



**The Lower Manhattan Development  
Corporation, New York, NY, Approved Invoices  
That Were Not Always Consistent With  
Subrecipient Agreements**



Issue Date: July 27, 2012

Audit Report Number: 2012-NY-1010

TO: Yolanda Chavez, Deputy Assistant Secretary for Grant Programs, DG

*Karen D. Campbell*

for

FROM: Edgar Moore, Regional Inspector General for Audit, New York/New Jersey  
Region, 2AGA

SUBJECT: The Lower Manhattan Development Corporation, New York, NY, Approved  
Invoices That Were Not Always Consistent With Subrecipient Agreements

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG's), final results of our review of the Lower Manhattan Development Corporation's administration of CDBG Disaster Recovery Assistance funds covering the period April 1, 2010 through March 31, 2011. The review was performed in response to a congressional mandate that HUD OIG continuously audit LMDC's administration of the \$2.783 million in Disaster Recovery Assistance funds awarded to the State of New York in the aftermath of the September 11, 2011, terrorist attacks on the World Trade Center in New York City.

HUD Handbook 2000.06, REV-4 sets specific time frames for management decisions on recommended corrective actions. For each recommendation in the body of the report 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 8L, 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.



July 27, 2012

## **The Lower Manhattan Development Corporation, New York, NY, Approved Invoices That Were Not Always Consistent With Subrecipient Agreements**

# Highlights

Audit Report 2012-NY-1010

### **What We Audited and Why**

We performed the 16th review of the Lower Manhattan Development Corporation's (LMDC) administration of the \$2.783 billion in Community Development Block Grant (CDBG) Disaster Recovery Assistance funds awarded to the State of New York.

The objective of the audit was to determine whether LMDC officials disbursed CDBG Disaster Recovery Assistance funds in accordance with the guidelines established under the HUD-approved partial action plans for the Chinatown Clean Streets and the New York Stock Exchange Security and Streetscape programs.

### **What We Recommend**

We recommend that HUD's Deputy Assistant Secretary for Grant Programs direct LMDC officials to (1) strengthen controls over the invoice approval process; (2) recoup, through offsets of future reimbursements, \$107,700 in ineligible and \$13,037 in unreasonable costs reimbursed under the Chinatown Clean Streets program; and (3) recover, through offsets of future reimbursements, \$4,039 in ineligible costs and provide supporting documentation for \$34,485 reimbursed under the New York Stock Exchange Security and Streetscape program.

### **What We Found**

LMDC officials generally disbursed the CDBG Disaster Recovery Assistance funds in accordance with the guidelines established under the HUD-approved partial action plans. However, officials approved invoices for reimbursement that were not always consistent with the terms of the subrecipient agreements and all applicable requirements. This condition occurred because LMDC officials deemed the subrecipient responsible for ensuring the proper use of the funds and did not perform a sufficient review of the invoices before approving them for reimbursement. As a result, LMDC officials improperly reimbursed \$159,261 in ineligible, unreasonable, and inadequately supported costs.

## TABLE OF CONTENTS

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Background and Objectives	4
Results of Audit	
Finding: LMDC Officials Approved for Reimbursement Invoices That Were Not Always Consistent With the Subrecipient Agreements	6
Scope and Methodology	11
Internal Controls	13
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	15
B. Auditee Comments and OIG's Evaluation	16
C. Schedule of Disbursements as of March 31, 2011	23

## BACKGROUND AND OBJECTIVES

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The Lower Manhattan Development Corporation (LMDC) 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 LMDC's affairs. The Empire State Development Corporation performs all accounting functions for LMDC.

The State of New York designated LMDC to administer \$2.783 billion<sup>1</sup> of the \$3.483 billion in Community Development Block Grant (CDBG) Disaster Recovery Assistance funds appropriated by Congress in the aftermath of the September 11, 2001, terrorist attacks on the World Trade Center to assist with the recovery and revitalization of Lower Manhattan. Planned expenditures of Disaster Recovery Assistance funds are documented in action plans that receive public comment and are approved by the U.S. Department of Housing and Urban Development (HUD). As of March 31, 2011, HUD had approved 15 partial action plans and multiple amendments that allocated the \$2.783 billion to various programs and activities (see appendix C for amounts by program), and LMDC had disbursed approximately \$2.1 billion, or 75 percent, of the \$2.783 billion appropriated.

During this audit, we reviewed disbursements related to the following programs:

The Chinatown Clean Streets Program: As of March 31, 2011, HUD had approved \$7 million for the Chinatown Partnership Local Development Corporation to initiate community improvements in Chinatown through a combination of short-term projects and long-term planning. LMDC officials allocated \$5.4 million of the \$7 million to the Chinatown Clean Streets program for the manual and mechanical sweeping of the sidewalks, curbs, and gutters; frequent removal of bagged litter from street corners; pressure cleaning of sidewalks; graffiti removal; and additional maintenance. The remaining \$1.6 million was allocated for short-term community development projects, marketing, and public outreach efforts undertaken by the Chinatown Partnership.

The New York Stock Exchange Security and Streetscape Program: As of March 31, 2011, HUD had approved approximately \$25.26 million for this program, of which LMDC officials allocated \$160,000 for an environmental review and the remaining \$25.1 million for the program's implementation. The program consisted of two phases. Phase one involved the installation of security barriers and guard facilities, the repaving of the Broadway intersections at Wall Street and Exchange Place, the installation of cobblestones along Broad Street between Wall Street and Exchange Place, the placement of "no-go" bollards, and the addition of new and more attractive street furniture to facilitate pedestrian circulation and enjoyment of the Financial District. Phase two involved aesthetic and security improvements that supported and enhanced the Financial District as a competitive location for businesses and residents. Such improvements included a fountain on Broad Street, the repaving of an expanded area of the Financial District using cobblestones, and enhanced lighting.

Our objective was to determine whether LMDC officials disbursed CDBG Disaster Recovery Assistance funds in accordance with the guidelines established under the HUD-approved partial

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<sup>1</sup> The Empire State Development Corporation administers the remaining \$700 million.

action plans for the Chinatown Clean Streets and the New York Stock Exchange Security and Streetscape programs.

## RESULTS OF AUDIT

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### Finding: LMDC Officials Approved for Reimbursement Invoices That Were Not Always Consistent With the Subrecipient Agreements

LMDC officials generally disbursed the CDBG Disaster Recovery Assistance funds in accordance with the guidelines established under the HUD-approved partial action plans for the Chinatown Clean Streets and the New York Stock Exchange Security and Streetscape programs. However, officials approved for reimbursement invoices that were not always consistent with the terms of the subrecipient agreements and all applicable requirements. This condition occurred because officials deemed the subrecipients responsible for ensuring the proper use of the funds and did not perform a sufficient review of the invoices before approving them for reimbursement. As a result, LMDC officials improperly reimbursed \$111,739 in ineligible, \$34,485 in unsupported, and \$13,037 in unreasonable costs. Officials also owed \$2,258 in underreimbursed payroll taxes to the Chinatown Partnership Local Development Corporation.

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#### Ineligible Costs Were Reimbursed

LMDC officials improperly reimbursed the subrecipient \$111,739 for ineligible costs. Of that amount, \$107,700 pertained to the Chinatown Clean Streets program, and \$4,039 pertained to the New York Stock Exchange Security and Streetscape program. With regard to the Chinatown Clean Streets program, officials reimbursed \$107,700 in payments under a contract let exclusively for the purchase of materials. However, such payments were not eligible for reimbursement with CDBG Disaster Recovery Assistance funds, as the Subrecipient's subcontractor improperly let the contract with the intent of circumventing Davis-Bacon Act prevailing wage requirements. According to 29 CFR 5.5a, any contract in excess of \$2,000 entered into for actual construction, alteration, or repair financed in whole or in part from Federal funds and subject to the labor standards provisions must contain the required provisions. Additionally, 29 CFR 5.6a stated that no payments shall be approved unless the required clauses and appropriate wage determinations of the Secretary of Labor are contained in such contracts.

In 2007, Chinatown Partnership Local Development Corporation officials divided a \$204,900 contract for the renovation of their new headquarters into two separate labor and material contracts. The labor contract was financed by private funding sources, and the materials contract was to be paid with LMDC's funds. A procurement justification memorandum prepared by a Chinatown Partnership official, dated May 14, 2007, stated that the contract was divided "to avoid

cumbersome Federal regulations regarding the use of Federal funds for construction projects.” Further, in a letter, dated May 13, 2010, a Chinatown Partnership official stated, “It was agreed by all parties that the LMDC/SBS<sup>2</sup> funding would be used exclusively for the purchasing of materials and private support would be used for the labor portion of the work. As such, the Davis-Bacon regulation does not apply in this project.”

While the materials contract and three related change orders valued at \$107,700 were obtained, the labor contract was not. Further, both labor and materials costs were included in the total cost of each of the changes orders. Based on a legal opinion obtained from HUD’s New York Regional Office of General Counsel, the Chinatown Partnership “cannot avoid Davis-Bacon prevailing wage requirements by using LMDC funds under a contract exclusively for the purchase of materials. The CDBG Disaster Recovery funds received by LMDC are governed by Section 110 of Title I of the Housing and Community Development Act of 1974, 42 USC [United States Code] 5310. Section 110 requires all laborers and mechanics be paid prevailing wages in accordance with Davis-Bacon when ‘construction work’ is financed ‘in whole or in part’ with Title I funds. HUD has interpreted ‘construction work’ to include the purchase of materials which are incorporated into the construction of a structure and have no independent use...the Chinatown Partnership LDC [Local Development Corporation] used LMDC funds to purchase materials including ceiling, painting, drywall, stones and tiles. These materials do not have an independent use outside of the project and so must be incorporated in construction. As a result, the purchase of these materials triggers Davis-Bacon coverage. Separating the LMDC funds into a contract exclusively for the purchase of materials does not avoid coverage.”

In addition, LMDC officials improperly reimbursed \$4,039 in ineligible costs under the New York Stock Exchange Security and Streetscape program for payroll costs incurred by staff not included in the consultant’s staff schedule. Section 2.02 A of the consultant contract stated that the staff schedule may be amended or supplemented with respect to any positions as agreed upon from time to time by the consultant and the subrecipient. However, evidence of such an amendment or supplement was not provided.

LMDC officials improperly reimbursed the subrecipient \$111,739 for ineligible costs under the Chinatown Clean Streets and the New York Stock Exchange Security and Streetscape programs because officials held the subrecipient responsible for ensuring the proper use of the funds and did not perform a sufficient review of the invoices before approving them for reimbursement. A more detailed review would have caused LMDC officials to question the construction contract let exclusively for the purchase of materials, given such work items as drywall, carpentry, painting, flooring, and electrical supplies included in the application for payment, which should have signaled the need for

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<sup>2</sup> The New York City Department of Small Business Services was the subrecipient for the Chinatown Clean Streets program.



labor that required compliance with the Davis-Bacon Act prevailing wage requirements. In addition, a more detailed review of the invoices might have alerted officials to the ineligible expenses included in the subrecipients' reimbursement requests.

### **Inadequately Supported Consultant Costs Were Reimbursed**

LMDC officials did not provide adequate documentation to support \$34,485 in consultant costs reimbursed under the New York Stock Exchange Security and Streetscape program. While the costs were incurred for eligible expenses, including \$33,729 in liability insurance premiums, and \$756 in overnight delivery and messenger services, they were not supported in accordance with the requirements of 24 CFR 85.20(b)(6) and Section IV of the subrecipient agreement. Officials provided the consultants' transaction reports in support of the liability insurance premiums and the overnight delivery and messenger services. However, these reports were not accompanied by source documentation or documentary evidence of the expenses such as bills, receipts, or copies of cancelled checks. These deficiencies occurred because LMDC officials deemed the documentation provided by the subrecipient as adequate support for the costs reimbursed. However, without the source documents, LMDC officials provided no assurance that \$34,485 in consultant costs was reimbursed to the subrecipient for the actual expenses incurred.

### **Unreasonable Rental Costs Were Reimbursed**

LMDC officials reimbursed the subrecipient \$13,037 for unreasonable rental costs. In accordance with the requirements of 2 CFR Part 225, appendix A, paragraph C.1.a., to be allowable under Federal awards, costs must be necessary and reasonable for the proper and efficient performance and administration of Federal awards. However, after the completion of the renovation of Chinatown Partnership officials' new headquarters in October 2007, officials continued to lease additional office space until December 2008. While time was needed to terminate the lease and move into the new headquarters, LMDC officials did not document the need for the additional space during the 14-month period. As a result, \$13,037 in associated rental costs for the period<sup>3</sup> February 1 through December 31, 2008, is deemed unreasonable and unnecessary for the program's operations.

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<sup>3</sup> For the stated period, LMDC officials provided documentation to support that the subrecipient received reimbursement for all but the March 2008 rental payment.

## **Payroll Taxes Were Underreimbursed**

LMDC officials owed the Chinatown Clean Streets program approximately \$2,258 in underreimbursed payroll taxes. This condition occurred because officials were unaware that payroll taxes were based on gross wages. As a result, the invoices approved for reimbursement contained payroll taxes that were miscalculated, as they were based on wages after deductions for health insurance and transit costs. The underreimbursed payroll taxes, attributed to four employees, were valued at \$1,129. However, since the Chinatown Partnership, as the employer, is also liable for the same amount of payroll taxes, twice the value, or \$2,258, was underreimbursed. Consequently, LMDC officials did not ensure that all eligible expenses incurred under the subrecipient agreement were properly reimbursed.

## **Reimbursed Consultant Payroll Costs Were Not in Accordance With the Contract**

LMDC officials approved for reimbursement consultant payroll costs that were not in accordance with the consultant contract. Section 2.02 A of the contract provided that the actual direct payroll of the consultant's technical and professional employees should exceed neither the hourly rates nor the multipliers set forth in the consultant's staff schedule. The consultant could increase salaries if there was an offsetting decrease in one or more of the other salaries, provided that the consultant had obtained prior written approval from the subrecipient. While LMDC officials reimbursed the subrecipient in excess of the rates set forth in the contract for five of the consultant's professional employees and in excess of the multiplier for one employee,<sup>4</sup> there were offsetting decreases in salaries; thus, this deficiency had no monetary impact. Nevertheless, officials did not provide evidence of the subrecipient's prior written approval of the salary changes. Consequently, there was no assurance that LMDC officials conducted a detailed review of the consultant's payroll costs before such costs were approved for reimbursement.

## **Conclusion**

LMDC officials generally disbursed the CDBG Disaster Recovery Assistance funds in accordance with the guidelines established under the HUD-approved partial action plans for the Chinatown Clean Streets and the New York Stock Exchange Security and Streetscape programs. However, officials improperly

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<sup>4</sup> While consultant officials charged a higher multiplier for this employee, they also charged a lower hourly rate than that set forth in the agreement. However, the net effect was that the payroll costs were overbilled.

reimbursed \$111,739 in ineligible, \$34,485 in unsupported, and \$13,037 in unreasonable costs. LMDC officials also underreimbursed \$2,258 in payroll taxes, and approved consultant payroll costs that were not in accordance with the contract. Consequently, opportunities exist to strengthen the controls over the invoice approval process to ensure that officials properly verify that the expenses submitted for reimbursement are consistent with the terms of the subrecipient agreements and all applicable requirements. While LMDC officials held the subrecipients responsible for ensuring the proper use of the funds, LMDC officials are ultimately responsible for the performance of the subrecipient and all subcontractors and must conduct effective subrecipient monitoring and oversight.

## Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs direct LMDC officials to

- 1A. Strengthen controls over the invoice approval process to ensure that the subrecipient is reimbursed in accordance with the terms of the subrecipient agreement and all applicable requirements.
- 1B. Recoup, through offsets of future reimbursements, \$107,700 in ineligible costs reimbursed to the subrecipient under the Chinatown Clean Streets program due to payments made under a construction contract improperly let with the intent of circumventing Davis-Bacon Act prevailing wage requirements.
- 1C. Recover, through offsets of future reimbursements, \$4,039 in ineligible costs reimbursed to the subrecipient under the New York Stock Exchange Security and Streetscape program due to incorrect consultant payroll billings.
- 1D. Provide adequate supporting documentation for \$34,485 in liability insurance premiums, and overnight delivery and messenger services costs. If adequate supporting documentation cannot be provided, LMDC should recapture the funds through offsets of future reimbursements.
- 1E. Recoup, through offsets of future reimbursements, \$13,037 in unreasonable costs reimbursed to the subrecipient under the Chinatown Clean Streets program due to the unreasonable cost of leasing two office spaces at the same time without a written justification.
- 1F. Pay \$2,258 owed to the Chinatown Partnership Local Development Corporation due to miscalculated payroll taxes.

## SCOPE AND METHODOLOGY

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To accomplish our audit objectives, we reviewed applicable laws, regulations, and program requirements; HUD-approved partial action plans; and LMDC’s records. We documented and reconciled disbursements recorded during the audit period, April 1, 2010, through March 31, 2011, in HUD’s Disaster Recovery Grant Reporting System.

LMDC disbursed \$245.2 million of the \$2.783 billion in Disaster Recovery Assistance funds appropriated for activities related to the rebuilding and revitalization of Lower Manhattan during the audit period. We obtained a general understanding of LMDC’s internal controls over the programs reviewed and tested approximately \$6.36 million, representing 2.6 percent of the amount disbursed for the period, as follows:

Program	Amount tested (in millions)	Amount disbursed from April 1, 2010, through March 31, 2011 (in millions)	Percentage tested
<b>Chinatown Clean Streets</b>	\$2.21	\$2.21	100%
<b>New York Stock Exchange Security and Streetscape</b>	4.15	6.21	67%
<b>Total</b>	<b><u>\$6.36</u></b>	<b><u>\$8.42</u></b>	

For the disbursements under the Chinatown Clean Streets program, LMDC officials authorized nine drawdowns, of which we reviewed 100 percent. For the New York Stock Exchange Security and Streetscape program, LMDC officials authorized two drawdowns, of which we reviewed a nonstatistical sample of one, equivalent to 50 percent or the greater of the 2 drawdowns.

We also selected a nonstatistical sample of 3, representing approximately 11.5 percent, of the 26 sub-subcontract street cleaning employees under the Chinatown Clean Streets program to test whether the reimbursed payroll costs were supported by the timesheets and the rates specified in the contract. The three employees selected held nonsupervisory positions and worked the most, the median, and the least hours during the period reviewed.

While we used the data obtained from HUD’s Disaster Recovery Grant Reporting System for informational purposes, we did not assess the system controls affecting the reliability of the data. However, we conducted limited data testing by reconciling the disbursements with an LMDC report and tracing the data relevant to our audit objective to their source documents. Consequently, we determined that the data were sufficiently reliable for the purposes of this report.

We performed the audit fieldwork at LMDC’s and the subrecipient’s offices located in Lower Manhattan and at LMDC’s parent company, the Empire State Development Corporation’s office, located in Midtown Manhattan from October 2011 through May 2012. 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions 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.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that the programs meet their objectives.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that the use of funds is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that the funds are safeguarded against waste, loss, and misuse.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

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

## Significant Deficiency

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

- Compliance with laws and regulations - LMDC officials approved expenses for reimbursement that were not always consistent with the terms of the subrecipient agreements and all applicable requirements.

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/	Funds to be put to better use 4/
1B	\$107,700			
1C	\$4,039			
1D		\$34,485		
1E			\$13,037	
1F	_____	_____	_____	<u>\$2,258</u>
Total	<u>\$111,739</u>	<u>\$34,485</u>	<u>\$13,037</u>	<u>\$2,258</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 policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ Recommendations that funds 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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the \$2,258 is paid to the Chinatown Partnership Local Development Corporation program for underreimbursed payroll taxes, it will result in funds to be put to their intended use.



## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

#### Comment 1



July 16, 2012

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 has reviewed the U.S. Department of Housing and Urban Development Office of Inspector General Draft Audit Report that was provided to us on June 29, 2012 covering the period from April 1, 2010 through March 31, 2011. We recognize the importance of this and the previous 15 congressionally mandated audits your office has performed.

Our response will address the action that we have already begun to take to strengthen our invoice review and approval process. As always, LMDC will continue to work diligently to insure Disaster Assistance funds are safeguarded and disbursed for eligible HUD-approved expenses.

Sincerely,

A handwritten signature in blue ink, appearing to read "D. Ciniello", is written over a faint, larger version of the LMDC logo.

Daniel A. Ciniello  
Senior Vice President - Operations

**Ref to OIG Evaluation**

**Auditee Comments**

**LMDC Response to HUD OIG Draft Report**

LMDC management reviewed the draft audit report from the HUD Office of the Inspector General (OIG) covering the period from April 1, 2010 through March 31, 2011. LMDC has and will continue to work diligently to insure Disaster Assistance funds are safeguarded and disbursed for eligible HUD-approved expenses.

We appreciate your recognition that the LMDC generally disbursed CDBG Disaster Recovery Assistance funds in accordance with guidelines established under the HUD-approved partial action plans for the \$8.4 million in programs you reviewed out of the \$245.2 million disbursed during the period under review. We respectfully disagree with your claim that "LMDC officials improperly reimbursed \$160,054 in ineligible, unreasonable, and inadequately supported costs." Although your claim amounts to less than 2% of costs reimbursed under the two programs you reviewed, we have taken the time to respond to your Finding.

**Comment 1**

While we agree with the potential Davis-Bacon Act issue you identified, we generally do not agree with your interpretation of regulations that led to your findings that LMDC did not have sufficient documentation to support reimbursements to subrecipients, or your finding that certain expenditures were not reasonable.

LMDC met the regulatory documentation standards that the OIG cited in its report, and that documentation was provided to the OIG. LMDC provided the OIG with its accounting records and those of its subrecipient. LMDC provided the OIG with contracts between the LMDC and our subrecipients, and contracts between our subrecipients and their contractors which included agreed upon budgets within which each reimbursement request you have questioned was funded. LMDC provided evidence that our subrecipients paid their contractors and LMDC provided complete paid contractor invoices which account for all of the costs in sufficient detail to establish the reasonableness of the cost.

**Area of Agreement**

**Comment 2**

As previously noted, we agree that executing separate material and labor contracts on the same renovation project does not excuse a contractor from complying with Davis-Bacon Act prevailing wage requirement. LMDC management initiated action during your audit to determine if prevailing wages were paid or not. Our subrecipient and their contractor were asked to obtain any and all documentation related to the payments made related to the labor performed on this renovation project so as to determine if prevailing wages were paid or to identify underpayments in order to rectify this matter. We have notified our subrecipient that \$107,700 has been preliminarily withheld from their next reimbursement until appropriate determinations can be made regarding this matter.

We have also discussed this incident with representatives from the United States Housing and Urban Development Office of Block Grant Assistance (HUD) for the purpose of seeking guidance in resolving this matter. An LMDC staff meeting was held on June 22, 2012 to, among other things, discuss "red flags" and other invoice review ideas that could help staff identify and prevent similar issues in the future. Information obtained from the OIG Audit team related to this matter, HUD representatives, our Internal Auditor, and others was shared with staff to prevent similar issues from occurring in the future.

**Comment 3**

Areas of Disagreement

The report states:

“LMDC officials deemed the subrecipient responsible for ensuring the proper use of the funds and did not perform a sufficient review of the invoices before approving them for reimbursement. As a result, LMDC officials improperly reimbursed \$160,054 in ineligible, unreasonable, and inadequately supported costs.”

It is true that the LMDC holds the subrecipient responsible for ensuring the proper use of the [federal] funds which is essential in a grantee subrecipient relationship. It appears the OIG is suggesting that the LMDC over-relies on the subrecipient and does not perform sufficient reviews of subrecipient reimbursement requests.

LMDC monitors its Subrecipient’s payment and documentation procedures and in addition carefully reviews the reimbursement requests submitted to LMDC and has done so effectively for years. The fact that LMDC staff did not, at the time of our initial review, determine that the material we reimbursed our subrecipient for on the Chinatown Clean Streets program was related to a construction project does not support the conclusion that our review process was insufficient. Our reviews of all other OIG questioned costs in this report were sufficient and subrecipient reimbursement documentation standards were appropriately applied in accordance with regulations and the terms of our subrecipient agreements which state... “Subrecipient shall submit reimbursement requests ...which documentary evidence shall be acceptable to LMDC in LMDC’s reasonable discretion.” The documentation we have accepted prior to reimbursing our subrecipients has been acceptable to the OIG and HUD for years.

We disagree with your characterizations of \$4,039 in subcontractor payroll costs associated with the New York Stock Exchange program as ineligible, \$35,278 in liability insurance, delivery, and communications costs for the same program as inadequately supported, and \$13,037 in rent expenses for the Chinatown Clean Streets program as unreasonable. Our responses to your specific recommendations made to the HUD Deputy Secretary for Grant Programs (HUD) are provided below.

**1A.** *Strengthen controls over the invoice approval process to ensure that the subrecipient is reimbursed in accordance with the terms of the subrecipient agreement and all applicable requirements.*

**Comment 4**

Although we do not agree with all of the documentation issues noted in this report, we do recognize that improvements can be made to strengthen the document review process. Efforts began during the audit and will continue as we move forward. LMDC staff has and will continue to maintain strong controls over the subrecipient reimbursement process. Every effort will be continue to carefully review all reimbursement requests prior to payment. We already have spent time with our staff focusing on sharing information from recent experiences. Training was conducted on June 22, 2012 and we will continue to share what we have learned with all staff involved in reviewing subrecipient reimbursement requests as well as LMDC invoices.

**1B.** *Recoup, through offsets of future reimbursements, \$107,700 in ineligible costs reimbursed to the subrecipient under the Chinatown Clean Streets program due to payments made under a construction contract improperly let with the intent of circumventing Davis-Bacon wage requirements.*

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 1**

As previously noted, LMDC has preliminarily withheld \$107,700 from our subrecipients next reimbursement until an appropriate determination can be made regarding this matter. We have also been in communication with HUD regarding this incident for the purpose of seeking guidance in resolving this matter.

**Comment 5**

**1C.** *Recover, through offsets of future reimbursements, \$4,039 in ineligible costs reimbursed to the subrecipient under the New York Stock Exchange Area Improvements program due to incorrect consultant payroll billings.*

The \$4,039 in payroll costs paid by our subrecipient to their contractor was contractually authorized and within the staff cost budget. Payment for the work performed by these individuals was project related and approved by our subrecipient in compliance with the terms of the contract executed between the subrecipient and their contractor. In reviewing the contractor invoices for these costs, LMDC staff determined that there was sufficient evidence that contractor staff included in the payroll were performing appropriate work on the project and that the Subrecipient had reviewed and approved the staff and their work hours. You indicated that the specific individuals on the contractor's payroll were not in the staff listing of the original contract. You referred to Section 2.02 of the Subrecipient's contract with their vendor regarding staff changes, but that section does not require the changes in staff to be documented in a specific way. Individual staff members change from time to time especially on a construction project that spanned more than five years and the Subrecipient's contract with their vendor does not establish a specific procedure for each change. As we do not agree with your determination that the \$4,039 reimbursed to our subrecipient is ineligible, no further action is planned at this time.

**Comment 6**

**1D.** *Provide adequate supporting documentation for \$35,278 in liability insurance premiums, overnight delivery and messenger services, and communication costs. If adequate supporting documentation cannot be provided, LMDC should recapture the funds through offsets of future reimbursements.*

We respectfully disagree with your claim that "LMDC officials did not provide adequate documentation to support \$35,278 in consultant costs under the New York stock exchange Security and Streetscape program". We obtained and you reviewed Subrecipient accounting records which establish that invoices submitted by their contractor were authorized and paid to the contractor for \$34,485 for insurance premiums and overnight delivery/messenger service costs in connection with the New York Stock Exchange Area Improvements program. We obtained and reviewed the detailed contractor invoices for these amounts which were sufficiently detailed to allow a determination of reasonableness to be made by LMDC staff. The documentation on file was sufficient enough for you to determine that these costs are eligible, as noted on page 8 of the report. The costs were project related and approved by our subrecipient in compliance with the terms of their contract with their contractor. Further evidence supporting the \$33,729 in insurance costs exists in the form of Certificates of Insurance naming the LMDC as an additional insured party. For all these costs, the subrecipient provided certifications that the invoices related to these costs included all back-up material required by the terms of their contract, and were reviewed for reasonableness and accuracy by responsible City employees.

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 6**

The contractor's invoice to the Subrecipient includes transaction reports supporting the November 2006 through October 2008 overnight delivery/messenger service costs ranging from \$7.05 to \$168.10 per month. This documentation was accepted by our subrecipient and certified to include all back-up material required by the terms of their contract with the contractor. Furthermore it was within the project budget. LMDC staff reviewed this invoice and determined that this level of documentation was sufficient. Additional documentation supporting the combined \$756 dollar reimbursement requests was not sought or deemed necessary for the LMDC to determine the reasonableness of these expenses as part of a \$25 million subrecipient agreement.

**Comment 7**

**Comment 8**

The \$793 communication costs are eligible and reasonable based on our review of the Subrecipient's contractor's invoice which contained copies of actual phone bills, the allocations used to determine what portions of those bills were actually charged to the program (as indicated on the phone bills), and our Subrecipient's approval of those expenses incurred by and reimbursed to their contractor. This standard review practice has been used and deemed acceptable for years by the LMDC, the City of New York and the OIG.

**Comment 9**

**IE.** *Recoup, through offsets of future reimbursements, \$13,037 in unreasonable costs reimbursed to the subrecipient under the Chinatown Clean Streets program due to the unreasonable cost of leasing two office spaces at the same time without a written justification.*

We do not agree that the payment of rent on a long-term lease of property used by our Subrecipient's consultant as part of their operation in compliance with their contract and within their budget was "unreasonable". The use of multiple locations during the consultant's operation was reasonable, eligible, practical, and authorized by our Subrecipient. Explanations as to why multiple locations were rented were provided to the OIG during the audit. Rent is an eligible expense and the amount paid was reasonable, and within their budget. Conditions or situation change over time resulting in management decisions needing to be made. Costs associated with those business decisions must be evaluated by our Subrecipient for reasonableness. In this case, that evaluation resulted in our Subrecipient approving the rent expense as reasonable. We reviewed this decision, concurred with it, and reimbursed our Subrecipient accordingly as is our prerogative within the realm of our authority and in compliance with the regulations.

**Comment 10**

**IE.** *Pay \$2,258 owed to the Chinatown Partnership Local Development Corporation due to miscalculated payroll taxes.*

If we receive supporting documentation that we deem acceptable and a request for reimbursement from our Subrecipient, we will consider processing a reimbursement to them.

## OIG Evaluation of Auditee Comments

- Comment 1** According to 24 CFR 85.20(b)(6), accounting records must be supported by such source documents as cancelled checks, paid bills, and contracts. However, LMDC officials provided blanket multi-million dollar contracts in support of the accounting records that were used to substantiate \$34,485 in reimbursed consultant costs. While these costs were eligible and in line with the approved budgets, LMDC officials did not provide the source documents for the actual expenses incurred in support of the reimbursements.
- Comment 2** LMDC officials have begun to take action in response to our recommendation.
- Comment 3** Reliance on the subrecipient is an integral part of the grantee/subrecipient relationship. However, as the grantee, LMDC is ultimately responsible for the subrecipient's performance and must carefully monitor its grant activities to ensure that HUD CDBG funds are properly used. Given the reimbursement request for materials, such as drywall, carpentry, painting, and flooring, which have no independent use outside of a construction project, coupled with the fact the materials were used in the subcontractor's office renovation, a careful review of the reimbursement request would have caused LMDC officials to question the absence of documents demonstrating the contractors' compliance with the Davis-Bacon Act prevailing wage requirements. While we cannot address documentation deemed acceptable to OIG and HUD in the past, during the current period reviewed, LMDC officials did not always provide source documents for the actual expenses incurred in support of the reimbursements.
- Comment 4** Despite LMDC officials' disagreement with all the documentation issues reported, they have begun to take action in response to our recommendation.
- Comment 5** The \$4,039 in payroll costs reimbursed was incurred by staff whose position categories were not specified in the consultant contract. While it is true that Section 2.02 A of the contract does not specify how changes in staff should be documented, it clearly states that the consultant must obtain prior written approval from the subrecipient for changes in salaries. In addition, the sentence that follows states that the staff schedule may be amended regarding positions or salaries as agreed upon from time to time. Based on the requirement that salary changes must be documented in writing, it is reasonable to maintain that position changes must be similarly documented. Without such documentation, the consultant's payroll costs cannot be properly verified.

Moreover, the service billings provided in support of the consultant's payroll costs reimbursed during the audit period reflected \$6,637 in costs incurred by unspecified staff. However, of that amount, only \$4,039 was included in the subrecipient's reimbursement request. This was an indication that the subrecipient considered some of the payroll costs ineligible. Nevertheless,

because the positions changes were not documented, the eligibility of the payroll costs incurred by the unspecified staff could not be verified.

- Comment 6** The accounting records used to support the reimbursement of \$34,485 in insurance premiums and overnight delivery and messenger service costs consisted of the consultant's transaction reports. Despite the eligibility of the costs, neither LMDC nor subrecipient officials provided the source documents for the actual expenses incurred to substantiate the reimbursements. With regard to the insurance costs, officials did not provide the Certificates of Insurance. Furthermore, without the source documents, the subrecipient's certification as to the reasonableness and accuracy of all back-up material for these costs could not be verified.
- Comment 7** Regardless of the dollar amount, LMDC officials must obtain source documents to ensure that the subrecipient is reimbursed only for actual expenses incurred.
- Comment 8** While the allocations used to determine the amount of communication costs chargeable to the program were indicated on the actual phone bills, we questioned the basis of the allocations since a cost allocation plan was not provided. However, such information was obtained directly from the subrecipient after the exit conference. As a result, this issue has been removed from the report.
- Comment 9** LMDC did not provide documentation to support its claim that based on an evaluation of associated costs, the subrecipient determined that it was reasonable for the subcontractor to continue to lease additional office space for a 14-month period after the renovation of its new headquarters. Furthermore, the documents obtained did not support the explanation provided by a LMDC official that it took time to break the long-term lease to avoid litigation and penalties. According to a letter from the landlord, dated December 22, 2008, a subcontractor official requested to be released from the lease on December 9, 2008, and in accordance with the letter, the landlord and a subcontractor official executed a Surrender of Lease Agreement on December 29, 2008, or less than three weeks later.
- Comment 10** LMDC officials should work with the subrecipient to ensure that the payroll taxes are properly paid.

## Appendix C

### SCHEDULE OF DISBURSEMENTS AS OF MARCH 31, 2011

Program	Budget as of Mar. 31, 2011	Audit period disbursement Apr. 1, 2010 – Mar. 31, 2011 <sup>5</sup>	Cumulative disbursed as of Mar. 31, 2011	Balance remaining as Mar. 31, 2011
Business Recovery Program	218,946,000	(44,951)	218,775,945	170,055
Job Creation & Attraction Program	143,000,000	1,574,546	107,572,886	35,427,114
Small Firm Attraction & Retention	29,000,000	(19,049)	27,702,141	1,297,859
Residential Grant Program	236,180,809		236,057,064	123,745
Employment Training Assistance	346,000		337,771	8,229
Interim Memorial	309,969		309,969	0
Columbus Park Pavilion	998,571		0	998,571
History & Heritage Marketing	4,612,619		4,612,619	0
Downtown Alliance Streetscape	4,000,000		4,000,000	0
NYSE Security Improvements	25,255,000	6,209,473	11,687,342	13,567,658
Parks & Open Spaces	46,981,689	251,552	18,126,302	28,855,387
Hudson River Park Improvement	72,600,000	933,310	72,568,082	31,918
West Street Pedestrian Connection	22,955,811		18,327,501	4,628,310
LM Communication Outreach	1,000,000		1,000,000	0
Pace Green Roof Design	100,000		0	100,000
Chinatown Tourism Marketing	1,160,000		1,159,835	165
Lower Manhattan Info	2,570,000		1,752,391	817,609
WTC Site	706,618,783	49,988,432	598,399,650	108,219,133
Lower Manhattan Tourism Programs	3,950,000		3,950,000	0
East River Waterfront	149,000,000	23,135,135	38,825,819	110,174,181
Lower Manhattan Street Management	9,000,000		4,191,122	4,808,878
East Side K-8 School	23,000,000		28,703	22,971,297
Fitterman Hall	15,000,000		1,784	14,998,216
Chinatown LDC	7,000,000	2,210,825	4,515,731	2,484,269
Lower Manhattan Housing	54,000,000	3,935,105	28,200,000	25,800,000
Lower Manhattan Public Service Programs	7,891,900	323,498	6,821,219	1,070,681
Planning & Administration	114,892,005	5,044,186	99,212,365	15,679,640
Community & Cultural Enhancements	87,855,844	12,682,820	48,947,734	38,908,110
Drawing Center	2,000,000		254,560	1,745,440
Fulton Corridor	39,000,000	49,909	1,211,596	37,788,404
Economic Development	6,775,000		1,016,007	5,758,993
Transportation Improvements	31,000,000	4,606	136,499	30,863,501
Education – Other	3,000,000		0	3,000,000
Utility Restoration and Infrastructure Rebuilding	483,382,087	116,660,000	483,382,087	0
Disproportionate Loss	33,000,000		32,999,997	3
Other World Trade Center Area Improvements	196,617,913	22,266,057	22,266,057	174,351,856
<b>Total</b>	<b>2,783,000,000</b>	<b>245,205,454</b>	<b>2,098,350,778</b>	<b>684,649,222</b>

<sup>5</sup> Negative amounts represent recoveries to the program.