



Issue Date September 28, 2007
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Audit Report Number 2007-NY-1013
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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**

This represents the ninth in our ongoing congressionally mandated audits of the Lower Manhattan Development Corporation's (the auditee) administration of the \$2.783 billion in Community Development Block Grant Disaster Recovery Assistance funds provided to the State of New York in the aftermath of the September 11, 2001, terrorist attacks on the World Trade Center in New York City. The auditee disbursed approximately \$98.7 million of these funds during our audit period, October 1, 2006, through March 31, 2007.

Our audit objectives were to determine whether the auditee (1) disbursed 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 Disaster Recovery Assistance funds for eligible administration and planning expenses in accordance with applicable laws and regulations, and (3) had a financial management system in place that adequately safeguarded funds and prevented misuse.

## **What We Found**

The auditee generally disbursed the \$98.7 million in Disaster Recovery Assistance funds in accordance with HUD-approved action plans, expended funds for eligible administration and planning expenses in accordance with applicable laws and regulations, and maintained a financial management system that adequately safeguarded funds and prevented misuse. However, our audit disclosed an internal control weakness resulting in the drawdown of more than \$1.2 million in Utility Restoration and Infrastructure Rebuilding program funds by a subrecipient without the auditee's written approval. As a result, documentation was lacking to ensure that drawdowns in the Utility Restoration and Infrastructure Rebuilding program were properly authorized.

## **What We Recommend**

We recommend that HUD's General Deputy Assistant Secretary for Community Planning and Development require the auditee to (1) strengthen its drawdown controls to ensure that its subrecipient complies with the subrecipient agreement.

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 19, 2007. The auditee provided written comments on September 21, 2007 and generally agreed with our finding, advising that it will work with subrecipients to ensure that effective controls are established and followed.

The complete text of the auditee's response can be found in appendix A of this report.

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## BACKGROUND AND OBJECTIVES

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The Lower Manhattan Development Corporation (auditee) was created in December 2001 as a subsidiary of the Empire State Development Corporation to function as a joint city-state development corporation. A 16-member board of directors, appointed equally by the governor of New York and the mayor of New York City, oversees the auditee's affairs. 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).

The auditee was designated by the State of New York to administer \$2.783 of the \$3.483 billion in Community Development Block Grant Disaster Recovery Assistance funds appropriated by Congress following the September 11, 2001, terrorist attacks on the World Trade Center to assist with the recovery and revitalization of lower Manhattan. The Empire State Development Corporation administers the remaining \$700 million. Planned expenditures of Disaster Recovery Assistance funds are documented in action plans that receive public comment and are approved by HUD. HUD had approved 15 partial action plans as of March 31, 2007, that allocated the total \$2.783 billion appropriated to various programs and activities (see appendix B for amounts by program). As of March 31, 2007, the auditee had disbursed more than \$1.24 billion, or 45 percent of the \$2.783 billion allocated.

Our audit consisted of a review of administration and planning expenses, monitoring procedures, and disbursements related to the following programs:

Utility Restoration and Infrastructure Rebuilding: As of March 31, 2007, HUD approved \$750 million for this program to provide financial assistance directly to energy and telecommunications service providers for the reimbursement of qualified emergency and temporary restoration costs, as well as costs associated with the permanent restoration of the utility infrastructure damaged in the aftermath of the September 11, 2001, terrorist attacks. Additionally, the program seeks to prevent costs borne by the utility service providers from being passed on to the customers.

World Trade Center Memorial and Cultural: As of March 31, 2007, HUD approved approximately \$622.5 million for this program to fund the planning, selection, coordination, and construction of a memorial and memorial center. In addition, funds were earmarked for planning and possible construction of memorial-related improvements and museum and cultural uses on the World Trade Center site and adjacent areas, complementing the commercial redevelopment and infrastructure improvements by the Port Authority of New York and New Jersey, the owner of the World Trade Center Site. Of the \$622.5 million, HUD approved \$207.1 million for the acquisition and deconstruction of 130 Liberty Street, the Deutsche Bank building.

Lower Manhattan Community and Cultural Enhancement Funds: As of March 31, 2007, HUD approved \$88.95 million for this program to provide grants through a competitive selection process to not-for-profit organizations for projects that address cultural and community needs in

lower Manhattan and demonstrate the ability to spur long-term revitalization of the area, benefiting area residents, workers, businesses, and visitors.

Small Firm Attraction and Retention Grant: As of March 31, 2007, HUD approved \$29 million for this program to help retain and create jobs at assisted firms.

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

## RESULTS OF AUDIT

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### Finding 1: The Auditee Generally Administered Grant Funds in Accordance with HUD Regulations

The auditee generally disbursed the \$98.7 million in Disaster Recovery Assistance funds in accordance with HUD-approved action plans, expended funds for eligible planning and administrative expenses in accordance with applicable laws and regulations, and maintained a financial management system that adequately safeguarded funds and prevented misuse. However, our audit disclosed an internal control weakness resulting in the subrecipient drawing down more than \$1.2 million in Utility Restoration and Infrastructure Rebuilding program funds without the auditee's written approval as required by the subrecipient agreement. Accordingly, documentation is lacking to ensure that this drawdown in the Utility Restoration and Infrastructure Rebuilding program was properly authorized. Thus, the auditee needs to strengthen controls over drawdown approvals to ensure that funds are used for allowable program costs.

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#### **Drawdown Made Contrary to Subrecipient Agreement**

The auditee executed an amended subrecipient agreement with its parent company, the Empire State Development Corporation, on June 30, 2005, to administer \$742.5 million under the Utility Restoration and Infrastructure Rebuilding program. Section D (a) of the agreement required the subrecipient to submit HUD drawdown authorization requests to the auditee before drawing down funds to make payments. Once the auditee approved the request, it would provide an approved HUD drawdown and transfer request allowing the subrecipient to draw down funds from the U.S. Treasury.

Contrary to section D (a) of the subrecipient agreement, on January 3, 2007, the subrecipient drew down \$1,289,698 in Utility Restoration and Infrastructure Rebuilding program funds without obtaining the auditee's written approval. It should be noted that auditee officials were aware of the proposed drawdown because of procedures previously implemented as a result of a prior Office of Inspector General (OIG) report<sup>1</sup>. In that report, auditee officials stated that drawdown procedures were discussed with the subrecipient and that since October 2004, all drawdowns from the Utility Restoration and Infrastructure Rebuilding program have complied with the subrecipient agreement. However, as previously noted, the subrecipient did not obtain the auditee's written approval before this drawdown was made. Further, when the auditee learned of the unauthorized

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<sup>1</sup> 2005-NY-1003, dated March 23, 2005.

drawdown, it immediately contacted the subrecipient to address the breakdown in the internal controls.

We are not taking a monetary exception to the amount drawn down and disbursed because our testing of the expenditures did not disclose any disbursements inconsistent with program regulations. However, although we recognize that operational challenges may exist because the subrecipient is also the auditee's parent company and performs all accounting functions for the auditee including drawing down HUD funds, there should be compliance with the subrecipient agreement to provide increased assurance that all drawdowns are used for only eligible purposes.

## **Conclusion**

Because of an internal control weakness, the auditee lacked documentation to ensure that a drawdown in the Utility Restoration and Infrastructure Rebuilding program was properly authorized. While there were no improper expenditures related to the Utility Restoration and Infrastructure Rebuilding program funds drawn down, the auditee should continue to approve all drawdowns to ensure that its funds are used for only allowable program expenses.

## **Recommendations**

We recommend that HUD's General Deputy Assistant Secretary for Community Planning and Development require the auditee to

- 1A. Strengthen HUD drawdown controls to ensure that its subrecipient always comply with the subrecipient agreement.

## SCOPE AND METHODOLOGY

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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 documented disbursements made during the audit period and reconciled disbursements recorded in HUD's Line of Credit and Control System.

During the audit period, October 1, 2006, through March 31, 2007, the auditee disbursed \$98.7 million of the \$2.783 billion in Disaster Recovery Assistance funds for activities related to the rebuilding and revitalization of lower Manhattan. We tested \$18.29 million, representing approximately 19 percent of the amount disbursed for the period in the following programs:

<u>Program</u>	<u>Amount disbursed October 1, 2006, through March 31, 2007</u>	<u>Amount tested</u>
Utility Restoration and Infrastructure Rebuilding	\$ 1.29 million	\$ 1.29 million
World Trade Center Memorial and Cultural	\$ 43.2 million	\$ 12.80 million
Lower Manhattan Community and Cultural Enhancement Funds	\$ 4.8 million	\$ 4.20 million
Total	\$ 49.29 million	\$ 18.29 million

We also tested \$639,929 of the auditee's administration and planning costs, along with its policies and procedures for monitoring the above programs. We focused our audit efforts regarding the Small Firm Attraction and Retention Grant program on testing the subrecipient's implementation of its compliance monitoring policies to evaluate whether recipients identified as noncompliant were treated in a consistent manner. In addition, we reviewed 12 Cultural Enhancement Funds program application files for completeness and compared the advisory panel's funding recommendations for 121 applicants to the 63 grants awarded by the board of directors to determine whether the board's determinations were adequately documented.

We performed our on-site work at the auditee's office in lower Manhattan and at the auditee's parent company, the Empire State Development Corporation, in midtown Manhattan from April through September 2007.

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



# INTERNAL CONTROLS

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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.

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## 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 identify any significant weaknesses. Nevertheless, the following item is a reportable weakness:

- Safeguarding resources - The auditee did not adequately safeguard resources when it permitted Disaster Recovery Assistance funds to be drawn down without its written approval as required by the subrecipient agreement.

## FOLLOWUP ON PRIOR AUDITS

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**Lower Manhattan Development Corporation, Community Development Block Grant Disaster Assistance Funds, New York, NY: 2005-NY-1003**

Audit Report number 2005-NY-1003 was issued on March 23, 2005, and contained two audit findings with recommendations for corrective action. The findings involved the disbursement of Disaster Recovery Assistance funds for ineligible administrative costs under the Utility Restoration and Infrastructure Rebuilding program and the absence of written documentation demonstrating that the auditee performed program monitoring.

The auditee implemented corrective actions to address the deficiencies cited in the reports above and stated that since October 2004, all drawdowns from the Utility Restoration and Infrastructure Rebuilding program have complied with the subrecipient agreement. Nevertheless, our audit revealed one instance in which the subrecipient drew down and disbursed more than \$1.2 million in Utility Restoration and Infrastructure Rebuilding program funds without the auditee's written approval as required (see finding).

# APPENDIXES

## Appendix A

### AUDITEE COMMENTS



**LMDC**  
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September 21, 2007

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 18, 2007. The LMDC understands the importance of your review of activities associated with the use of CDBG funds and your recommendation. The attached document presents LMDC management's response to the draft Audit Report.

Sincerely,

David Emil  
President

Attachment

# Appendix A

## AUDITEE COMMENTS

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### **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 September 2006 through March 31, 2007. As you know, the LMDC has and will continue to work diligently to insure Disaster Assistance funds are safeguarded and appropriately disbursed for eligible expenses. This report reflects our accomplishments in that no significant weaknesses were identified. Our response to your recommendation is provided below.

*HUD IG Recommendation 1A: Strengthen HUD drawdown controls to ensure that its subrecipient always comply with the subrecipient agreement.*

LMDC's drawdown controls are already very strong in that prior written authorization (including 3 LMDC signatures) is required to authorize drawdowns and LMDC monitors all HUD financial activity regularly. A drawdown was made by LMDC's subrecipient and parent company without the required prior written authorization because procedures in place were not followed, not because the controls were inadequate. A lack of familiarity with procedural details during a period of transition contributed to this matter. However, as this report acknowledges, LMDC's detective controls identified the unauthorized drawdown promptly preventing further incidents of noncompliance and permitting management to reinforce procedural knowledge. LMDC's Chief Financial Officer spoke with Finance Department personnel at our parent company and the LMDC project manager to reemphasize the importance of complying with the drawdown procedures. LMDC will continue to work with its subrecipients to insure effective internal control procedures are in place and followed.

## Appendix B

### SCHEDULE OF PROGRAM FUNDING AND DISBURSEMENTS AS OF MARCH 31, 2007

Program	Budget as of Mar. 31, 2007	Audit period disbursements Oct. 1, 2006 – Mar. 31, 2007	Cumulative disbursed as of Mar. 31, 2007	Balance remaining as of Mar. 31, 2007
Business Recovery Grant Program	\$218,946,000		\$218,940,531	\$5,469
Job Creation and Retention	150,000,000	\$23,536,478	97,955,947	52,044,053
Small Firm Attraction	29,000,000	4,368,500	20,122,000	8,878,000
Residential Grant (Housing Assistance)	237,500,000	277,481	236,131,385	1,368,615
Employment Training Assistance	346,000	-	345,909	91
Memorial Design & Installation	315,000	10,000	309,969	5,031
Columbus Park Renovation	998,571	-	-	998,571
Marketing History/Heritage Museums	4,664,000	720,689	3,838,835	825,165
Downtown Alliance Streetscape	4,000,000	-	4,000,000	-
New York Stock Exchange Area Improvements	25,160,000	5,669	5,474,644	19,685,356
Parks and Open Space	46,981,689	7,914,215	17,634,707	29,346,982
Hudson River Park Improvements	72,600,000	1,873,222	4,542,272	68,057,728
West Street Pedestrian Connection	22,955,811	-	12,842,870	10,112,941
Lower Manhattan Communications Outreach	1,000,000	113,806	1,001,583	(1,583)
Green Roof Project	100,000	-	-	100,000
Chinatown Tourism & Marketing	1,160,000	79,910	999,835	160,165
Lower Manhattan Information Program	2,570,000	-	1,752,391	817,609
World Trade Center Memorial and Cultural Program	622,517,180	43,200,737	306,657,092	315,860,088
Lower Manhattan Tourism	4,176,000	20,000	3,971,650	204,350
East River Waterfront Project	150,000,000	547,118	704,849	149,295,151
Local Transportation and Ferry Service	9,000,000	6,952	6,952	8,993,048
East Side K-8 School	23,000,000	14,531	28,703	22,971,297
Filterman Hall Reconstruction	15,000,000	1,784	1,784	14,998,216
Chinatown LDC	7,000,000	4,123	4,123	6,995,877
Affordable Housing	54,000,000	-	7,153	53,992,847
Public Services Activities	6,796,900	873,972	5,603,180	1,193,720
Administration & Planning	112,262,000	9,058,521	73,314,694	38,947,306
Disproportionate Loss of Workforce	33,000,000	-	32,999,997	3
Utility Restoration and Infrastructure Rebuilding	735,000,000	1,289,698	192,845,121	542,154,879
Lower Manhattan Enhancement Fund	88,950,849	4,802,980	4,802,980	84,147,869
Drawing Center	2,000,000	-	-	2,000,000
Fulton Corridor Revitalization	38,000,000	10,784	10,784	37,989,216
Economic Development - Other	30,000,000	-	-	30,000,000
Transportation Improvements	31,000,000	-	-	31,000,000
Education - Other	3,000,000	-	-	3,000,000
<b>Total</b>	<b>\$2,783,000,000</b>	<b>\$98,731,170</b>	<b>\$1,246,851,940</b>	<b>\$1,536,148,060</b>