these funds as reimbursement for working capital expenses related to their businesses.

[1] Businesses with multiple Sandy-impacted locations were eligible to receive up to $250,000.

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Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

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The Small Business Grants Program has successfully awarded more than $50 million dollars in disaster relief funds to help eligible small businesses recover from the effects of Sandy. As the State's Program administrator, the Economic Development Authority[2] ("EDA") has approved 1,081 applications and awarded $53,336,648 in grants. Importantly, 97% of the awarded funds have gone to businesses in the nine most-impacted New Jersey counties (as designated by the Department of Housing and Urban Development ("HUD")), totaling $51,458,892 of economic revitalization assistance to these hardest-hit areas. By providing much-needed working capital, these grants have enabled many New Jersey small businesses to resume and sustain their operations in the years following Sandy. In turn, these small businesses have helped stabilize Sandy-impacted communities by providing vital jobs and services.

Comment 1

In its audit report, OIG finds that the State appropriately awarded and disbursed CDBG-DR funds under the Small Business Grants Program in accordance with HUD and federal requirements. OIG specifically acknowledges that EDA developed comprehensive program policies and procedures and maintained extensive documentation to demonstrate applicant eligibility and to support program expenditures. The State thanks OIG for recognizing the strength of its program policies and readily agrees that EDA instituted a rigorous system of controls to ensure the proper distribution of CDBG-DR grants. Although OIG did not identify any areas needing improvement, the State will continue to work closely with our disaster recovery partners at HUD to discuss any avenues of improvement in the Small Business Grants Program, as well as the State's other CDBG-DR funded programs, as we continue to award CDBG-DR funds in an effective and efficient manner.

As always, we look forward to continuing our strong working relationship with HUD and OIG as we address these important disaster recovery issues together. Please do not hesitate to contact us if we may be of further assistance.

Very truly yours,

Daniel J. Kelly
Deputy Director
Superstorm Sandy Compliance Unit

[2] The EDA is an independent State authority whose primary mission is to strengthen New Jersey's economy by retaining and growing businesses through financial assistance and by renewing communities.

OIG Evaluation of Auditee Comments

Comment 1 As discussed with the State during the exit conference, our audits are generally focused on transactions, events, and records for a specific period in time. This audit covered the period May 2013 through September 2014. Our audit objective was to determine whether the State awarded grants and loans to eligible businesses in accordance with HUD and Federal requirements during our audit period. For the five grants that we reviewed, we concluded that the State adequately maintained documentation to demonstrate eligibility for the businesses and expenses. The State's program is ongoing. We reserve the right to initiate future audits of the State's program.