State of New York
Office of the State Comptroller
Division of Management Audit

URBAN DEVELOPMENT CORPORATION
AND
JOB DEVELOPMENT AUTHORITY

STAFF STUDY: CONSOLIDATION OF THE STATE'S ECONOMIC DEVELOPMENT ENTITIES AND PROGRAMS

REPORT 96-D-19

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit

Report 96-D-19

Mr. Charles Gargano
Chairman
Urban Development Corporation
Job Development Authority
633 3rd Avenue
New York, New York 10017-6745

Dear Mr. Gargano:

The following is our staff study on the consolidation of the State's economic development entities and programs for the period January 1, 1994 through February 28, 1997.

The study was done according to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. We list major contributors to this report in Appendix A.

Office of the State Comptroller
Division of Management Audit

December 24, 1997

Executive Summary

Urban Development Corporation And Job Development Authority Staff Study: Consolidation Of The State's Economic Development Entities And Programs

Scope of Study

The State Legislature created four primary entities to aid economic development within the State. These entities are the Department of Economic Development (DED), the Job Development Authority (JDA), the Urban Development Corporation (UDC), and the Science and Technology Foundation (STF). Traditionally, these entities have provided grants, loans, and training to assist businesses in New York State. Prior to 1995, each of these entities was administered separately. However, since 1995, the four entities have been operationally merged and referred to as Empire State Development (ESD). The Commissioner of DED chairs the boards of directors of UDC, JDA, and STF.

To guide the consolidation, officials developed a plan known as "The New Beginning." This plan included 11 recommendations for the consolidation of the four organizations. The recommendations included such items as reductions in the number of employees and programs, and decentralization of the loan review process. In addition, to facilitate the consolidation, officials created the Empire State Development Corporation (ESDC), as permitted by state law. ESDC is a subsidiary of UDC and administers the programs of JDA and UDC. An Executive proposal submitted with the 1997-98 budget to merge the Department of Economic Development, and Science and Technology Foundation into the ESDC was not enacted by the State Legislature.

We reviewed The New Beginning and ESDC's current state of operations to determine whether the plan's 11 recommendations were implemented. In addition, we evaluated the level of customer service satisfaction as a result of the consolidation. We reviewed its database system, its current governance structure and briefly reviewed JDA's loan portfolio management in follow-up to an earlier audit. We also reviewed the levels of program activity of the State economic development entities from April 1, 1992 through January 31, 1997. Our study sought to answer the following questions:

- Did the merger/restructuring have a positive effect on ESDC's strategic goals and performance?
- How has customer service been impacted by the consolidation?

Study Observations and Conclusions

Most of The New Beginning's recommendations have been implemented. For example, there are fewer and more flexible economic development programs and the cost to administer the programs is lower. However, management still needs to complete efforts to decentralize loan review processes and meet its goal to further reduce the entities' aggregate budget. We also noted that the consolidation plan lacked formal time frames for full implementation of recommendations and performance indicators to help assess the impact of this initiative. Without formal benchmarks and subsequent assessments to measure the impact of the consolidation, management has limited assurance that the consolidation is achieving its objectives of economic development initiatives. (See pp. 5-8)

Although ESDC has improved (customer community organizations that provide economic development assistance to local businesses) service by providing one-stop shopping through its ten regional offices, it still has not placed loan review officers at four of these offices or developed alternatives to doing so. Further, some of the customer organizations we surveyed stated that since the consolidation they have been unable to obtain relevant and timely program information from the regional offices. Some respondents indicated that regional office staff appear to be unsure of which programs are active and have to contact central ESDC offices in New York City or Albany to get answers. This may have a negative impact on overall program activity. (See pp. 9-13)

ESDC officials could not provide us with a comprehensive report which summarized all of ESDC's program activity. Instead, officials provided us with separate reports from each entity, with the exception of the DED (for which no report was provided). Such a report could not be generated because information needed on the report was maintained on different databases that were not totally linked. Moreover, the reports received were incomplete and/or contained errors. System weaknesses increase the risk that economic development recipients may receive funding when they are no longer qualified for it. Efforts to improve data systems must therefore be accelerated. (See p. 15)

The internal control environment of an organization can be significantly impacted by the actions of its board of directors, which provides direction on major issues. The level of attention and direction provided by the board can help set the tone of an organization and influence the control consciousness of management. Consequently, the presence of an independent board is necessary to help ensure that adequate internal control exists within an organization. However, the board of directors of ESDC is not independent, because the Commissioner is both board chairman and CEO of ESDC. We would note that major problems in recent years at JDA (prior to the current administration) have been attributed, at least in part, to the inadequate oversight by the board of directors. Thus, we conclude that ESDC's board of directors should be independent from its executive management. (See pp. 17-18)

Comments of Officials

In their response to the draft report, ESDC officials indicated that they have taken and will be taking actions to address all but one of the issues we identified for consideration. Officials stated that the Commissioner's dual position of CEO and Board Chairman of ESDC does not impact the quality of Board oversight of ESDC activities. In response to our concern that ESDC establish measurable goals and objectives, ESDC officials cited improvements in the statistics on Statewide employment and various other economic indicators. However, we believe that these statistics are not an appropriate gauge of the impact of New York's economic development programs and do not confirm the effectiveness of ESDC's efforts in contributing to those factors. For example, ESDC's response ignores the fact that the State's economic growth has been driven by the strength of the financial markets in New York City, where employment has grown at over twice the upstate pace since 1995. New York ranks 45th among states in private sector job growth from January 1994 to August 1997, and ranks 48th on a total employment basis. ESDC officials also cite the Governor's tax reductions and regulatory reforms as the cause of New York's improvements. However, ESDC has not provided an analysis to support the claim that personal income tax reductions and regulatory reform have led to significant job creation in New York or had measurable impacts on the business climate. In fact, New York State still ranks among the states with the highest cost of doing business according to independent studies. The claim that ESDC's efforts have improved New York State's economic development remains unsubstantiated by findings within this study.

Contents

Introduction

Background

The New York State Legislature created four primary entities with the mission of generating economic development within the State. These entities are the Department of Economic Development (DED), the Job Development Authority (JDA), the Urban Development Corporation (UDC), and the Science and Technology Foundation (STF). Prior to 1995, each of these entities existed and were administered separately. However, since 1995, State economic development officials have collectively referred to these entities as Empire State Development (ESD), as part of their effort to consolidate the State's economic development programs. ESD is neither a public corporation nor a State agency. ESD is a name created by the current administration to help market these programs. Also in 1995, UDC created a subsidiary named the Empire State Development Corporation (ESDC), as permitted by State law. JDA and UDC conduct affairs under the name of ESDC. An organization chart of the ESD entity is included as Exhibit A.

The DED was created in 1941 as the lead agency to coordinate all statewide economic development programs, prepare strategic plans, and review program plans in conjunction with State authorities and agencies. Its' programs emphasize technical assistance for economic development. The DED promotes domestic and international investment in New York State to create private sector jobs and generate additional tax revenues. It also coordinates its own technical and financial assistance with that provided by public and private development agencies to attract new industries, encourage existing businesses to expand, increase foreign investment and trade, promote tourism, and encourage manufacturers to use secondary or recycled materials.

JDA is a public benefit corporation, created in 1961 to promote, encourage, and develop the general prosperity and economic welfare of the State. JDA provides loans to companies seeking to expand facilities, build new plants, and acquire machinery and equipment. In addition, the JDA operates special programs for rural development, long-term economic development, and construction bonding assistance. JDA also administers several special revenue funds and is currently authorized to issue $750 million in state-guaranteed bonds and notes to generate the operational funds it needs. As of March 31, 1996, JDA had a cumulative operating deficit of $71.7 million, which was generated during the prior administration. To eliminate this deficit, UDC officials had to develop a multi-year deficit reduction program.

UDC is a public benefit corporation created in 1968 to develop housing for people with low and moderate incomes; its program emphasis was shifted in the late 1970s from housing to economic development. UDC's goal is to create and retain jobs in the State; help industries and businesses start up, retool, and expand; and eliminate blight in economically-depressed areas. To achieve this goal, UDC administers a series of economic development programs designed to assist businesses and industries. UDC obtains State appropriations to fund its operations.

The STF is a public benefit corporation established in 1963 to create and administer programs that promote scientific and technical education, industrially-relevant research and development, industrial productivity, and the capitalization of new businesses in high technology. Funded primarily through annual State appropriations, STF makes equity investments, loans, and awards through a variety of programs.

The Commissioner of the DED chairs the boards of directors of UDC, JDA, and STF. The Commissioner is also the President and CEO of the UDC, as well as the board chairman and CEO of ESDC.

In 1995, to guide the administration of the State's economic development programs, the Governor's transition team developed a consolidation plan called "The New Beginning." This team included representatives from each of the four entities. The goal of the plan was to "prune bureaucracy to more efficiently deliver services that encourage new growth in the private sector, and reduce spending..." To meet this goal, the plan recommended that the four economic development entities be legally consolidated into two entities. The DED would absorb the STF's functions, and the UDC would absorb the JDA's functions and be renamed the Empire State Development Corporation. This Executive proposal for 1997-98 was not enacted by the State Legislature.

Study Scope, Objectives and Methodology

We reviewed the effects of the consolidation of the four entities for the period January 1, 1994 through February 28, 1997. Our objectives were to answer the following questions:

- Did the merger/restructuring have a positive effect on ESDC's strategic goals and performance?
- Was customer service impacted by the consolidation?

To accomplish our objectives, we reviewed relevant laws, rules, regulations, policies, procedures, and other documents relevant to the consolidation. We interviewed ESDC officials and visited a DED regional office. We also interviewed officials from local development corporations and the New York Power Authority. In addition, we sent a survey on customer satisfaction to organizations that have transacted business with the State economic development entities.

We note that prior reports issued by the Office of the State Comptroller identified serious deficiencies in JDA's loan portfolio management. In those reports, we recommended that JDA strengthen its loan review procedures and enhance monitoring of outstanding loans and loan guarantees. As part of this study, we surveyed ESDC's portfolio management procedures to determine if improvements had been made. We also surveyed JDA's old and new loan review and portfolio management procedures to determine JDA's exposure to delinquent loans. We found that the new procedures require ESDC's staff to perform more testing of financial information received from the borrower. ESDC has also placed a cap on the dollar amount of loans given to applicants. Further, ESDC officials informed us that the billing functions at JDA will be outsourced, thereby freeing ESDC's staff to address the problem loans already issued. The combination of these factors should allow JDA to maximize its collection of receivables, while minimizing its risk of loss that occurs when borrowers do not pay their loans. Thus, our study does not include any further detail on this issue.

Comments of Agency Officials

We provided draft copies of this study to ESDC officials for their review and formal comment. We have considered their comments in preparing this final report and have included them as Appendix B.

Within 90 days after final release of this study, we request the Chairman of Empire State Development Corporation to report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to address the issues for consideration contained herein, and where such issues were not addressed, the reasons therefor.

Consolidation Design and Implementation

To facilitate the process of decision-making, a governmental entity should establish and communicate relevant goals and objectives, set measurable targets for accomplishment and develop and report indicators that measure its progress in achieving those goals and objectives. We reviewed ESDC's consolidation plan to determine whether it outlined goals and objectives, a time frame for implementing those goals, and performance indicators to measure the outcome of implemented objectives.

We found that, although the plan outlined 11 recommendations (or objectives) for consolidating the four entities, it lacked a time frame for implementation or performance indicators for measuring the impact of implemented objectives. Without formal benchmarks and subsequent assessments to measure the effectiveness of the consolidation of the State's economic development programs, there is limited assurance that ESDC's program operations have been improved sufficiently. For example, one of the plan's stated objectives was to reduce operating costs. ESDC implemented this objective by reducing staffing levels and the number of programs to administer. However, without performance measures, it is difficult to determine what impact, positive or negative, that these staff and program reductions had. Furthermore, since no time frame was established for completing the consolidation, it is uncertain when it will be completed and therefore measurable.

We sent survey questionnaires to Local Development Corporations (LDCs) which serve as the contact between businesses wishing to obtain economic development aid and ESDC. The results of the survey indicate that some LDCs were unsure about which programs were still available through ESD. For example, LDC officials we interviewed indicated that the uncertainty had caused them to reduce their marketing efforts in certain programs, such as the Minority Women Business Revolving Loan Fund, because they are unsure of the status of the program. This could be detrimental to businesses that genuinely need loans to compete effectively, but do not receive them.

To accomplish the Governor's goal of streamlining State government, representatives from the DED, JDA, UDC, STF and the Governor's office formed a transition team. In early 1995, the team produced a planning document (The New Beginning) that highlights ESDC's operation, and made 11 recommendations for a consolidation of the four entities. We reviewed ESDC's operations to determine whether the 11 recommendations have been implemented. The following table summarizes each of the plan's recommendations and indicates its stage of implementation at the time of our review:

The New Beginning Recommendations	Stage of Implementation

Number of agencies should be reduced to two - the DED/STF and JDA/UDC (ESDC).	Partially implemented
UDC should absorb the functions of JDA.	Implemented
Reduce JDA staff from 40 to 12 employees and place remaining staff on UDC's payroll.	Implemented
Reduce JDA budget from $5.3 million annually to $1.1 million.	Implemented
Provide for an orderly workout of JDA Debt.	Implemented
The chief administrative officer should hold a joint appointment at the two organizations, heading all administrative functions.	Implemented
Reduce the number of programs to fewer, more flexible programs.	Implemented
Create one-stop shops at regional offices.	Implemented
Decentralize program approval process.	Partially Implemented
Reduce the entities' aggregate budget from $362 million to $148.6 million.	Partially Implemented
Submit legislation that would: 1. Provide for common membership of the Boards of JDA, UDC, and STF. 2. Change the name of UDC to ESDC. 3. Make other technical changes to the enabling statutes.	Partially Implemented

As indicated by the table, ESDC officials have implemented most of the plan's recommendations. For example:

- JDA's budget was reduced by over $4 million, and its staff was reduced from 40 to 12 employees. UDC absorbed JDA's functions and its remaining employees. Both JDA and UDC now do business as ESDC. As a result of the consolidation, the four entities now do business as one organization - ESD. In addition, UDC refinanced its outstanding bonds and used some of the proceeds to reduce JDA's debt. Also, one individual was appointed to serve as the Chief Administrative Officer of both the DED and ESDC.

- The number of programs was reduced and the Economic Development Fund, a comprehensive loan and grant fund, was created. This fund provides financing for most of the economic development programs ESDC offers. ESDC implemented one-stop shopping by offering all of its programs at its regional offices and by providing a standard (or "universal") application form that can be used at any of the four economic development entities.

The plan also contained four recommendations that ESDC has not fully implemented, as described by the following:

- Although ESDC officials have programmatically consolidated the agencies, they have not legally consolidated the agencies. The Legislature must approve the legal consolidation. (Note: ESDC officials submitted their response to our draft report after the Legislature passed the 1997-98 State budget. In their response, ESDC officials noted that the Legislature chose not to support a proposal to statutorily merge DED and STF into ESDC.)

- ESDC attempted to decentralize the program approval process by placing a loan review officer at each of its 10 regional offices. Currently, however, only 6 of the 10 regional offices has a loan review officer assigned to it. (Note: In their response to the draft study, ESDC officials indicated that they have not placed an officer in each regional office at this time because they did not believe that loan volume justified placement of a loan officer in all of the smaller regional offices.)

- ESDC reduced overall program costs by $163 million compared to its goal of $213 million during the 1996 fiscal year. (Note: In their response to the draft study, ESDC officials acknowledged that they had not completely reached this budgetary objective. They further noted that the reduction achieved was 45 percent of the prior year's spending level.)

- At the beginning of our fieldwork (August 1996), ESDC officials had not submitted a legislative proposal to consolidate the four entities into two by statute. Thus, each of the four entities' original statutes are still in force. Also, the UDC, JDA and STF boards continue to operate as separate bodies. The Commissioner of DED is the Chairman of the boards of UDC, JDA and STF. However, in January 1997, the Governor's office submitted a legislative proposal, with the 1997-98 Executive Budget, to merge the DED and STF into ESDC. (Note: As stated previously, this legislation was not enacted.)

Issues to be Considered

1. When will ESDC officials establish formal, measurable program goals and objectives to assess the impact of the consolidation and a time frame for completing the consolidation?

2. What impact has the Legislature's action not to approve the merger of the four entities had on ESDC's plans for the future, both internally and externally?

Customer Service and Level of Program Activity

A major goal of the consolidation was to improve customer service by: (a) reducing the number and complexity of programs; (b) providing customers with one-stop shopping; and (c) providing decentralized decision making. We reviewed UDC/JDA's (ESDC's) operations and found that, for the most part, ESDC accomplished these three goals. Including programs previously administered by the DED, the total number of programs provided by ESDC has been reduced, with some programs eliminated and others merged. ESDC also created the Economic Development Fund, that enables ESDC to make available money for any project that meets the prescribed criteria, thus making ESDC's overall funding effort more flexible.

ESDC provides customers (community organizations that provide economic development assistance to local businesses) with one-stop shopping through the DED's regional offices. Businesses that need economic development aid can now obtain information about the various programs offered by all four economic development entities at any regional office. ESDC has also developed a universal application available at any regional office that the customer can use to apply for economic development aid. To facilitate one-stop shopping for its customers, ESDC will provide decentralized decision-making at the regional offices. It planned to accomplish this goal by providing each regional office with a loan review officer.

The loan review officer determines whether or not an applicant qualifies for funding from ESDC and which applications will be sent to the board for approval. However, at the time of our review, only six of the ten regional offices had a loan review officer. By reducing the number of programs, providing its customers with one-stop shopping, and attempting to place loan review officers at regional offices, ESDC has improved customer service. (Note: As stated previously, in their response to the draft study, ESDC officials indicated that they have not placed an officer in each regional office at this time because they did not believe that loan volume justified placement of a loan officer in all of the smaller regional offices.) ESDC has also developed a web site that allows the public to obtain information, through the Internet, about doing business in New York State.

Because one function of the State's economic development entities is to provide loans to business to strengthen the economy, we concluded that a potential indicator of program performance is the aggregate level of loans made (funds disbursed) over specific time periods. ESDC officials advised us that the amounts of appropriations and drawdowns of those appropriations can significantly impact the level of loan disbursements made by ESDC. Consequently, we tried to assess program activity by comparing the number and dollar amount of drawdowns, disbursements, and appropriations over the most recent four to five fiscal years to identify trends. The following table summarizes the indicators that could be used to assess changes in ESDC's program activity levels. However, because ESDC officials did not provide us with data on the DED's programs, our summaries do not include the DED's program activities. As a result, we could not draw any reasonable conclusions from the statistics nor could we identify the causes for the variations from year to year.

Appropriations - *(The amounts allocated pursuant to the State budget for the years indicated.)*

Fiscal Years	DED Appropriations	UDC Appropriations	STF Appropriations	Total Appropriations
4/1/96-3/31/97	$43,536,200	$127,080,100	$22,581,000	$193,197,300
4/1/95-3/31/96	$46,814,600	$127,350,276	$23,800,000	$197,964,876
4/1/94-3/31/95	$58,852,000	$295,152,576	$34,645,000	$388,649,576
4/1/93-3/31/94	$38,505,000	$102,208,276	$21,873,000	$162,586,276
4/1/92-3/31/93	$32,403,400	$ 78,585,808	$17,113,000	$128,102,208

Drawdowns - *(The amounts of funds that ESDC entities received from the Division of the Budget during the years indicated.)*

Fiscal Years	Number of projects	Total $ Drawn down
4/1/96-1/31/97	308	$26,789,159
4/1/95-3/31/96	440	$39,477,494
4/1/94-3/31/95	359	$58,799,533
4/1/93-3/31/94	321	$40,090,941
4/1/92-3/31/93	289	$25,762,755

Disbursements - *(The actual amounts paid out by ESDC entities to grant/loan recipients for the years indicated.)*

Fiscal Years	Number of projects	Total $ Disbursed	Total $ Disbursed (Excluding Sports Facility Asst. Prgm.)
4/1/96-1/31/97	230	$93,163,477	$52,214,974
4/1/95-3/31/96	618	$84,649,579	$50,117,851
4/1/94-3/31/95	582	$54,374,960	$40,056,571
4/1/93-3/31/94	532	$49,623,440	$49,566,382

(We present total disbursements both including and excluding disbursements for the Sports Facility Assistance program because of its unique nature. In general, using bond proceeds, ESDC disbursed comparatively large sums of money for a small number of stadium, arena and athletic field projects under this program. Sports Facility Assistance disbursements totaled $57,058 for two projects in fiscal year 1993-94; $14.3 million for four projects during 1994-95; $34.5 million for six projects during 1995-96; and $57.8 million for ten projects during 1996-97, through January 31, 1997.)

As the table indicates, the indicators provide varying results. For example, the amounts of appropriations and drawdowns increase from FY 1992-93 through FY 1994-95, and decrease thereafter. Also, the amount of program funding disbursed by ESD organizations increased annually from $49.6 million in fiscal year 1993-94 to $93.2 million during the 1996-97 year, through January 31, 1997. However, when disbursements for the Sports Facility Assistance program are excluded, annual disbursements fluctuated during that period in the narrower range of $40.1 million to $52.2 million. Moreover, the number of projects funded decreased significantly, from more than 500 per year from the 1993-94 through 1995-96 years, to 230 during the 1996-97 year (as of January 31, 1997). Although there were still two months remaining in the 1996-97 year at the time our fieldwork ended, we believe that it was unlikely that the number of projects funded during 1996-97 would approach the levels of prior years. Consequently, based on this set of indicators, it is unclear whether or not the consolidation has had a positive programmatic impact on ESDC operations.

(Note: In their response to the draft study, ESDC officials stated that our study focused on the number and amount of project disbursements as indicators of program performance. Regarding the number of projects funded, officials noted that they have refocused current efforts more on larger projects which can attract and retain significant numbers of jobs.

While ESDC's response indicates that its programs have resulted in the "recent increases in employment growth rates...," we note that there are other factors that should also have been mentioned to provide a balanced picture. For example, the response ignores the fact that the State's employment growth has been driven by New York City, where employment has grown at over twice the upstate pace since 1995. In addition, New York State ranks 45th among the states in private sector growth from January 1994 to August 1997, and ranks 48th on a total employment basis. As a result, we believe that ESDC officials need to consider additional factors when assessing the impact of its programs.)

In the responses to a customer satisfaction survey questionnaire we sent to organizations that coordinate economic development efforts with ESDC, several organizations told us that ESDC has improved the administration of economic development programs. However, other respondents stated that since the consolidation they have been unable to obtain relevant and timely program information from the regional office staff. They claim that some staff at the regional offices appear to be unsure of which programs are active and frequently need to contact central offices (in New York City or Albany) to get answers. Some respondents also indicated that the consolidation may have negatively impacted the number and dollar value of projects that received funds. We believe that ESDC should address this issue to ensure that the consolidation does not adversely or unfairly affect businesses that are its customers.

(Note: In responding to the draft study, ESDC officials asserted that the broad growth of the State's economy suggests that ESDC's programs are effective. In addition, as part of a new strategic plan initiative, ESDC officials will request operating divisions to assess current activities and to propose initiatives to remedy shortcomings. However, ESDC's response does not provide an analysis to support its claims that personal income tax reductions and limited regulatory reform have led to significant job creation in New York State or have had measurable impacts on the business climate. ESDC officials also replied that they have undertaken several initiatives to improve the quality of their customer service. For example, a Re-engineering Task Force was created to identify key areas of concern and in need of improvement and to make recommendations to Senior Management. They added that several of the Task Force recommendations coincided with ours and corrective action has been taken. Another initiative is the development of a Product Guide describing all of the economic development assistance programs available through the State.)

Issues to be Considered

3. How will ESDC expedite loan reviews in the smaller regional offices in absence of placing a loan officer in each of them?

4. Should State policymakers require ESDC to analyze the trend in the decrease of the number of projects to determine if any type or category of business or need has been adversely affected?

ESDC Database System

A key component of an organization's operation is a management information system and database that allows the organization to capture and exchange information in a form and time frame that enables staff to carry out their responsibilities effectively. However, our review of ESDC identified a weakness in its database systems. Specifically, we requested a comprehensive report which summarized all of ESDC's program activity. However, ESDC officials could not produce this report. Instead, officials provided us with separate reports from each entity, with the exception of the DED (for which no report was provided). Moreover, the reports received were incomplete and/or contained errors. For example, the dates of loan approval and closing (fund disbursement) were sometimes missing. In other instances, the dates the loans were closed preceded the approval dates.

In addition, we noted that the databases were not shared within each entity. For example, to obtain detailed summary information about programs we requested a comprehensive report from ESDC management. However, management could not produce this report because the required information was maintained on two different databases that were not adequately linked. Therefore, we obtained a separate report from each entity and combined them to produce one report that summarized the entities' aggregate program activities. Also, the planned consolidation of the four agencies did not include establishing a common database that was accessible to more than one user within the individual economic development entities. This made overall project monitoring more difficult than it should have been. We also note that system weaknesses increase the risk that economic development recipients may receive funding when no longer qualified to do so.

When we discussed these system weakness with ESDC officials, they stated that they were taking actions to update the system. Specifically, officials purchased Microsoft Access and were standardizing both the hardware and software used by all four entities. In addition, at the time of our review, UDC officials were taking actions to fill the vacant position of Chief Information Officer. The person hired will be responsible for centralizing ESDC's computer system and developing a universal database system.

(Note: In response to the draft report, ESDC officials indicated that staff have designed a new project tracking system to be used by all ESD entities to collect information for management reporting. Officials added that testing of the system would begin in September 1997. Officials plan to have the system fully operational by the end of 1997. In addition, the Board of Directors has approved the hiring of a systems integration consultant who will review ESD system needs, personnel, and applications and develop an integration plan to implement ESD's information technology strategy.)

Issue to be Considered

6. Should ESDC establish a formal plan and timetable to merge systems, including databases, as necessary, to facilitate efforts to enable staff to more readily produce comprehensive management reports and databases for the entire ESDC entity?

Internal Control Environment

As noted previously, the State Legislature created the DED, JDA, UDC, and STF to promote economic development, each entity in a somewhat different manner from the others. Currently, these entities are directed by the Commissioner of the DED who serves as both the maker and implementer of major policy decisions, through ESDC. State law permits the Commissioner of Economic Development to be the chairman of the boards of directors of JDA, UDC, and STF to help ensure that the State's economic development programs are effectively coordinated. The Commissioner has chaired the boards of these entities for many years, including prior administrations.

The internal control environment of an organization can be significantly impacted by the actions of the board of directors, which provides direction on major policy and program issues. Specifically, the level of attention and direction by the board can help set the tone of an organization and influence the control consciousness, philosophy and operating style of management. The board also functions as a check over the most significant actions of senior management. Consequently, the presence of an independent board is necessary to ensure that adequate internal control exists within the organization.

However, the board of directors of ESDC (UDC and JDA) is not independent, because the Commissioner is both board chairman and Chief Executive Officer of ESDC. The lack of independence becomes more significant given the proposal to merge the DED and the STF into ESDC. We believe that the absence of adequate independence can compromise the oversight of a board of directors. In turn, poor board oversight can create an environment where significant problems occur. It is worthy to note that in a prior Comptroller's report (95-S-13, issued December 15, 1995), we attributed problems with JDA's loan portfolio management, at least in part, to deficiencies in the board's oversight. Although these problems occurred during the prior administration, we conclude that ESDC's board of directors should be independent from its executive management.

In addressing this issue, we do not infer that we have identified any wrongdoing on the part of any official associated with the DED, UDC, JDA, and ESDC. Rather, we believe that an independent Board of Directors will help to preserve the appearance and influence of objectivity and to protect executive management from future challenges related to independence.

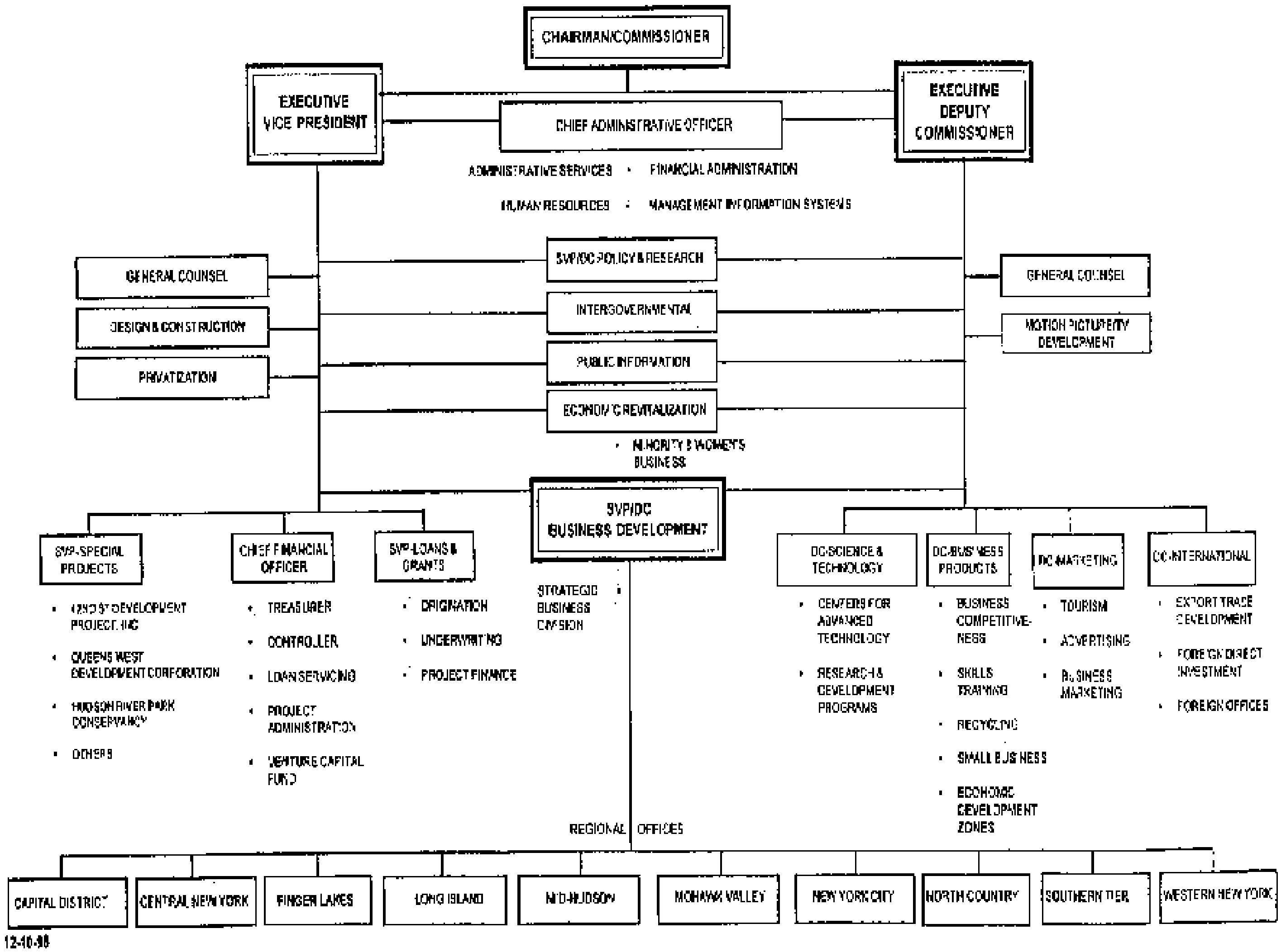
(Note: In their response to the draft study, ESDC officials stated that they do not believe that the quality of Board oversight relates to the issue of whether or not the Commissioner holds a dual position as CEO and Chairman. Officials added that this structure is consistent with numerous corporations throughout the world and is an accepted practice in the private sector.

However, we believe that there are significant distinctions in the obligations and responsibilities of officials of public benefit corporations and those of officials of private commercial corporations. Specifically, officials of public corporations are generally held to higher standards of accountability because they authorize the disbursement of public funds. Thus, we maintain that an independent Board of Directors would help to establish a satisfactory control environment for ESDC.)

Issue to be Considered

7. Should the Governor and Legislature evaluate the Commissioner's dual position as Board Chairman and Chief Executive Officer and consider separating these roles to make the Board more independent to provide improved accountability?

EMPIRE STATE DEVELOPMENT



(See Notes 1 and 2 on Exhibit A-2)

Notes

1.) The programs and activities of UDC and JDA are administered through the offices of the Chief Financial Officer and the SVP-Loans and Grants under the Executive Vice President of ESDC.

2.) The programs and activities of the STF are administered through the office of the Deputy Commissioner-Science and Technology under the Executive Deputy Commissioner of DED.

Acronyms Used In This Report

CEO	Chief Executive Officer
DED	Department of Economic Development
ESD	Empire State Development
ESDC	Empire State Development Corporation
JDA	Job Development Authority
LDC	Local Development Corporation
STF	Science and Technology Foundation
UDC	Urban Development Corporation

Major Contributors to This Report

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Empire State Development

Charles A. Gargano
Chairman
and Chief Executive Officer

August 25, 1997

Honorable H. Carl McCall
Comptroller
Office of the State Comptroller
A. E. Smith Office Building
Albany, New York 12236

Attention: Mr. David R. Hancox

Dear Comptroller McCall:

Thank you for the opportunity to respond to your draft study of our consolidation efforts since January 1995. As you are aware, we have made a great effort toward consolidating the functions within Empire State Development, and we have made it easier for our customers to access our services. We appreciate the recognition by your office that, of the eleven tasks which we identified in our Strategic Plan, seven or 64 percent of these tasks have been fully implemented and the remaining four tasks have been, at least, partially implemented. We believe that this study demonstrates this Administration's commitment to improving the business climate in New York and a reaffirmation that these actions were necessary to create more jobs and opportunity for the State's residents.

I would like to respond to some of the "Issues to Be Considered," raised in the Draft Staff Study Report.

1. Can ESDC officials establish formal, measurable program goals and objectives that will be used to assess the impact of the consolidation and a time frame for completing the consolidation?

The draft report indicates that the goals were generally formal and measurable. For example, the absorption of JDA staff functions was a formal program goal. The goal was accomplished. Similarly, in six of the remaining goals listed in the draft report, ESD has, as the report acknowledges, accomplished the objectives. Impacts of accomplishment of the goals are, in most cases, obvious: reduction in the number of agencies has reduced program costs, and eliminated customer confusion. Reduction of staff and budgets has a measurable impact on program costs that is implicit in the goal. The orderly workout of JDA debt allowed taxpayers to avoid assuming responsibility for a significant financial burden.

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Partially Achieved Goals:

--Reduction in the number of agencies to two. Accomplishment of this goal depends on the Legislature's approval of legislation to complete the merger. To date, the Legislature has not supported this proposal.

--Submit legislation that would: (1) provide for common membership of the Boards of JDA, UDC and STF; (2) Change the name of UDC to ESDC; (3) Make other technical changes to enabling statutes. Although the report identifies this as partially implemented, in fact, legislation was submitted to the legislature for these purposes. It has not yet been approved.

--Reduce the entities' aggregate budget from $362 million to $148.6 million. Although we substantially achieved the budget reduction that we sought to reach in "The New Beginning," we did not completely reach our objective. We recognize that fact, but wish to point out that the reduction achieved was 45 percent of the prior year spending level.

--Decentralize Program Approval Process. Management has been reviewing the desirable extent of program approval by regional offices. To date, we have determined that approval of certain kinds of grants valued at less than $50,000 is feasible. This step has been implemented.

2. Is further consolidation of ESD's current organizational structure warranted, and if so, should the governor and legislature formally assess the benefits of creating a new entity e. g., public benefit corporation, public authority or a state agency?

The Governor proposed further consolidation of ESD's current organizational structure in the most recent Executive Budget. The legislature chose not to approve the proposal. Consequently, this issue has been considered and a decision made by the Governor and the Legislature as a part of the most recent budget process.

3. Would it be beneficial for ESDC officials to develop a timetable for ensuring that loan review officers are available at all ESDC regional offices?

The report indicates that although our initial plan indicated our intention to place a loan officer in each regional office, in fact, loan officers have only been placed in six of ten offices. We have not placed an officer in each office at this time because we do not believe that loan volume currently justifies placement of a loan officer in all of our smaller offices. Consequently, in some cases, loan staff are assigned to multiple regional offices. As you have pointed out in this study, we have reduced staff significantly throughout the organization. For this reason, we have had to weigh our priorities to determine which divisions or departments receive additional staff.

4. Can ESDC officials establish formal, measurable program goals and objectives which can be used to assess adequacy of program activities in terms of the number of projects funded and the amount of dollars distributed?

The recent evidence of increased economic activity in New York State is a strong formal measure of the effectiveness of the Administration's economic development policies. As our "Strategic Plan" indicates, we believe that the most important economic development tool available to Empire State Development has been the reductions in taxes and workers compensation reforms proposed by Governor Pataki and approved by the Legislature. Changing the perception that New York was hostile to business was critical to the successes that we have had in encouraging businesses to relocate to New York, or to remain here.

The performance of the State's economy in the past two years is the harshest possible test of the effectiveness of ESD's and the Administration's economic development efforts. The evidence of New York's economic recovery is impressive:

- From January, 1995 to May, 1997, State private sector employment growth was 158,700. During the comparable 29 month period at the end of the last administration when the national economy was growing at a nearly 3 percent rate, U.S. Department of Labor statistics showed an increase of only 36,500 private sector jobs in New York, an increase of 0.6 percent. The 1995 to 1997 gain is an increase of over 300 percent.
- In the period 1992-94, the State private job growth rate was under 20 percent of the national level. However, with Governor Pataki's tax reductions and regulatory reforms, since the beginning of 1995, the State rate has been over 40 percent of the national level. **For 1996 and, for the first five months of 1997, the job creation rate for both total and private jobs is just slightly below the national rate.** This is the economy's best performance for the first five months of the year since 1987.
- Another measure of the State's economic health is construction activity: Overall construction increased by $260 million during the first two years of the Pataki Administration, compared with a decrease of $630 million during the prior two years.
- Location decisions by businesses are another gauge of the State's economic health. New York has not ranked in the top ten nationally in new industrial sites and expansions of business facilities in more than a decade. Yet, in 1995, New York ranked tenth in the nation in new and expanded business facilities. Last year, our ranking jumped to 5th place. The number of new and expanding sites almost doubled in 1995, and shot up another 70 percent in 1996. The number of new jobs associated with this investment almost tripled during the same time period.
- The quality of jobs created has been good as well. The ten industries with the greatest growth of employment since 1995 had high average salaries. The three largest --business services, health services and education --had average salaries in excess of $30,000, while two others in the top ten --management services and motion pictures --showed average salaries in excess of $40,000.

The Draft report focuses primarily on the number and amount of project disbursements as an indicator of ESDC activities. With regard to the number of project disbursements, it is clear that we have refocused our efforts on larger projects than we had in the past. This reflects our view that in order to maximize the effectiveness of the limited resources available to us, we must work successfully to attract and retain businesses offering significant numbers of jobs. As your report notes, the dollar value of project disbursements increased throughout the period.

It should be noted that both drawdown and disbursement data lag behind project approvals because of the nature of the funding that we provide. While some projects receive funding in the same year that they are approved, others take several years before any cash is disbursed. A review of project approvals from the Jobs Now, Empire State Economic Development Fund, Regional Economic Development and Minority and Women's Business

Development Program shows that project approvals increased in value by 66 percent between 1995 and 1996, while the number of projects approved from those funds doubled.

5. Is there a need for ESDC to analyze the trend in the decrease of the number of projects to determine if any type or category of business or need has been adversely affected?

First, we again note that the evidence of the trend to a decrease in the number of projects is, in our view, ambiguous, (see response to question 4). ESD's activities have been directed by the need to focus on those efforts that had the greatest potential to positively affect the growth of the State's economy, and by the Legislature's decisions about program funding. Both these factors have required us to move away from funding activities that have little direct, measurable economic benefit, and from those for which adequate private sector funding or assistance is available. We believe that the best evidence of the effectiveness of this approach can be found in the data presented in response to question four. The broad growth of the State's economy suggests that our programs are effectively meeting needs.

As you know, we have a regional office network, and work on an ongoing basis with local economic developers to assist businesses. In addition, our Policy and Research Division regularly reviews economic trends within the State. As a part of those efforts, we gather information about market needs. In addition, we anticipate issuing a new ESD Strategic Plan within the coming year. As a part of that process, divisions will be asked to assess current activities, and to propose initiatives needed to remedy shortcomings.

6. Would a formal plan and timetable to merge systems, including databases, as necessary, enable staff to more readily produce comprehensive management reports and databases for the entire ESDC entity?

We have designed a new project tracking system to be used by all entities of ESD for the collection of this information. We are in the process of writing the actual screens for the system and will be in a position to begin beta testing by the end of September. We hope to fully roll out the system for use by the end of this year.

In addition, this month, the Board of Directors will approve the hiring of a systems integration consultant who will be charged with reviewing the systems, needs, personnel, and applications of ESD and develop an integration plan to be used to implement our information technology strategy for the next few years. This will include recommendations regarding budgets, personnel, software, hardware and applications needed to strengthen our operation. By October, a wide area network will be installed which will improve the communications and information transfer between and among the Regional Offices, Albany and New York City.

7. Should the governor and the legislature evaluate the Commissioner's dual position as board Chairman and Chief Executive Officer and consider separating these roles to make the board more independent and thus provide better accountability?

We do not believe that the quality of Board oversight relates to the issue of whether or not the Commissioner holds a dual position as CEO and Chairman. As you know, this structure is consistent with numerous corporations operating throughout the world and is an accepted management practice in the private sector. We will, however, ensure that our internal control systems are continuously reviewed in order to avert any potential problem which may arise.

Other Issues:

Your report noted that some respondents to a survey conducted as a part of your Staff Study Report noted that they had been unable to obtain relevant and timely program information from regional office staff. Because of our concern about the quality of our customer service, we have undertaken several initiatives to improve it. For example, during the time your study was underway, we undertook the following initiatives:

- We created a Re-engineering Task Force which identified key areas of concern and in need of improvement and made recommendations to Senior Management. Several of these recommendations coincide with your recommendations. As a result, we have already begun to take steps to rectify areas in need of improvement.
- We developed a Product Guide describing all the economic development assistance programs available through the state. In the Guide, ESD staff and other professional economic developers can find types of assistance available, funding limits, eligibility criteria and other pertinent information. The Guide is available in all of our Regional Offices and through our corporate intranet, so that all of our staff has it available on their computers so that it is readily available when they are working with clients. We have also presented the Guide to the members of the New York State Economic Development Council for their review and use.
- With the development of the new flexible financing programs created by the Legislature in 1996-97, Senior Regional staff introduced all the Regional staff to these new programs through a series of full day sessions throughout the state.
- We have recently completed development of a formal benefit/cost model to enable us to evaluate the effectiveness of alternative formulations of incentive packages presented to companies considering a new or expanded location within New York State. The model is now being incorporated in the approval process for all incentive projects. It will be a significant addition to the tools available to us in allocating our limited resources among the project proposals that are presented to us.
- We have engaged a consultant to work with staff in improving customer service throughout the organization. Through this process, we hope to instill in all of our employees the need to deliver the best service to their customers. The process will also allow us to identify weaknesses in our processes that impede service. From those analyses, methods to improve our processes and staff will be developed.
- We are in the process of updating our Project Manual. The Project Manual identifies the project development and approval process to be used by all the various departments involved. It will be available in the Fall. In addition, we will offer a series of sessions throughout the state to properly train our field staff on the development and approval process.

We appreciated the opportunity to review your Staff Study Report. We have worked hard to accomplish the goals noted in it. We are committed to creating continuous improvement within our organization. This is reflected in the many actions we have already taken to improve the way in which we do business, and in the mechanisms that we have established internally to continue to streamline our processes. We continue to believe that our efforts have, and will continue to help New York offer its residents opportunity to work and prosper.

Thank you for your comments.

Sincerely,

Charles A. Gargano
Chairman
and Chief Executive Officer