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Audit Report Number 2011-NY-1007
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TO: Edward T. De Paula, Director, Office of Public Housing, 2FPH

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FROM: Edgar Moore, Regional Inspector General for Audit, NY/NJ Region, 2AGA

SUBJECT: The Jersey City Housing Authority, Jersey City, NJ, Had Financial Control Weaknesses in Its Recovery Act Funded Public Housing Capital Fund Program

## **HIGHLIGHTS**

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

We audited the Jersey City Housing Authority's (Authority) administration of its public housing capital fund program funded under the American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup>. This is the second audit report regarding the Authority's capital fund programs. We selected the Authority because of the size of its capital fund programs and because of its U.S. Department of Housing and Urban Development (HUD) risk rating. Our audit objective was to determine whether the Authority obligated and expended its Recovery Act Public Housing Capital funds in accordance with HUD regulations.

### **What We Found**

Authority officials generally complied with HUD regulations while obligating and expending their Capital Fund Recovery Act funds; however, weaknesses existed in the Authority's financial management system. Specifically, (1) it was difficult to trace the drawdowns of Recovery Act Capital funds to the source documentation, (2) Authority officials charged their Recovery Act Capital Fund program with more expenses than were incurred, and (3) costs were miscategorized. Consequently, (1)

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<sup>1</sup> The Recovery Act of 2009 was instituted to stimulate the economy by providing funds to: (1) create new jobs and save existing ones, (2) spur economic activity and invest in long-term growth, and (3) foster unprecedented levels of accountability and transparency in government spending.

HUD was precluded from effectively and efficiently monitoring and evaluating the Authority's administration of its Recovery Act Capital funds, (2) more than \$5,000 was overcharged to the Recovery Act Capital Fund program, (3) more than \$13,000 in administrative costs was inadequately reported to HUD as dwelling structure expenses, and (4) there was a risk that administrative costs could exceed the 10 percent limitation of the total grant amount. These deficiencies were due to the lack of adequate fiscal controls and accounting procedures in place and because Authority officials believed that their accounting system was adequate and complied with HUD regulations.

### **What We Recommend**

We recommend that the Director of HUD's New Jersey Office of Public Housing instruct Authority officials to (1) improve their financial controls and accounting procedures to ensure that drawdowns can be traced to source documentation as required by HUD regulations; (2) develop procedures to ensure that drawdowns are made only on a reimbursement basis so that the specific costs paid are identified for each drawdown; (3) reimburse more than \$5,000 from non-Federal funds to the Recovery Act Capital Fund program; (4) reimburse more than \$13,000 to the dwelling structure line item from the administrative costs line item and correct the financial records in HUD's Line of Credit Control System to ensure that the proper categories were charged; and (5) develop procedures to improve the accounting system and internal controls to ensure that funds are drawn down and used as budgeted and financial reports are accurate, current, and complete.

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

### **Auditee's Response**

We discussed the results of our review during the audit and at an exit conference held on February 18, 2011. On February 18, 2011, Authority officials provided their written comments and generally disagreed with the draft report findings but their proposed corrective actions were responsive to the recommendations. The Authority official's comments and associated appendixes were already forwarded to HUD Public Housing staff. The complete text of Authority officials' response, along with our evaluation of that response, can be found in appendix B of this report. We did not incorporate the Authority officials' appendixes to the comments into the report due to their significant volume.

# TABLE OF CONTENTS

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Background and Objective	4
Results of Audit	
Finding 1: Weaknesses Existed in The Authority's Financial Management System	5
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Schedule of Questioned Costs	12
B. Auditee Comments and OIG's Evaluation	13

## BACKGROUND AND OBJECTIVE

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The Jersey City Housing Authority (Authority) is a nonprofit corporation organized under the laws of the State of New Jersey to provide housing for qualified individuals in accordance with U.S. Department of Housing and Urban Development (HUD) rules and regulations. The Authority is governed by a board of commissioners, which is essentially autonomous but is responsible to HUD and the State of New Jersey's Department of Community Affairs. The executive director is appointed by the board to manage the daily operations of the Authority.

The Authority is responsible for the development, maintenance, and management of public housing for low- and moderate-income families residing in Jersey City. Operating and modernization subsidies are provided to the Authority by HUD. The Authority received capital fund program formula grant subsidies from HUD of more than \$5 million annually from 2006 to 2009 and obtained a \$10 million loan under the Capital Fund Financing Program. We audited the Authority's administration of these capital fund programs and issued an audit report (Audit Report No. 2011-NY-1001) on October 19, 2010.

Based on the issues identified during the above prior audit, we decided to review the Authority's capital fund program funded under the American Recovery and Reinvestment Act of 2009 (Recovery Act). On February 17, 2009, President Obama signed the Recovery Act into the law. This legislation includes a \$4 billion appropriation of capital funds for public housing agencies to carry out capital and management activities as authorized under Section 9 of the United States Housing Act of 1937. The Recovery Act requires that \$3 billion of these funds be distributed as formula funds and the remaining \$1 billion through a competitive process. Housing agencies are required to obligate 100 percent of the grant within one year and expend 100 percent of the grant within 3 years from the date that funds are made available. On March 18, 2009, the Authority received a capital fund formula grant of more than \$7.87 million under the Recovery Act, all of which had been properly obligated before the March 17, 2010, deadline. As of December 31, 2009, the Authority had disbursed \$366,740 of the \$7.87 million grant. As of January 13, 2011, Authority officials disbursed approximately 82 percent of the total grant amount, which indicates that they have complied with the requirement to expended 60 percent of the grant funds by March 17, 2011.

The objective of this audit was to determine whether the Authority obligated and expended its Recovery Act Public Housing Capital funds in accordance with HUD regulations.

## RESULTS OF AUDIT

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### Finding 1: Weaknesses Existed in the Authority's Financial Management System

Authority officials generally complied with applicable HUD regulations while obligating and expending Recovery Act Capital Funds; however, weaknesses existed in the Authority's financial management system. Specifically, (1) it was difficult to trace the drawdowns of Recovery Act Capital funds to the source documentation, (2) Authority officials charged their Recovery Act Capital Fund program with more expenses than were incurred, and (3) costs were miscategorized. As a result, (1) HUD was precluded from effectively and efficiently monitoring and evaluating the Authority's administration of its Recovery Act Capital Fund program, (2) more than \$5,000 was overcharged to the Recovery Act Capital Fund program, (3) more than \$13,000 in administrative costs was inadequately reported to HUD as dwelling structure expenses, and (4) there was a potential risk that administrative costs could exceed the 10 percent limitation of the total grant. These deficiencies were due to the lack of adequate fiscal controls and accounting procedures in place and because Authority officials believed that their accounting system was adequate and complied with HUD regulations.

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#### **Drawdowns Not Easily Traceable to Source Documentation**

Contrary to the regulations at 24 CFR (Code of Federal Regulations) 85.20(a), it was difficult to trace drawdowns to source documentation based on the Authority's financial system. Instead of implementing a mechanism to associate the drawdowns with underlying expenses and supporting documents, Authority officials periodically compared the costs, which had been incurred and recorded in the general ledger, with the accumulated amount of Recovery Act Capital funds received through prior drawdowns and then drew down the difference from HUD's Line of Credit Control System (LOCCS).<sup>2</sup> Therefore, to test the eligibility and reasonableness of one drawdown, all expenses recorded in the general ledger had to be reviewed up to the date of the subject drawdown, and then the source of all of the documentation associated with these transactions had to be verified. In 2009 Authority officials made seven drawdowns, we were able to test and review each of these drawdowns recorded in the general ledger, although all the seven drawdowns were not easily traceable to the source documentation. However, if the program had existed for a longer period and more drawdowns and financial transactions had been involved, it would have been difficult to trace the drawdowns to the general ledger and, ultimately, to the source documents.

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<sup>2</sup> The Line of Credit Control System (LOCCS) is a HUD grant disbursement system that provides disbursement controls for over 100 HUD grant programs. Each year over \$20 billion is disbursed to thousands of HUD business partners through LOCCS.

This weakness existed because Authority officials did not have adequate fiscal controls and accounting procedures in place to ensure that funds could be sufficiently traced to expenditures. As result, HUD was precluded from efficiently and effectively monitoring and evaluating the Authority's administration of its Recovery Act Capital Fund program.

### **Overcharge to the Recovery Act Capital Fund Program**

Authority officials charged their Recovery Act Capital Fund program with more expenses than were incurred. Following asset management accounting rules, Authority officials drew down funds from their recovery grant for work conducted by employees on projects funded by this program based on the hourly rates approved by HUD, which included the employee fringe benefit expenses. However, Authority officials mistakenly made a duplicate charge of \$4,674 to the Recovery Act Capital Fund program related to employee benefit costs for April 2009, which had already been included in the hourly labor rates that had been billed to the program for these employees.

In addition, Authority officials mistakenly overcharged \$381 to the Recovery Act Capital Fund program, which was more than the actual costs incurred by two electricians who worked on recovery grant-funded projects.

Both deficiencies were due to human error and although the total monetary amount was not material compared to the total Recovery Act capital funds received by the Authority; Authority officials made corrective adjustments after we notified them of the deficiencies.

### **Expenses Miscategorized**

Regulations at 24 CFR 85.20(b)(1) and (2) provide that housing authorities must provide accurate, current, and complete disclosure of financial results of financially assisted activities and must maintain records that adequately identify the source and application of funds provided for the activities. However, Authority officials inappropriately categorized the expenses when reporting to HUD. For example, \$80,164 was drawn down from the Authority's Recovery Act Capital funds as reimbursement for dwelling structure expenses; however, \$13,519 of this amount was used for administrative costs, and information recorded in LOCCS did not reflect the actual use of these funds. Authority officials said that it was their common practice to draw down funds from one budget category, but use the funds for other purposes. Therefore, \$13,519 in administrative expenses was inadequately reported to HUD as dwelling structure costs. As a result, there was a risk that administrative costs could exceed the 10 percent administrative cost limitation as imposed by the regulations at 24 CFR

968.112(n)(2)(ii), as HUD was not aware of this issue due to Authority officials' improper recording and reporting in LOCCS.

We attribute this deficiency to the lack of proper accounting controls to ensure that accounting records were accurate and properly supported, and to Authority officials' belief that their accounting system was adequate and complied with HUD regulations

## Conclusion

Authority officials generally complied with HUD regulations while obligating and expending their Recovery Act Capital funds; however, weaknesses existed in the Authority's financial management system. Specifically, (1) it was difficult to trace the drawdowns of Recovery Act Capital funds to the source documentation, (2) Authority officials charged their Recovery Act Capital Fund program with more expenses than were incurred, and (3) costs were miscategorized. Consequently, (1) HUD was precluded from effectively and efficiently monitoring and evaluating the Authority's administration of its Recovery Act Capital Funds, (2) more than \$5,000 was overcharged to the Recovery Act Capital Fund program, (3) more than \$13,000 in administrative costs was inadequately reported to HUD as dwelling structure expenses, and (4) there was a risk that administrative costs could exceed the 10 percent limitation of the total grant amount. These deficiencies were due to the lack of adequate fiscal controls and accounting procedures in place, and because Authority officials believed that their accounting system was adequate and complied with HUD regulations.

## Recommendations

We recommend that the Director of the New Jersey Office of Public Housing instruct Authority officials to

- 1A. Improve their financial controls and accounting procedures to ensure that drawdowns can be traced to source documentation as required by HUD regulations.
- 1B. Develop procedures to ensure that drawdowns are made only on a reimbursement basis so that the specific costs paid are identified for each drawdown.
- 1C. Reimburse \$5,055 from non-Federal funds to the Recovery Act Capital Fund program.
- 1D. Reimburse \$13,519 to the dwelling structure line item from the administrative costs line item and correct the financial records in LOCCS accordingly to ensure that the proper categories were charged.

- 1E. Develop procedures to improve the accounting system and internal controls to ensure that funds will be drawn down and used as budgeted, and financial reports are accurate, current, and complete.

## SCOPE AND METHODOLOGY

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Our review focused on whether the Authority obligated and expended Recovery Act Capital Fund program funds in accordance with HUD requirements. To accomplish our objective, we

- Reviewed relevant HUD regulations, program requirements, and applicable laws.
- Obtained an understanding of the Authority's management controls and procedures.
- Interviewed appropriate personnel of HUD and the Authority.
- Reviewed reports from HUD systems, such as LOCCS.
- Reviewed HUD's monitoring report and independent accountant audit reports.
- Traced financial data reported to HUD to the general ledgers and supporting documentation.
- Tested 100 percent of the drawdowns disbursed in 2009, which amounted to \$366,740.

The audit covered the period March 18, 2009, the inception of the Recovery Act Capital Fund program, through December 31, 2009. We performed the audit fieldwork from January through October 2010 at the Authority's office located at 400 U.S. Highway #1, Jersey City, NJ. We also performed additional verification of documentation provided by Authority officials from October through December 2010 at HUD's Newark, New Jersey field office.

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 objectives. 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 objective:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A 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 the following item is a significant deficiency:

- Authority officials did not implement effective controls to safeguard assets and ensure that the financial information related to their Recovery Act Capital Fund activities were complete, accurate, and current (see finding).

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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<u>Recommendation number</u>	<u>Ineligible 1/</u>
1C	\$5,055
1D	<u>\$13,519</u>
Total	<u>\$18,574</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.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

Jersey City  
Housing Authority

#### Auditee Comments

400 U.S. Highway #1 (Marion Gardens) Jersey City, New Jersey 07306  
Tel 201.547.6600 TDD 201.547.8989 Web www.jcha.us

February 18, 2011

Edgar Moore, Regional Inspector General for Audit  
US Department of Housing and Urban Development  
Office of the Inspector General  
26 Federal Plaza, Room 3430  
New York, NY 10278 0068

Dear Mr. Moore:

We are writing to respond to those tentative findings and draft audit report with respect to the review of Jersey City Housing Authority's ("JCHA") ARRA Capital Fund Program. We are pleased about your determination that we generally complied with the regulations with respect to obligating and expending ARRA capital funds, but wanted to take the opportunity to respond to your comments concerning perceived weaknesses in our financial management system. We hope that you will consider these responses prior to issuing your audit report (the Report"), and we also request the opportunity to review your draft Report prior to your issuance of the final report.

As you know, JCHA takes its reputation in our immediate community with lenders, with funders, with HUD and with the Inspector General very seriously and any questions that are raised with respect to our financial management systems risk harming this reputation. While your draft Report was generally positive, we do believe that it is crucial to resolve any open items with the body of the final Report. We appreciate the opportunity to have this dialogue, as we do believe that your feedback serves to strengthen our financial management systems, as reflected in our comments below and the improvements put into place based, in part, on your feedback. We also believe however, and we hope that you concur, that the items identified are relatively minor in scope and suggest generally effective financial management systems. We hope that our responses below and our attached documentation resolve all open items to your satisfaction, and to the extent that any findings are associated with the final Report, we believe that this information resolves those items.

Responses follow each observation:

- A. Drawdowns Not Easily Traceable to Source Documentation

February 18, 2011  
Letter to Edgar Moore, Regional Inspector General For Audit  
US Department of Housing and Urban Development

Comment 1

As you suggest, 24 CFR 85.20(a)(2) requires that our records must permit the tracing of funds to expenditures adequate to ensure that funds have been used appropriately. Of course, there is no single way to accomplish this, and we believe that our records have been adequate to support such expenditures, but as discussed in the context of our response to HUD OIG Audit Report No. 2011-NY-1001, we are in the process of adding a section to the “contract register” that indicates the source of funds to make it easier to track obligations in one place. Again, we believe our existing system is workable, we agree that a one-stop document is preferable and easier to review.

Comment 1

Additionally, we have substantially increased the documentation related to each payment requisition in response to a recommendation from our auditor based on OMB guidance from March 31, 2010. Attached at Appendix A please find samples of documentation related to sample voucher entries, which we believe makes it far easier to verify the source of the documentation. We believe that you will concur that the documentation set forth at Appendix A, along with the modifications to the contract register that are currently being implemented adequately address any concerns raised with respect the tracing of drawdowns. We request that you review the current and proposed modifications to our system and either dismiss the finding entirely or recognize the modifications in your Report.

B. Over Charge to ARRA Fund

Comment 2

As you know, JCHA administered \$7.8 million in formula ARRA funds, including \$2.7 million of work carried out with force account. We understand that of the \$2.7 million, OIG determined that there was an overcharge of \$5,055, or .18%. We do not believe that this level of overcharge is indicative of a weakness in our financial management system, but we do strive for perfection and have identified and corrected the error in February 2010, as reflected at Appendix B. We believe that given the fact the error was diminimis and has since been corrected, any associated finding can be removed.

C. Expenses Were Miscategorized

Comment 3

The draft Report suggested that JCHA mischaracterized \$13,519 in administrative costs as dwelling structure expenses. JCHA routinely ensures that administrative expenses are within permitted caps and the \$13,519 was within the 10% cap on administrative expenses. In addition, JCHA ensures that when we issue our Annual Statement/Performance and Evaluation Report (Form HUD-50075.1), all Budget Line Items are correctly labeled to illustrate that we are within all caps and that funds have been utilized for their intended purposes. Nevertheless, we agree that there have been instances when funds have not been correctly spread in LOCCS but rather reconciled through the Performance and Evaluation Reports, and we are putting procedures into place to ensure that we work with the NJ HUD Field Office to ensure that those funds are correctly spread at the outset rather than through the annual reporting process. Attached please find at Appendix C the most recent Annual Statement to reflect the correct Budget Line Items of all funds expended. Given this explanation, we request that you remove this finding, and to the extent that any mention of this finding remains, we request that

February 18, 2011  
Letter to Edgar Moore, Regional Inspector General For Audit  
US Department of Housing and Urban Development

the reports reflects that: (i) all subsequent reporting has been done appropriately pursuant to the applicable Performance and Evaluation Reports; (ii) administrative expenses have been with the 10% cap; and (iii) procedures are being put into place to ensure that Budget Line Items are appropriately spread at the outset.

Comment 4

Thank you so much for your attention to this matter. Again, we would appreciate the opportunity to discuss any open items and to resolve these matters prior to the issuance of your Report. We would also appreciate the opportunity to review a draft Report, prior to the time that the final Report is issued. Thank you for your continued cooperation and support.

Very truly yours,

//SIGNED//  
Maria T Maio  
Executive Director

xc: JCHA Board of Commissioners  
E.DePaula, HUD New Jersey  
File

## OIG Evaluation of Auditee Comments

- Comment 1 Authority officials believed that their existing system was workable. In addition, Authority officials stated that they had substantially increased the documentation related to each payment requisition, and provided samples of documentation. We reviewed these samples and concluded that the new recording methodology can improve the Authority's financial controls and address concerns regarding the tracing of drawdowns to source documentation. Thus, since the Authority officials' actions are responsive to recommendations 1A and 1B, a final action will be recorded into HUD's audit resolution and corrective action tracking system for these recommendations after the report is issued.
- Comment 2 Authority officials believed that the \$5,055 overcharge was not material in relation to the total Recovery Act capital funds received by the Authority. Nevertheless, Authority officials corrected this error upon being notified by HUD OIG auditors in April 2010. However, the adjustment was inappropriately back dated to February 2010. This issue of back dating adjusting journal entries was previously reported along with other financial management deficiencies in our previous audit report (Audit Report No. 2011-NY-1001). However, since the actions taken by Authority officials' are responsive to recommendation 1C, a final action will be recorded into HUD's audit resolution and corrective action tracking system for this recommendation after the report is issued.
- Comment 3 Authority officials stated that they routinely ensure that administrative expenses are within permitted caps; nevertheless, they agreed that there had been instances when funds were not correctly spread in LOCCS. Authority officials indicated that they were putting procedures into place to ensure that funds are correctly spread at the outset rather than through the annual reporting process. As a result, Authority officials have prospectively agreed to modify their accounting procedures, but did not show that the questioned amount had been reclassified and reimbursed to the appropriate account. Thus, the documentation provided should be further verified by the HUD Public Housing staff as part of the audit resolution process to ensure that \$13,519 has been refunded to the appropriate account, and that the new procedures are in compliance with HUD regulations.
- Comment 4 Authority officials wanted another opportunity to review any adjustments to the draft report. However, since only minor changes were made to the draft report Authority officials will have a chance to respond further to the report during the audit resolution process with the HUD Public Housing field office.