



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

## Community Development Block Grant Disaster Recovery-Funded Interim Assistance Rapid Repairs Program

**Office of Audit, Region 2  
New York - New Jersey**

**Audit Report Number: 2017-NY-1004  
December 21, 2016**



**To:** Stanley A. Gimont  
Acting Deputy Assistant Secretary for Grant Programs, DG

//SIGNED// Fran Ranzie  
for

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

**Subject:** The City of New York, NY, Lacked Adequate Controls To Ensure That the Use of CDBG-DR Funds Was Always Consistent With the Action Plan and Applicable Federal and State 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 City of New York, Office of Management and Budget's administration of Community Development Block Grant Disaster Recovery (CDBG-DR) funds for its Interim Assistance Rapid Repairs 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: 2017-NY-1004**

**Date: December 21, 2016**

**The City of New York, NY, Lacked Adequate Controls To Ensure That the Use of CDBG-DR Funds Was Always Consistent With the Action Plan and Applicable Federal and State Requirements**

## Highlights

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### What We Audited and Why

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We audited the City of New York, Office of Management and Budget's administration of the Interim Assistance Rapid Repairs 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 objective of the audit was to determine whether City officials had adequate controls to ensure that the use of CDBG-DR funds was consistent with the Interim Assistance Rapid Repairs Program guidelines established under the HUD-approved action plan, applicable Federal requirements, and City policy.

### What We Found

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City officials lacked adequate controls to ensure that the use of CDBG-DR funds was always consistent with the action plan and applicable Federal and State regulations. Specifically, City officials disbursed \$18.2 million in CDBG-DR funds for State sales tax on repairs and maintenance services<sup>1</sup> that the City was exempt from paying under New York State tax law, section 1116(a)(1). We attributed this deficiency to City officials' decision to rapidly implement an emergency sheltering program and including sales tax in the negotiated contractual unit prices for repairs and maintenance services. As a result, City officials could not assure HUD that more than \$18.2 million in CDBG-DR funds was disbursed for allowable, reasonable, and necessary expenses in compliance with the action plan and Federal and State requirements.

### What We Recommend

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We recommend that HUD instruct City officials to (1) reimburse the Program from non-Federal funds more than \$18.2 million in exempt State sales tax on repairs and maintenance services and (2) strengthen controls over disbursements to ensure that all costs charged to the Program are allowable, reasonable, and necessary in compliance with the HUD-approved action plan and Federal and State requirements.

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<sup>1</sup> According to City officials, repairs and maintenance services represent the services and labor provided by the Program contractors.

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# Background and Objective

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Hurricane Sandy destroyed homes, left hundreds of thousands of New Yorkers without power, and damaged critical public and private infrastructure when it hit New York City on October 29, 2012. On January 29, 2013, Congress enacted the Disaster Relief Appropriations Act of 2013, Public Law 113-2, appropriating \$16 billion in Community Development Block Grant Disaster Recovery (CDBG-DR) funds. The purpose of this funding was to cover necessary expenses occurring from calendar years 2011 through 2013 that were related to long-term recovery, infrastructure and housing restoration, and housing and economic revitalization for locations that were declared disaster areas in accordance with the Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1974. Of the \$16 billion in CDBG-DR funds appropriated, \$4.21 billion was awarded directly to the City.

In the immediate aftermath of Hurricane Sandy, the Federal Emergency Management Agency (FEMA) designed the Sheltering and Temporary Essential Power (STEP) Pilot Program to assist State and local governments in performing work and services essential to saving lives, protecting public health and safety, and protecting property. FEMA intended STEP to provide essential power, such as restoration of temporary electricity, heat, and hot water, to affected residences, thereby reducing the demand for other shelter options and allowing individuals to return to or remain in their homes.

City and FEMA officials worked together to create and implement STEP as the Interim Assistance Rapid Repairs Program. The Program assisted residential owners impacted by Hurricane Sandy with emergency repairs to their private properties needed to alleviate the emergency conditions affecting the surrounding area caused by the storm. Emergency repairs included restoration of heat, electrical power, and hot water and other limited repairs to protect a home from further significant damage. The Program, announced by the mayor of New York City on November 9, 2012, was the first program of its kind in the country. Repair work began on November 21, 2012 and approximately 11,800 homes were repaired, representing more than 20,000 units when the Program ended at the end of March 2013. As of our audit period, March 31, 2016, City officials had allocated \$98 million of that amount to the Program and had disbursed more than \$97 million.

FEMA's Public Assistance Grant Program provided the majority of funding for the Interim Assistance Rapid Repairs Program. Under FEMA's public assistance projects, the scope of work and funding is detailed in a FEMA project worksheet. The cost-sharing agreement between FEMA and the City provided that FEMA would reimburse the City 90 percent of the eligible costs that fell under FEMA guidelines. The City used CDBG-DR funds to cover the remaining 10 percent cost share,<sup>2</sup> as well as the other three cost categories, which were not approved on the project worksheet

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<sup>2</sup> For the purposes of CDBG-DR funding, cost share represents the share of funds beyond what was spent using FEMA, United States Army Corps of Engineers, and other Federal agency contributions. Generally, the costs are not paid under another Federal award, except when authorized by Federal statute to be used for cost sharing or matching. Section 105(a)(9) of the Housing and Community Development Act of 1974 gives a statutory exception, allowing CDBG funds to be used to pay the share of unmet needs.

but the City determined were CDBG-DR eligible. The City referred to the following three cost categories, which do not fall within FEMA guidelines but are determined to be CDBG-DR eligible, as breakage items:

- **Scope of work** – Items that were not identified at the beginning of the Program but were reasonable and necessary to achieve the Program’s goal of restoring heat, hot water, and power;
- **Incentive payments** – Bonus payments to motivate contractors to accelerate progress; and
- **Unit-price differential** – New York State sales tax of 6 percent on repairs and maintenance services provided by contractors.

Program costs were incurred prior to the preparation of the City’s initial action plan approved by HUD in May 2013 and prior to interim assistance being identified as a contemplated activity. In accordance with HUD’s March 5, 2013 Notice, with regard to pre-award requirements, HUD allowed the City to use CDBG-DR funds for reimbursement of Program costs. The City is subject to the provisions of regulations at 24 CFR (Code of Federal Regulations) 570.200(h) but may reimburse itself or its subrecipients for otherwise allowable costs incurred on or after the incident date of the covered disaster.

The City of New York’s Office of Management and Budget is the primary agency within the City that has responsibility for the CDBG-DR grant. This office also directly manages the Interim Assistance Rapid Repairs Program, which is part of the larger Infrastructure and Other City Services Program. The Office of Management and Budget’s responsibilities include implementing Program policies and procedures for financial management, determining and ensuring the eligibility of funded activities, overseeing the compliance and monitoring of the Program, and ensuring that the program files comply with all applicable HUD and other Federal regulations.

The objective of the audit was to determine whether City officials had adequate controls to ensure that the use of CDBG-DR funds was consistent with the Interim Assistance Rapid Repairs Program guidelines established under the HUD-approved action plan, applicable Federal requirements, and City policy.

# Results of Audit

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## **Finding: City Officials Lacked Adequate Controls To Ensure That the Use of CDBG-DR Funds Was Always Consistent With the Action Plan and Applicable Federal and State Requirements**

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City officials lacked adequate controls to ensure that the use of CDBG-DR funds was always consistent with the Interim Assistance Rapid Repairs Program guidelines established under the action plan and applicable Federal and State regulations. Specifically, City officials disbursed \$18.2 million in CDBG-DR funds for State sales tax on repairs and maintenance services that the City was exempt from paying under New York State tax law, section 1116(a)(1). We attributed this deficiency to City officials' decision to rapidly implement an emergency sheltering program and including sales tax in the negotiated contractual unit prices for repairs and maintenance services. As a result, City officials could not assure HUD that more than \$18.2 million in CDBG-DR funds was disbursed for allowable, reasonable, and necessary expenses in compliance with the HUD-approved action plan and Federal and State requirements.

### **CDBG-DR Funds Used for Exempt State Sales Tax Costs**

According to City officials, the City was faced with emergency situations that required rapid solutions to protect the life and safety of the public as a result of Hurricane Sandy. City officials rapidly implemented a first-in-the-Nation emergency sheltering program with the objective to safely shelter tens of thousands of residents from the post-Sandy environment. To achieve their goals and quickly implement the Program, the City needed construction contractors capable of providing the personnel and financial resources necessary to work on a large number of private residences. Once contractors were procured, the City needed to establish fair and reasonable unit prices that could be equally accepted by all contractors involved in the Program. By December 24, 2012, the City completed the negotiation process to establish unit prices based on values obtained from a national cost estimate database adjusted for the New York City construction market and risk factors identified in the field. The unit prices were for all direct work items in the homes, which included replacing circuit breakers, hot water heaters, and boilers. Additionally, the unit prices were to be all inclusive, including all taxes, markups, overhead and profit, labor, material, equipment, travel costs, tools, and incidentals necessary to perform the work as indicated.

City officials maintained that during the unit price negotiations, they were aware of a sales tax exemption for repairs and maintenance services; however, they could not find a solution to avoid including the 6 percent sales tax in the unit prices. Officials stated that the sales tax cost was necessary to get all contractors to accept the unit prices and complete the emergency work on time. According to City officials, the contractors would have balked if the unit prices had been reopened and the sales tax had been deducted from the unit price. Additionally, City officials asserted that the negotiated unit prices represented fair and reasonable costs given the program



goals. Officials maintained that the City's main focus was to protect the life and safety of the public and it would not have been possible to rapidly implement the program without including the sales tax in the unit prices. In addition, City officials were confident that FEMA, with which they worked closely throughout the implementation of the Program, would find that the Program was implemented in line with the intent and requirements of STEP.

The Program was completed at the end of March 2013. However, when FEMA issued its revised project worksheet in March 2014, City officials realized that FEMA would not reimburse the sales tax on services. The revised project worksheet validated other costs for reimbursement, including direct work, repair and scope assessments, and integrity monitoring. City officials did not ask FEMA to explain why the sales tax was not allowable since it understood that FEMA would not reimburse the City for all of its incurred Program expenses. City officials stated that they became aware that CDBG-DR funds were available and decided to use those funds to cover the sales tax costs. During the period April through August 2015, City officials disbursed more than \$18.2 million in CDBG-DR funds to pay for the sales tax on the Program repair and maintenance services.

In accordance with New York State tax law, section 1116(a)(1), the City was exempt from paying sales tax when it was the purchaser, user, or consumer of services or when it was a vendor of services or property of a kind not ordinarily sold by private persons. The City was the purchaser of the Program services, for which contractors provided repair and maintenance services under the Program and invoiced the City. The City paid for the services provided by the contractors; thus, the charges for the repair and maintenance services performed as part of the Program were not subject to sales tax.

Regulations at 2 CFR (Code of Federal Regulations) Part 225, appendix A, paragraph C(1)(a), and the HUD-approved action plan provide that to be allowable under Federal awards, costs must be necessary and reasonable for the proper and efficient performance and administration of Federal awards and must be authorized or not prohibited under State or local laws or regulations. Contrary to 2 CFR Part 225, appendix B, section 40(a), which states that taxes a governmental unit is legally required to pay are allowable, the City was not legally required to pay the State sales tax. Therefore, the \$18.2 million in CDBG-DR funds disbursed for sales tax was ineligible.

## **Conclusion**

City officials disbursed more than \$18.2 million in CDBG-DR funds for State sales tax on Program repairs and maintenance services that the City was not legally required to pay under New York State tax law. Federal requirements state that to be allowable under Federal awards, costs must be necessary, reasonable, and authorized or not prohibited under State or local laws or regulations. We attributed this deficiency to City officials' decision to rapidly implement an emergency sheltering program and including sales tax, which the officials were aware was exempt, in the negotiated contractual unit prices for repairs and maintenance services. As a result, City officials could not assure HUD that more than \$18.2 million in CDBG-DR funds was disbursed for allowable, reasonable, and necessary expenses.



### **Recommendations**

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

- 1A. Reimburse the Program from non-Federal funds \$18,274,054 in exempt State sales tax on repairs and maintenance services.
- 1B. Strengthen controls over disbursements to ensure that all costs charged to the Program are allowable, reasonable, and necessary in compliance with the HUD-approved action plan and Federal and State regulations.

# Scope and Methodology

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The review generally covered the period November 9, 2012, through March 31, 2016, and was expanded as necessary. Audit fieldwork was performed onsite from April through July 2016 at the City's Office of Management and Budget located at 255 Greenwich Street, New York, NY.

To accomplish our audit objective, we

- Reviewed New York State tax law, relevant CDBG-DR program requirements, and applicable Federal regulations, including the Disaster Relief Appropriations Act of 2013, Federal Register notices, HUD Office of Community Planning and Development notices, CFR requirements, and HUD guidance.
- Reviewed FEMA Recovery Program guidance for STEP and FEMA project worksheets.
- Reviewed the City's HUD-approved action plan and applicable amendments.
- Reviewed the City's written policies and procedures, including the Financial Management and Procurement Compliance Manual, Guidance on Invoice Preparation and Supporting Documentation, and the City of New York's Cost Reasonable Justification for the Rapid Repairs Sheltering Program.
- Met with City officials to obtain an understanding of the Program's operations and internal controls.
- Reviewed HUD's monitoring report, dated February 5, 2016.
- Reviewed quarterly performance reports for the period October 1 to December 31, 2015, generated from the Disaster Recovery Grant Reporting system<sup>3</sup> to obtain background information on the City's activities and disbursement of CDBG-DR funds only. We did not assess the data.
- Reviewed the City's single audit report and management letter for the year ending in June 2015.
- Reviewed the U.S. Department of Homeland Security, Office of Inspector General, audit report on FEMA's STEP Pilot Program, dated December 7, 2012.

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<sup>3</sup> 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.

As of March 31, 2016, City officials had disbursed more than \$97 million in CDBG-DR funds to contractors to complete repair work on approximately 11,800 homes. The universe of disbursements consisted of 24 voucher drawdowns containing hundreds of work orders. To gain a general understanding of the City's internal controls, we selected a nonstatistical<sup>4</sup> sample of 38 work orders totaling more than \$1 million, based on the highest invoice amounts for four cost categories: FEMA 10 percent match, scope of work, incentive payments, and the unit-price differential.

Cost categories	CDBG-DR funds disbursed	Sampled invoice amounts	Sampled work orders
FEMA 10 percent match	\$56,318,274	\$840,629	10
Scope of work	17,941,315	178,389	8
Incentive payments	5,672,232	0	10
Unit-price differential	17,197,575	70,912	10
<b>Totals</b>	<b>97,129,396</b>	<b>1,089,930</b>	<b>38</b>

We reviewed 10 work orders from the FEMA 10 percent match and 8 work orders from the scope of work cost categories. We also reviewed 10 work orders from the incentive payment cost category to determine whether the contractor completed the single-family dwelling repairs, based on the City's required period covering December 27, 2012, and January 17, 2013. The incentive payments were bonuses that City officials offered to the contractors to accelerate progress on home repairs. We did not include incentive payment invoice amounts since CDBG-DR funds were not used to pay for the invoices in the incentive payment files. In addition, we reviewed 10 work orders from the unit-price differential cost category. While we selected a nonstatistical sample to accomplish our objective, the results from these samples related only to the items sampled and could not be projected to the population.

City officials calculated the New York State sales tax as approximately 6 percent of the negotiated unit costs. Specifically, City officials disbursed nearly \$17.2 million for State sales taxes on repairs and maintenance services attributed to unit-price differential. In addition, they disbursed more than \$1 million (\$17,941,315 x 6%) for State sales tax on repairs and maintenance services attributed to scope of work. In total, City officials disbursed more than \$18.2 million (\$17,197,575 + \$1,076,479) in CDBG-DR funds for State sales tax on repairs and maintenance services that were not required under New York State tax law, section 1116(a)(1).

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<sup>4</sup> A nonstatistical sample is appropriate when the auditor knows enough about the population to identify a relatively small number of items of interest. The results of procedures applied to items selected under this method apply only to the selected items and must not be projected to the portion of the population that was not tested.

Based on the work order files and disbursement data City officials provided, we concluded that the computer-processed data City officials provided were sufficiently reliable. Our assessment of the reliability of the data was limited to the data reviewed; therefore, we did not assess the reliability of HUD's Disaster Recovery Grant Reporting system. We performed a minimal level of testing and found the data to be adequate for our purposes. We were able to trace the contractual unit prices for repairs and maintenance services to the work order files and reconcile the disbursement data provided by City officials to HUD's Disaster Recovery Grant Reporting system to confirm that more than \$97 million in CDBG-DR funds were disbursed for Program costs.

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 objective.

# Internal Controls

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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:

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

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 Deficiencies**

Based on our review, we believe that the following items are significant deficiencies:

- City officials did not have adequate controls to ensure compliance with laws and regulations since they did not always disburse CDBG-DR funds in accordance with the Program guidelines established under the HUD-approved action plan and applicable Federal and State regulations.

- City officials did not have adequate controls to ensure that funds were always safeguarded against fraud, waste, and abuse as CDBG-DR funds were used for New York State sales tax that the City was exempt from paying.

# Appendixes

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## Appendix A

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### Schedule of Questioned Costs

Recommendation number	Ineligible 1/
1A	\$18,274,054

- 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.



## 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, 6<sup>th</sup> Floor  
New York, New York 10007

November 28, 2016

Ms. Kimberly Greene  
Regional Inspector General for Audit, 2AGA  
U.S. Department of Housing and Urban Development  
Office of the Inspector General  
26 Federal Plaza, Room 3430  
New York, NY 10278-0068

Re: Draft Audit Report concerning the City of New York, NY, lacked adequate controls to ensure that the use of CDBG-DR funds was always consistent with the Action Plan and applicable Federal and State Requirements

Dear Ms. Greene:

The City of New York's Office of Management and Budget is in receipt of the Draft Audit Report concerning the City of New York, NY, lacked adequate controls to ensure that the use of CDBG-DR funds was always consistent with the Action Plan and applicable Federal and State Requirements

We would like to express our gratitude to your audit team for their due diligence in reviewing the City's administration of Community Development Block Grant Disaster Recovery funds for its Interim Assistance Rapid Repair Program during the period November 9, 2012, through March 31, 2016.

The City believes it has adequately addressed the Finding contained in your Draft Audit Report in our attached response.

Again, the City of New York's Office of Management and Budget appreciates the efforts of your audit team and looks forward to working with you in the future.

Sincerely,

A handwritten signature in blue ink, appearing to read "Calvin Johnson".

Calvin Johnson,  
Assistant Director, CDBG-DR

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

### Comment 1



The City of New York  
**Office of Management and Budget**  
255 Greenwich Street • New York, New York 10007-2146

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**CITY OF NEW YORK'S  
RESPONSE TO OCTOBER 2016  
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL  
PROPOSED AUDIT REPORT**

**PREPARED BY THE NEW YORK CITY  
OFFICE OF MANAGEMENT AND BUDGET  
NOVEMBER 22, 2016**

#### OVERVIEW

The City of New York values all feedback provided by oversight agencies and auditors. The Office of Inspector General's independent oversight provides valuable information that the City can utilize to better implement its Community Development Block Grant funded Hurricane Sandy disaster recovery housing activities. This relationship with our federal partners is critical to successful Program implementation.

In October 2012, approximately 100,000 residential buildings were impacted by Hurricane Sandy. Not only were these residential buildings flooded, affecting lower levels of residential units where utility equipment and mechanical systems were housed, but temperature forecasts were projected to be dangerously low as the winter season was approaching – thus creating the immediate need for assistance. It was estimated that approximately 10,000 to 14,000 of these residential buildings would remain without heat, electricity, and hot water if assistance was not immediately provided. The combination of flooding, loss of essential housing conditions for storm impacted residents, and approaching cold weather created a significant threat to public health, safety, and welfare and required the need for expedited emergency assistance to be provided by the City to the impacted population.

Various options to assist those affected by the storm were considered, but some of these options were determined to be either too costly or impractical in a densely populated urban city like New York. In November 2012, the City implemented the Rapid Repairs Program (RRP), which was designed to restore heat, electricity, and hot water to storm-affected homes in both a timely and cost effective manner. A total of nine contractors (reimbursed by CDBG-DR) and their hundreds of subcontractors were engaged to perform these services on the City's behalf to approximately 20,000 impacted residential units. Cost savings were realized through the use of negotiated unit prices. The City negotiated unit prices as the most efficient and cost effective option to quickly secure contractors' services and insure restoration of essential services on an

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

#### Comment 1

expedited basis. Unit price is an acceptable method to meet the Federal government's requirements for demonstrating costs are necessary and reasonable for critical services.

Given the scope of damage to residential property in the City that occurred as a result of the storm, as well as other emergency conditions that the City had to address, the City and its RRP Contractors agreed to a fixed unit price on December 24, 2012. These unit prices were the result of several weeks of negotiations between NYC and its contractors and would be used for all scope of work pay items for most remaining work performed under the Program. In an effort to reach a reasonable unit price for a first-of-its-kind pilot Program, all interested parties had to assess and account for multiple cost factors, one of which was the potential for a sales tax on labor which at the time of negotiation was not known to be exempt. The Rapid Repairs Program (RRP) was the first time that the City of New York hired contractors to perform work on private residences; therefore, the issue of how New York State would apply its and the City's laws regarding sales tax had never been addressed before. The City does have experience dealing with contractors and work performed on City property and would not have asked for tax guidance if this were the case; however, here the City is dealing with work performed on private residences. Consequently, under emergency circumstances and in order to save lives, the RRP proceeded with its established unit prices which included sales tax on labor component, and materials and equipment as part of the negotiations to avoid an unnecessary delay in contractors proceeding with emergency restoration work. Throughout the negotiations in November and December, 2012, the city was not aware that sales on labor would be exempt, and the negotiated fixed unit price reached on December 24, 2012 was considered by the city to be a settled matter on all components included in the price.

#### Comment 2

Hurricane Sandy occurred in October 2012 and by March 31, 2013, essential services had been substantially restored to affected homes. After all substantial work had been completed; the New York State Department of Taxation and Finance issued a letter dated April 5, 2013 providing clarification on this unique situation. This was the first time that the matter of labor being exempt from NYS sales tax was brought to the attention of the city. The State determined that sales tax was not applicable to contractor labor. Based on this determination, the City notified its contractors via email on April 22, 2013 that the City would deduct 6 percent (an agreed upon estimate and agreed upon estimate for sales tax) from the scope of work pay items that had a labor component.

On July 26, 2013, an accounting, tax, audit, and consulting firm requesting on behalf of Sullivan, a RRP contractor, filed a formal dispute against a reducing scope of work pay items by 6 percent, and the City denied their request on September 26, 2013. In the interim, the City was also working with FEMA to obtain final approval for all the RRP's scope of work items that would be eligible for reimbursement. FEMA made its final eligibility determination in August 2013, which then allowed the City to move forward with submitting its RRP costs in order for FEMA to conduct its validation and release FEMA Public Assistance funds to the City. FEMA required the City to begin submitting costs by September 30, 2013.

In order to meet FEMA's September 30, 2013 deadline, the City met with FEMA on September 11, 2013, to obtain FEMA's approval on the methodology the City was going to use to reduce the unit prices to account for sales tax on labor. On September 13, 2013, FEMA approved the

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

Comment 2

City's approach, and the City confirmed this approval via email on September 18, 2013. The City proceeded with submitting detailed costs to FEMA for validation. In late October 2013, the City made an internal decision to reevaluate its decision to reduce the unit prices by 6 percent. On December 13, 2013, NYC formally notified Sullivan that it had modified its original determination and would grant Sullivan's request. By this time, the City had already started its validation process with FEMA for several Contractors, which included the sales tax on labor reduction from the City's claim to FEMA

Notably, affected homeowners were not displaced from their homes during this period, which was one of the primary objectives of this sheltering Program. This result also saved the federal government substantial money because temporary shelter did not need to be provided.

#### The City's Response to Finding 1

**City Officials Lacked Adequate Controls To Ensure That the Use of CDBG-DR Funds Was Always Consistent With the Action Plan and Applicable Federal and State Requirements**

New York City takes its compliance responsibilities seriously. Controls throughout Program implementation and at close-out were put in place to ensure that funding decisions were fair, timely, complied with regulations and Program policy, and would not be subject to recapture.

The City of New York firmly believes that it had and continues to have adequate controls to ensure that the use of CDBG-DR funds was and is always consistent with the Action Plan and applicable Federal and State requirements. CDBG-DR funding for the Rapid Repair Program was described in a HUD-approved Action Plan as an eligible activity (§ 570.201 (f) Interim Assistance) and the program addressed a clearly identified Sandy need. There was no duplication of benefits, as CDBG-DR funds were used to cover the costs not reimbursed by other sources funds, particularly FEMA. And lastly, the use of CDBG-DR funds for the Rapid Repair Program was demonstrated to be necessary and reasonable. Necessary in that the City had a contractual obligation to pay negotiated unit costs, and reasonable in that the unit cost rate itself was validated and deemed appropriate. Furthermore, the costs for delivering emergency sheltering services for RRP was approximately \$30,000 (per home) compared to approximately \$200,000 (per FEMA trailer) for temporary housing in the aftermath of Hurricane Katrina.

#### *A. CDBG-DR Funds Used for Exempt State Sales Tax Costs*

On December 24, 2012, NYC and its RRP Contractors agreed to fixed unit prices. These unit prices were the result of several weeks of negotiations between NYC and its contractors and would be used for all scope of work pay items for all remaining work performed under the Program. In an effort to reach reasonable unit prices for a first-of-its-kind pilot program, all interested parties had to assess and account for multiple cost factors. The agreed upon unit prices meet the standards found in 2 CFR 200.404: "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost." The

Comment 3

Comment 4



## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

Comment 4

circumstances prevailing at the time for the Rapid Repairs Program included the onset of winter, an outbreak of norovirus at many City shelters, and the need to restore essential housing conditions in order to make sheltering in place feasible, safe, and sanitary. The HUD OIG audit acknowledges in the report, the urgent need as well as the first of its kind nature of the Rapid Repairs Program. HUD OIG acknowledges that unit prices were paid for necessary services delivered to carry out the purpose and urgent need of the Rapid Repair Program.

The City recognizes HUD OIG's argument and will work with HUD's Disaster Recovery and Special Issues Division to develop a remedy for these exigent circumstances, possibly in the form of a waiver or alternative requirement issuance (if applicable).

Based on the above, the City respectfully asserts that:

Comment 5

- CDBG-DR funds were not used for exempt sales tax costs but, rather, were used to cover a portion of a unit price negotiated and agreed with contractors consistent with 2 CFR 200.404 and 24 CFR Part 95 – Subpart 36.

Comment 6

- Many factors noted by the HUD OIG in the draft report went into the deliberations regarding establishing the unit price including the potential impact of 8.875 percent sales tax, but the ultimate unit price was accepted by the contractors as all-inclusive of a wide range of factors.

Comment 7

- Sullivan, as one of the contractors, made it clear that the unit price was a settled matter since the NYS tax letter simply advised that the contractor did not have to pay sales tax on the unit price. The NYS tax letter did not opine or consider that a portion of the unit price might have been sales tax to be removed. In reviewing the matter, the City concurred that the unit price was a settled matter, and it was impossible to factor a portion of the price which the contractors did not have to pay sales tax on top of the unit price.

- City will work with HUD's Disaster Recovery and Special Issues Division to develop a remedy for these exigent circumstances, possibly in the form of a waiver or alternative requirement issuance (if applicable).

#### City Response to Recommendation 1A

Comment 5

*Reimburse the Program from non-Federal funds \$18,274,054 in exempt State sales tax on repairs and maintenance services.*

It is the City's position that the \$18,274,054 was paid to cover the balance of the unit price not exempt States sales tax, and, therefore, it should not have to make any reimbursement.

#### City Response to Recommendation 1B

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

#### Comment 3

*Strengthen controls over disbursements to ensure that all costs charged to the Program are allowable, reasonable, and necessary in compliance with the HUD-approved action plan and the Federal and State regulations.*

It is the City's position that the controls over disbursements for costs charged to the Program are allowable, reasonable, and necessary in compliance with the HUD-approved action plan and the Federal and State regulations.

## OIG Evaluation of Auditee Comments

- Comment 1      City officials provided historical background related to Hurricane Sandy and the implementation of the Interim Assistance Rapid Repairs program. City officials stated that the unit price is an acceptable method to meet the Federal government's requirements for demonstrating costs are necessary and reasonable. We agree with City officials, however unit price costs have to meet Federal and State requirements as well.
- Comment 2      According to City officials, after they received clarification from the New York State Department of Taxation and Finance that the City was exempt from paying sales tax on labor, the officials notified the contractors that the 6 percent sales tax would be deducted from the unit price. Later, the City officials met with FEMA and received approval from FEMA to reduce the unit prices by the 6 percent sales tax. However, City officials reversed their initial decision and paid the 6 percent sales tax to the contractors after FEMA approved them to reduce the unit prices by 6 percent. Thus, City officials should use non-Federal funds of \$18.2 million to cover the State sales tax on repairs and maintenance services.
- Comment 3      City officials firmly believed that they had adequate controls to ensure that the use of CDBG-DR funds was always consistent with the HUD-approved action plan and applicable Federal and State requirements. Additionally, officials stated the use of CDBG-DR funds was demonstrated to be necessary and reasonable. However, in addition to the use of funds being necessary and reasonable, Federal requirements provide that to be allowable under Federal awards, costs must be authorized or not prohibited under State or local laws or regulations. Therefore, while we agree with City officials that the CDBG-DR funding for the Program addressed an identified Sandy need and was used to cover the costs not reimbursed by other sources, CDBG-DR funds should not be used for State sales tax costs that the City is not legally required to pay.
- Comment 4      City officials cited 2 CFR 200.404 pertaining to cost reasonableness. However, 2 CFR 200.404 further provides that consideration must be given to requirements imposed by Federal and state laws and regulations. In addition, City officials were not in compliance with 2 CFR 200.404 when they significantly deviated from their established practices and policies regarding the incurrence of exempt sales tax costs.
- Comment 5      City officials stated that CDBG-DR funds were not used for exempt sales tax costs, but rather, were used to cover a portion of a negotiated unit price. However, documentation provided by City officials supported that \$18.2 million in CDBG-DR funds was used to cover the State sales tax on repairs and maintenance services which the City was not legally required to pay. Accordingly, we recommend that City officials reimburse the



Program from non-Federal funds of \$18.2 million in exempt State sales tax on repairs and maintenance services.

Comment 6      City officials stated that many factors went into the deliberations regarding establishing the unit price including the potential impact of 8.875 percent sales tax, but the ultimate unit price was accepted by the contractors as all-inclusive of a wide range of factors. However, City officials failed to find a solution to avoid including the 6 percent sales tax in the unit prices.

Comment 7      According to City officials, New York State Department of Taxation and Finance advised that contractors did not have to pay sales tax on the negotiated unit price and did not offer further opinion as to whether the sales tax portion of the unit should be removed. Further, City officials stated it would have been difficult to factor a portion of the price which the contractors did not have to pay sales tax. On the contrary, FEMA approved the City's request to reduce the unit prices to account for sales tax on labor. It was the City's decision to pay the contractors for the sales tax on labor. Therefore, the City should use non-Federal funds of \$18.2 million to cover the State sales tax on repairs and maintenance services.