



Issue Date September 27, 2006

Audit Report Number 2006-NY-1013

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

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: Lower Manhattan Development Corporation, New York, New York,
Community Development Block Grant Disaster Recovery Assistance Funds

HIGHLIGHTS

What We Audited and Why

Pursuant to congressional mandate, we performed the seventh of our ongoing audits of the Lower Manhattan Development Corporation's (the auditee) administration of the \$2.783 billion in Community Development Block Grant (Block Grant) Disaster Recovery Assistance funds provided to the State of New York following the September 11, 2001, terrorist attacks on the World Trade Center in New York City. The auditee disbursed approximately \$129.7 million of these funds during our audit period from October 1, 2005, through March 31, 2006.

Our audit objectives were to determine whether the auditee (1) disbursed Block Grant Disaster Recovery Assistance funds in accordance with the guidelines established under U.S. Department of Housing and Urban Development (HUD) - approved partial action plans, (2) expended Block Grant Disaster Recovery Assistance funds for eligible planning and administrative expenses in accordance with applicable laws and regulations, and (3) had a financial management system in place that adequately safeguards funds.

What We Found

The auditee generally disbursed the \$129.7 million in Disaster Recovery Assistance funds in accordance with HUD-approved action plans, expended Disaster Recovery Assistance funds for eligible planning and administrative expenses in accordance with applicable laws and regulations, and maintained a financial management system that adequately safeguarded the funds. However, expenditures were misclassified in HUD's Line of Credit Control System and a consultant's fees were overpaid. This occurred because of weaknesses in the auditee's procedures for classifying funds drawn down from the Line of Credit Control System and reimbursing a consultant's fee. Consequently, funds may not be available to drawdown from the correct budget line items and could be used for other than their intended purposes.

What We Recommend

We recommend that HUD's general deputy assistant secretary for community planning and development require the auditee to (1) reclassify costs totaling \$186,749 to the appropriate HUD Line of Credit Control System program budget line item, (2) reimburse \$3,053 to the World Trade Center Memorial and Cultural program, and (3) strengthen controls over the invoice approval process to ensure consultants are reimbursed in accordance with the terms of agreements and other applicable requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the contents of the report with the auditee during the audit and at an exit conference on September 21, 2006, and the auditee provided written comments on September 22, 2006. Auditee officials generally agreed with our findings, and advised that they are taking corrective action to address the recommendations.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding: Weaknesses Exist in Classifying and Reimbursing Costs	6
Scope and Methodology	8
Internal Controls	9
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	11
B. Auditee Comments and OIG's Evaluation	12
C. Schedule of Program Funding and Disbursements as of March 31, 2006	14

BACKGROUND AND OBJECTIVES

In the aftermath of the September 11, 2001 terrorist attacks on the World Trade Center in lower Manhattan, Congress authorized \$3.483 billion in Community Development Block Grant (Block Grant) Disaster Recovery Assistance funds to assist with recovery and revitalization. On November 5, 2001, the Office of Management and Budget designated \$700 million in Block Grant 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 Block Grant funding, earmarking at least \$500 million to compensate small businesses, nonprofit organizations, and individuals for their economic losses.² On August 2, 2002, Congress appropriated an additional \$783 million in Block Grant funding.³

The Lower Manhattan Development Corporation (auditee), created in December 2001 as a subsidiary of the Empire State Development Corporation to function as a joint city-state development corporation, was designated by the State of New York to administer the \$2.783 billion appropriated in the January and August 2002 Emergency Supplemental Acts. The Empire State Development Corporation, the parent company of the auditee, administers the remaining \$700 million. A 16-member board of directors, appointed equally by the governor of New York and the mayor of New York City, manages the affairs of the auditee. The Empire State Development Corporation performs all accounting functions for the auditee, including payroll, payments to the auditee's vendors, and drawing down funds from the U.S. Department of Housing and Urban Development (HUD).

Planned expenditures of Disaster Recovery Assistance funds are documented in action plans that receive public comment and are approved by HUD. HUD approved 13 partial action plans as of March 31, 2006 that provided for the allocation of approximately \$2.556 billion, or 92 percent of the \$2.783 billion appropriated, to specific programs and activities (see appendix C for amounts by program). As of March 31, 2006, the auditee had disbursed more than \$1.07 billion, or 42 percent of the \$2.556 billion allocated.

After our audit period, the auditee announced that it will begin transitioning its grant responsibilities to other entities in the fall of 2006; however, HUD and the auditee have not finalized a formal transition plan for the commitment of the undisbursed funds and the monitoring of on-going activity.

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.

We reviewed the auditee's planning and administrative expenses, monitoring procedures, and disbursements made during the period October 1, 2005 through March 31, 2006 in the following programs:

World Trade Center (WTC) Memorial and Cultural: As of March 31, 2006, HUD approved more than \$494 million for this program to fund the planning, selection, coordination and construction of a memorial, memorial center, and museum and cultural uses on the World Trade Center site and adjacent areas to complement certain commercial redevelopment and infrastructure improvements to be made by the Port Authority, the owner of the World Trade Center site. For our audit period, HUD's Line of Credit Control System reported \$95 million disbursed for this program.

New York Stock Exchange Area Security and Aesthetic Improvements: As of March 31, 2006, HUD had approved more than \$25 million for this program for installing security barriers and guard facilities on critical streets, developing a more effective street treatment, and providing more attractive street furniture to facilitate secure pedestrian and vehicular circulation within lower Manhattan. During our audit period, \$5.4 million was reported disbursed for this program.

Small Firm Attraction and Retention Grant: As of March 31, 2006, HUD had approved \$50 million for this program to help retain and create jobs at assisted firms. During our audit period, \$7.6 million was reported disbursed for this program.

Lower Manhattan Tourism: As of March 31, 2006, HUD had approved more than \$4.1⁴ million for this program. The purpose of the program is to provide funding to aid the travel and tourism industry in New York City. The program consists of three subprograms: (1) Tribeca Film Festival, (2) Splendor of Florence Festival, and (3) River to River Festival. For our audit period, HUD's Line of Credit Control System reported \$1.6 million disbursed for this program.

Neighborhood Parks and Open Space: As of March 31, 2006, HUD had approved more than \$27 million for this program, which is intended to enhance existing parks and create new green spaces across residential communities in lower Manhattan. During our audit period, \$4.4 million was reported disbursed for this program.

Public Service Activities: As of March 31, 2006, HUD had approved almost \$7.3 million for this program, which consists of four subprograms: (1) Tribute in Light, (2) Story Corps World Trade Center Story Booth Project, (3) Living Memorial Project, and (4) Tribute Visitor Center. During our audit period, \$1.09 million was reported disbursed for this program.

Our audit objectives were to determine whether the auditee (1) disbursed Block Grant Disaster Recovery Assistance funds in accordance with the guidelines established under HUD-approved partial action plans, (2) expended Block Grant Disaster Recovery Assistance funds for eligible planning and administrative expenses in accordance with applicable laws and regulations, and (3) had a financial management system in place that adequately safeguards funds.

⁴ An additional \$5.9 was allocated to the Chinatown Tourism and History and Heritage Downtown Marketing Initiative programs, thus complying with the legislative requirement to allocate \$10 million to Tourism.

RESULTS OF AUDIT

Finding: Weaknesses Exist in Classifying and Reimbursing Costs

Expenditures were misclassified in HUD's Line of Credit Control System and a consultant's fees were overpaid. This occurred because of weaknesses in the auditee's procedures for classifying funds drawn down from the Line of Credit Control System and reimbursing a consultant's fees. Consequently, funds may not be available to drawdown from the correct budget line items and could be used for other than their intended purposes.

Misclassification of Costs

On February 11, 2006, \$156,650 in costs were classified to the Lower Manhattan Tourism budget line item in HUD's Line of Credit Control System; however, these costs should have been classified as World Trade Center Memorial and Cultural program costs. While the auditee was diligent in making adjustments to the Line of Credit Control System to correct prior errors, an adjustment was inadvertently charged to the wrong program. The alternative procedures published in the *Federal Register* require the auditee to annually include a financial reconciliation of funds budgeted and expended in its Disaster Recovery Grant Report, which should include ensuring that information in the Line of Credit Control System is correct.

On February 17, 2006, the auditee classified \$30,099 in costs to the World Trade Center Memorial and Cultural program budget line in HUD's Line of Credit Control System; however, documentation disclosed that these costs were related to other programs. Specifically, \$2,910 was related to the Hudson River Park Improvements program and \$27,189 was related to planning and administrative costs. These costs were incorrectly charged to the World Trade Center Memorial and Cultural program because the approved drawdown and transfer request form was missing the HUD grant number and the auditee's parent corporation incorrectly charged them to the Memorial and Cultural program. Auditee officials were unaware of this error and agreed to coordinate with their parent corporation to correctly charge the costs to the Hudson River Park Improvements program and to planning and administration.

Weakness in Reimbursing Costs

The auditee reimbursed a consultant at rates different than that prescribed in the consultant agreement under the World Trade Center Memorial and Cultural program. The consultant billed professional fees at rates different than those established in the existing agreement, resulting in excess reimbursement of \$3,053.

Conclusion

Weaknesses in the auditee's internal controls resulted in incorrect classification of costs in HUD's Line of Credit Control System and noncompliance with provisions of a consultant agreement. Correction of these errors and weaknesses will ensure that costs are properly classified and charged to the HUD grant.

Recommendations

We recommend that HUD's general deputy assistant secretary for community planning and development require the auditee to

- 1A. Reclassify \$156,650 in costs within HUD's Line of Credit Control System from the Lower Manhattan Tourism program to the World Trade Center Memorial and Cultural program.
- 1B. Reclassify \$2,910 in costs within HUD's Line of Credit Control System from the World Trade Center Memorial and Cultural program to the Hudson River Park Improvements program.
- 1C. Reclassify \$27,189 in costs within HUD's Line of Credit Control System from the World Trade Center Memorial and Cultural program to planning and administration.
- 1D. Reimburse the World Trade Center Memorial and Cultural program \$3,053 for overpaid consultant fees.
- 1E. Strengthen controls over the invoice approval process to ensure that consultants are reimbursed in accordance with the terms of agreements and other applicable requirements.

SCOPE AND METHODOLOGY

During the audit period, October 1, 2005, through March 31, 2006, the auditee disbursed \$129.7 million of the \$2.783 billion in Disaster Recovery Assistance funds for activities related to the rebuilding and revitalization of lower Manhattan. We tested \$89.4 million, representing approximately 69 percent of the amount disbursed for the period.

To achieve our audit objectives, we reviewed applicable laws, regulations, and program requirements; HUD-approved partial action plans; and the auditee's accounting books and records. We examined and tested the documentation supporting disbursements related to the following:

- World Trade Center Memorial and Cultural program
- New York Stock Exchange Area Security and Aesthetic Improvements program
- Small Firm Attraction and Retention Grant program
- Lower Manhattan Tourism program
- Neighborhood Parks and Open Spaces program
- Public Service Activities program

We also reviewed the auditee's planning and administrative expenses and policies and procedures for monitoring the above programs.

The audit covered the period from October 1, 2005, through March 31, 2006, and was expanded when necessary. We performed our on-site work at the auditee's office and the office of the auditee's parent company, the Empire State Development Corporation, from May 2006 through August 2006.

We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined 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 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 the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we did not find significant weaknesses. However, we did identify weaknesses in the auditee's internal controls which resulted in incorrect classification of costs in HUD's Line of Credit Control System and non-compliance with consultant agreements (see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A		\$156,650
1B		2,910
1C		27,189
1D	<u>\$ 3,053</u>	_____
Total	<u>\$3,053</u>	<u>\$186,749</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.

2/ “Funds to be put to better use” are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if the Auditee implements our recommendation, the misclassification of funds will be corrected, thus making available the proper funds in the future for each of the affected programs.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



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September 22, 2006

Edgar Moore
Regional Inspector General for Audit
U.S. Department of Housing and
Urban Development
26 Federal Plaza, Room 3430
New York, NY 10278

Dear Mr. Moore,

The Lower Manhattan Development Corporation ("LMDC") has reviewed the U.S. Department of Housing and Urban Development Office of Inspector General Draft Audit Report that was provided to us on September 20, 2006. The LMDC understands the importance of your review of activities associated with the use of CDBG funds and your recommendations. The attached document presents LMDC management's responses to the draft Audit Report.

Sincerely,

Daniel A. Ciniello
Senior Vice president - Operations

Attachment

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

LMDC Response to HUD OIG Draft Report

LMDC has reviewed the draft audit report from the HUD Office of the Inspector General (OIG) covering the period from October 2005 through March 2006. As you are aware, the LMDC has and will continue to work diligently to insure Disaster Assistance funds are safeguarded and disbursed for eligible HUD-approved expenses. This report reflects that effort in that no significant weaknesses were identified. This report identifies two classification mistakes and an overpayment to one vendor all of which are in the process of being corrected. Our responses to the findings noted and recommendations are provided below.

HUD IG Recommendation 1A: *Reclassify \$156,650 in costs within HUD's Line of Credit Control System from the Lower Manhattan Tourism program to the World Trade Center Memorial and Cultural program.*

We are working with the HUD Community Block Grant Development Office and our parent organization's Accounting and Treasury departments to reclassify these costs.

HUD IG Recommendation 1B: *Reclassify \$2,910 in costs within HUD's Line of Credit Control System from the World Trade Center Memorial and Cultural program to the Hudson River Park Improvements program.*

We are working with the HUD Community Block Grant Development Office and our parent organization's Accounting and Treasury departments to reclassify these costs.

HUD IG Recommendation 1C: *Reclassify \$27,189 in costs within HUD's Line of Credit Control System from the World Trade Center Memorial and Cultural program to planning and administration.*

We are working with the HUD Community Block Grant Development Office and our parent organization's Accounting and Treasury departments to reclassify these costs.

HUD IG Recommendation 1D: *Reimburse the World Trade Center Memorial and Cultural program \$3,053 for overpaid consultant fees.*

The consultant's next invoice payment request has been reduced by this \$3,053 plus other amounts not authorized in the normal course of review. The consultant has been notified of this corrective action which offsets the reported excessive charge to the program. Consequently, there is no need to recover the \$3,053 from the consultant.

HUD IG Recommendation 1E: *Strengthen controls over the invoice approval process, to ensure that consultants are reimbursed in accordance with the terms of agreements and other applicable requirements.*

Both the Project Managers and Finance staff have been reminded of their need to more carefully review invoices and supporting documentation to insure compliance with the agreements and other requirements. Management will continue to emphasize the importance of effective reviews.

Appendix C

SCHEDULE OF PROGRAM FUNDING AND DISBURSEMENTS AS OF MARCH 31, 2006

<u>Program</u>	Budget as of Mar. 31, 2006	Audit period disbursements Oct. 1, 2005 – Mar. 31, 2006	Cumulative disbursements as of Mar. 31, 2006	Balance remaining as of Mar. 31, 2006
Business Recovery Grant	\$224,500,000	(\$15,811)	\$213,878,518	\$10,621,482
Job Creation and Retention	150,000,000	1,371,753	62,566,015	87,433,985
Small Firm Attraction and Retention	50,000,000	7,659,000	7,659,000	42,341,000
Residential Grant	280,500,000	353,331	235,853,904	44,646,096
Employment Training Assistance	500,000		345,909	154,091
Memorial Design and Installation	350,000		299,969	50,031
Columbus Park Renovation	998,571			998,571
Marketing History/Heritage Museums	4,664,000	927,797	2,647,990	2,016,010
Downtown Alliance Streetscape	4,000,000		4,000,000	-
New York Stock Exchange Area Improvements	25,160,000	5,468,467	5,468,467	19,691,533
Neighborhood Parks and Open Space	27,481,689	4,403,164	9,720,492	17,761,197
Hudson River Park Improvements	72,600,000	15,601	2,482,569	70,117,431
Millennium High School	3,007,500			3,007,500
West Street Pedestrian Connection	22,955,811	1,949	12,842,870	10,112,941
Lower Manhattan Communication Outreach	1,000,000	87,568	887,777	112,223
Pace Green Roof	100,000			100,000
Chinatown Tourism and Marketing	1,160,000	182,426	919,925	240,075
Lower Manhattan Information	2,570,000	831,319	1,752,391	817,609
World Trade Center Memorial and Cultural	494,017,180	95,503,971	217,401,774	276,615,406
Lower Manhattan Tourism	4,176,000	1,516,928	3,630,000	546,000
East River Waterfront Project	150,000,000	30,078	30,078	149,969,922
Local Transportation and Ferry Service	9,000,000			9,000,000
East Side K-8 School	20,000,000			20,000,000
Fiterman Hall Reconstruction	15,000,000			15,000,000
Chinatown Local Development Corporation	7,000,000			7,000,000
Affordable Housing	50,000,000			50,000,000
Public Service Activities	7,296,900	1,094,534	4,456,929	2,839,971
Administration and planning	115,000,000	10,381,678	61,405,423	53,594,577
Disproportionate Loss of Workforce	33,000,000		32,999,997	3
Utilities Restoration and Infrastructure	735,000,000		190,313,178	544,686,822
Cultural Enhancement Fund: Capital	35,000,000			35,000,000
The Drawing Center	10,000,000			10,000,000
Totals	\$2,556,037,651	\$129,813,755	\$1,071,563,177	\$1,484,474,474