



Issue Date November, 25, 2008
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Audit Report Number 2009-NY-1002
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TO: Mirza Negron Morales, Director, Office of Public Housing, 2APH

FROM: *Edgar Moore*  
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: The New York City Housing Authority, New York, New York, Had Administration Weaknesses in Its Capital Fund Program

## **HIGHLIGHTS**

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

We performed an audit of the New York City Housing Authority's (Authority) administration of its capital fund program as part of the Office of Inspector General's (OIG) strategic plan goals to improve the U.S. Department of Housing and Urban Development's (HUD) fiscal accountability. We selected the Authority based on the size of its capital fund program, more than \$2 billion authorized and more than \$1.3 billion expended in fiscal years 2001 through 2006, and our preliminary analyses of this activity in HUD's Line of Credit Control System. The objectives of the audit were limited to determining whether the Authority (1) obligated and disbursed capital funds in a timely manner as prescribed by regulations, (2) charged eligible contract costs to the capital fund program, and (3) complied with applicable procurement policies and federal regulations.

### **What We Found**

There were weaknesses in the Authority's controls over the obligation and disbursement of capital funds. Specifically, the Authority (1) lacked adequate documentation to support that all funds were obligated within

prescribed timeframes, (2) charged the capital fund for routine maintenance costs that should have been charged to its low-rent housing program, and (3) executed contracts with timeframes that exceeded those authorized by its procurement policy. These deficiencies occurred because the Authority did not have adequate procedures in place to (a) document that all capital grant funds were properly obligated within prescribed timeframes, (b) charge routine maintenance to the low-rent housing program, and (c) ensure that procurement terms complied with regulations. As a result, the Authority lacked support that \$82 million was properly obligated, improperly charged \$590,363 in routine maintenance expenses to the capital fund, and executed contracts for terms that exceeded program limitations.

### **What We Recommend**

We recommend that the Director of HUD's New York Office of Public Housing, instruct the Authority to (1) provide support that \$82 million, in capital funds were obligated within prescribed timeframes, (2) reimburse \$590,363 to the capital fund program for the routine maintenance costs charged, and (3) strengthen procurement controls to ensure compliance with its policy.

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 July 30, 2008. Authority officials were asked to provide written comments by August 14, 2008, which we received on August 7 and 12, 2008. Auditee officials generally disagreed with our finding. As a result of the auditee comments relating to the concept of fungibility, we sought legal guidance from HUD's Office of General Counsel on September 25, 2008. Based upon guidance received on October 14, 2008, we adjusted the draft finding as indicated in our evaluation of the auditee comments. The complete text of the Authority's response, along with our evaluation of that response can be found in appendix B of this report.

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## **BACKGROUND AND OBJECTIVES**

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The New York City Housing Authority (Authority) was established by the City of New York as a municipal housing authority in 1934 and is a public benefit corporation chartered under the New York State Public Housing Law. As such, it possesses all powers, rights, and duties set forth in Article Five of the State Housing Law. The general organization and operation of the Authority is governed by Chapter 44-A of the Consolidated Laws of New York State. The membership of the Authority consists of three full-time members appointed by the mayor of the City of New York. One member is designated as the chair and serves at the discretion of the mayor, and the other members serve for a five-year term. The current general manager of the Authority is Mr. Douglas Apple.

The Authority provides affordable housing to more than 405,000 low-and-moderate income New York City residents in 344 housing developments that contain approximately 159,000 federally funded and 20,000 New York State and City funded apartments. In addition, the Authority assists approximately 87,000 families through the Section 8 Housing Choice Voucher program and oversees more than 400 community facilities.

The Authority receives financial assistance from the U.S. Department of Housing and Urban Development (HUD), the State of New York, and the City of New York. HUD provides assistance through annual operating subsidies to provide maintenance and administrative services to federally aided low-rent public housing developments, Section 8 housing choice voucher assistance to reimburse landlords who provide low-income families housing at reduced rents, debt service contributions to pay down principal and interest on maturing debt, and capital funds to assist modernization and development activities. For the period ending December 31, 2006, HUD provided about \$2 billion in total assistance.

HUD distributes capital funds through annual grants to public housing authorities on a formula basis. These grants can be used for development, financing, modernization, and management improvements. The Authority was authorized a total of \$2.28 billion in capital fund grants for the years 2001 through 2006.

The objectives of the audit were limited to determining whether the Authority (1) obligated and disbursed capital funds in a timely manner as prescribed by regulations, (2) charged eligible contract costs to the capital fund program, and (3) complied with applicable procurement policies and federal regulations.

## RESULTS OF AUDIT

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### Finding 1: The Authority Had Administrative Weaknesses in Its Controls over Capital Funds

There were weaknesses in the Authority's controls over the obligation and disbursement of capital funds. Specifically, the Authority (1) lacked adequate documentation to support that funds were obligated within prescribed timeframes, (2) charged the capital fund program for routine maintenance costs that should have been charged to its low-rent housing program, and (3) executed contracts with timeframes that exceeded those authorized by its procurement policy. These deficiencies occurred because the Authority did not have adequate procedures in place to (a) document that capital grant funds were obligated within prescribed timeframes, (b) charge routine maintenance expenses to the low-rent housing program, and (c) ensure that procurement terms complied with regulations. As a result, the Authority lacked support that \$82 million was properly obligated, improperly charged \$590,363 in routine maintenance expenses to the capital fund program, and executed contracts with terms that exceeded procurement limitations.

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#### **Inadequate Documentation to Support Obligation of Funds within Prescribed Timeframes**

The Authority lacked adequate documentation to support that 2002, 2004, and 2005 capital grant funds were properly obligated within prescribed timeframes. Regulations at 24 CFR (*Code of Federal Regulations*) 905.120(a)(i) require that capital funds be obligated no later than two years after the funds were made available to the housing authority. In addition, 24 CFR (*Code of Federal Regulations*) 968.305 allows capital fund program grant recipients to exercise the concept of fungibility when obligating its funds. The regulation defines fungibility as a concept which permits a PHA to substitute any work item from the latest approved five-year action plan to any previously approved budget and to move work items among approved budgets without prior HUD approval.

While the Authority provided contracts for which it reported obligating capital funds, contracts in the amount of \$82 million<sup>1</sup> did not have an award date, thus preventing determining when the applicable funds were obligated. In addition, contracts in the amount of \$247.8 million were awarded prior to the availability of the funds without assurance that these contracts were not previously used to obligate prior years' grants.

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<sup>1</sup> \$2.5 million related to the 2002 capital grant, \$58.2 million related to the 2004 capital grant, and \$21.3 million related to the 2005 capital grant

### **Regulations permit movement of contracts among grant years**

While Public and Indian Housing Notice 2000-22 cautions that fungibility can only be exercised between work items that are included in an authority's latest approved Annual or 5-Year Action Plan, we found little definitive guidance on the implementation of the concept of fungibility, especially with regard to using a contract to obligate funds that were not yet available at the time the contract was executed. The Authority maintained that there was no criteria or HUD guidance on the concept of fungibility that prohibit the use of previously executed contracts to obligate subsequent years' funds. As a result, we requested guidance from the HUD general counsel office as to what is permitted under fungibility as defined in HUD's existing regulations and programmatic guidance, and whether 24 CFR (*Code of Federal Regulations*) 905.120 permits grantees to obligate grant funds with contracts awarded prior to the availability of funds.

HUD's general counsel guidance opined that "fungibility permits a public housing agency to substitute a work item from the most recent approved 5-Year Plan to any previously approved budget or annual plan". Accordingly, HUD's general counsel concluded that "a prior year's contract could support a later year's obligation and meet the requirements of section 9(j) of the United States Housing Act of 1937 as implemented by 24 CFR (*Code of Federal Regulations*) 905.120.

However, HUD's general counsel further opined that, while the Authority could move a work/contract item into another year of the 5-Year Plan or another 5-Year Plan and use the contract and work to satisfy its obligation requirements, records must (1) support that when the contract was entered into there were available capital funds to carry out the contract work and (2) show how each year of capital fund grants met the two year obligation and four year expenditure requirement.

### **Obligations supported by contracts with no award date**

Initially, the Authority did not provide a consolidated contract list to support the obligation of approximately \$100.8 million in 2002 capital grant funds. Therefore, we contacted various departments reported to obligate capital funds and identified contracts to support obligation of \$79.7 million. After we expressed concern to Authority officials that \$21.1 million of obligations were unsupported, Authority officials did provide a

consolidated list of contracts that were obligated against the 2002 capital grant. However, contracts for \$2.5 million lacked an award date.

Similarly, Authority officials were unable to initially provide a consolidated list of contracts to support the required obligation of \$210 million and \$206 million for the 2004 and 2005 capital grants, respectively. In response to our requests, the officials provided multiple revised lists of contracts purported to support the obligation of \$237.7 million of the 2004 capital grant and \$358.8 million of the 2005 capital grant, which exceeds the grant amounts and amounts required to be obligated<sup>2</sup>. However, some of the contract amounts did not provide specific award dates. The lack of an award date prevented a determination as to whether the funds were obligated in a timely manner. As shown in the table below, obligations of \$58.2 million and \$21.3 million of 2004 and 2005 capital grant funds, respectively, were not adequately supported because the contracts did not have an award date with which to determine whether they represented an obligation of funds in a timely manner.

Table 1: Schedule of Contracts without an Award Date

<b>Description</b>	<b>2004 Grant</b>	<b>2005 Grant</b>
Contract amounts provided to support obligations	\$ 237,782,112	\$ 358,821,098
Less: Contract amounts without an award date	( 85,482,656 )	( 173,716,195 )
Contract amounts with a contract award date	\$ 152,299,456	\$ 185,104,903
Amount required to be obligated	\$ 210,491,946	\$ 206,452,759
Less: Obligations supported	( 152,299,456)	( 185,104,903)
Obligations not supported	\$ 58,192,490	\$ 21,347,856

**Obligations supported by contracts with award dates prior to the availability of funds**

Contracts were provided with award dates prior to the date that the capital grant funds were available for obligation. For instance, while the 2004 capital grant was made available for obligation as of September 14, 2004, \$107 million in contracts with award dates prior to that were provided to support obligation of that year's grant. Similarly, while the 2005 capital

<sup>2</sup> 24 CFR 905.120(b)(3) requires that 90 percent of a capital grant funds be obligated within two years of the funds' availability. Thus, the Authority was required to obligate \$210,491,946 (90 percent of \$233,879,941) for 2004 and \$206,452,759 (90 percent of \$229,391,955) for 2005.



grant was made available for obligation as of August 18, 2005, contracts totaling \$140.8 million were awarded prior to that date. Further, contracts of \$1.3 million and \$1 million that were awarded prior to 1999 and 2000 were used to support the obligation of 2004 and 2005 capital grants, respectively, which is more than five years prior to the funds being made available.

While we recognize that the concept of fungibility allows a housing authority to substitute fund obligations and disbursements among grant years, implementation of this concept raises issues of timeliness and adequate documentation for the substitution of obligations. As noted by the HUD general counsel, without the records to show how each year of capital fund grants met the two year obligation and four year expenditure requirement, there is a question as to whether these contracts were previously used to obligate funds from earlier grant years. Consequently, regardless of what parameters within which fungibility permits a housing authority to substitute fund obligations and disbursements among grant years, there needs to be adequate documentation to ensure that contracts awarded prior to the availability of funds were not previously used to obligate earlier years' grant funds.

### **Ineligible Costs Charged to Capital Funds**

Regulations at 24 CFR (*Code of Federal Regulations*) 968.112(g)(2)(v) requires that a preventive maintenance system should provide for regular inspections of building structures, systems, and units and distinguish between work eligible to be paid from for low-rent housing funds for routine maintenance and from capital grant funds for non-routine maintenance. A three-year elevator service contract that was allocated to the capital fund program consisted of \$590,363 in costs that Authority officials stated included making service calls repairing, replacing, and lubricating parts, and other preventive maintenance to maintain elevators in a safe operating condition. The New York City Office of Public Housing advised that these were routine maintenance items that should be charged to the low-rent program and not part of a preventive maintenance system under the capital fund program. Consequently, we regard the \$590,363 as an inappropriate charge to the capital fund program.

### **Contract Terms in Excess of Prescribed Timeframes**

Seven of fourteen contracts we reviewed were executed with terms that exceeded the timeframe allowed by the Authority's procurement policy.



The Authority's Contract Procurement Resolution, section 116, entitled "Professional Service Contracts," prohibits the Authority from executing contracts for personal, management, legal, or other professional services with an initial term in excess of two years without HUD's prior written consent.

The Authority executed a \$16.7 million architect and engineering consultant contract for a five-year term; four separate construction management service contracts, each valued at \$89 million, for three year terms; a service contract for survey, inspection, testing, repair and alterations to fire alarm systems valued at \$819,353 with a term of three years, and a \$6.6 million elevator service contract for a term of 2.4 years. While the Authority may have realized cost efficiencies through these extended terms, there was no evidence of HUD approval as required or a rationale as to why the contracts exceeded the maximum contract term allowed.

## Conclusion

The Authority lacked adequate controls over its capital fund program activities to adequately support that obligations were made in a timely manner, costs charged to the capital fund program were eligible, and contract durations complied with the Authority's own procurement policy. We attribute these deficiencies to weaknesses in the Authority's controls over capital fund program administration.

## Recommendations

We recommend that the Director of HUD's New York City Office of Public Housing instruct the Authority to

- 1A. Provide documentation to support that \$82 million of contracts were properly executed to support the obligation of applicable capital grant year funds (\$2.5 million from the 2002 capital grant, \$58.2 million from the 2004 capital grant, and \$21.3 million from the 2005 capital grant). If documentation cannot be provided, take appropriate action in accordance with 24 CFR (*Code of Federal Regulations*) 905.120.
- 1B. Provide documentation to provide assurance that obligations of \$107 million and \$140.8 million from the 2004 and 2005 capital grants, respectively were not previously used to obligate funds from earlier grant years.

- 1C. Strengthen controls over procurement obligation and disbursement documentation to ensure that records can readily show how each year of capital fund grants meets the two year obligation and four year expenditure requirements as stipulated by 24 CFR (*Code of Federal Regulations*) 905.120.
- 1D. Reimburse the capital fund program from low-rent housing program funds for the \$590,363 in routine maintenance costs charged to the capital fund program.
- 1E. Review other elevator maintenance contracts to identify any additional routine costs that are being charged to the capital fund program and ensure that these are appropriately charged to the low-rent program, thus ensuring that the funds are put to better use.
- 1F. Strengthen controls to ensure that routine elevator maintenance costs are not charged to the capital fund program, and that contract terms comply with its procurement policy.

## SCOPE AND METHODOLOGY

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To accomplish our objectives, we

- Reviewed applicable laws, regulations, and HUD program requirements at 24 CFR (*Code of Federal Regulations*) Parts 85, 905 and 968.
- Analyzed the Authority's obligation and disbursement of capital funds in HUD's Line of Credit Control System.
- Reconciled the Authority's financial data schedules to the amounts reported in HUD's Line of Credit Control System.
- Reviewed HUD's administrative files and monitoring reports for the Authority's capital fund program. Conducted interviews with the Authority's audit, budget, capital projects, information technology, and finance staff to gain an understanding of the internal controls related to the administration of the capital fund program.
- Reviewed program policies and procedures, its five-year and annual plan, the annual audited financial statements, board of commissioner minutes, budgets, general ledgers, contract registers, and Line of Credit Control System drawdown vouchers related to the capital fund program.
- Selected a nonrepresentative sample of 14 procurements and reviewed the process to ensure compliance with procurement and contract award regulations and procedures. These 14 contracts represented \$408 million of more than \$1.3 billion expended in fiscal years 2001 through 2006.
- Conducted interviews and inquiries with HUD's Office of Public and Indian Housing New York City field office, headquarters capital fund program and, Real Estate Assessment Center staff, to obtain an understanding of the Authority's capital grant program. In addition, we discussed the concept of fungibility with, and obtained a legal opinion on its implementation from, HUD's Office of General Counsel.

We performed our fieldwork between August 2007 and May 2008 at the Authority's offices located at 250 Broadway and 90 Church Street, New York, New York. Our audit generally covered the period January 1, 2003, through December 31, 2005, and was expanded as necessary.

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

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved.

- Effectiveness and efficiency of operations,
- Reliability of financial reporting,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and segregation of duties.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

Based on our audit, we believe the following items are significant weaknesses:

- The Authority did not ensure compliance with laws and regulations when it did not maintain adequate documentation to support that capital funds were obligated and disbursed in accordance with regulations, and contracts were executed with timeframes in excess of that authorized by its procurement policy.

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible <sup>1/</sup>	Unsupported <sup>2/</sup>
1A		<u>3/</u>
1D	\$590,363	
Total	<u>\$590,363</u>	

- <sup>1/</sup> 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.
- <sup>2/</sup> 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 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.
- <sup>3/</sup> To be reasonably precise about the amount involved with the \$82 million in questioned costs associated with recommendation 1A that is applicable to obligations without contract dates, we will defer specifying an amount until HUD has had an opportunity to review any documentation provided by the Authority as part of the audit resolution process.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments



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August 12, 2008

Mr. Edgar Moore  
Regional Deputy Inspector General for Audit  
Office of the Inspector General  
United States Department of Housing & Urban Development  
Jacob K. Javits Federal Building  
26 Federal Plaza  
New York, NY 10278

RE: The New York City Housing Authority Capital Fund Program Audit Report

Dear Mr. Moore:

We are in receipt of the United States Department of Housing & Urban Development Office of the Inspector General, New York Office ("HUD OIG") draft Audit Report received via e-mail on August 1, 2008 (the "Report") on the capital fund program administered by the New York City Housing Authority ("NYCHA" or "Authority"), for which the New York Regional Office of HUD has oversight responsibilities for monitoring NYCHA's receipt of HUD funds. We appreciate the efforts of you and your staff and their professionalism in conducting this review and the findings presented in the Report. We would also like to take this opportunity to comment on the findings contained therein.

In your letter of August 17, 2007, the objectives of the review were to determine whether (1) funds obligated and received under the Capital Funds Program were used in accordance with HUD requirements; (2) disbursements of program funds were for items that are reasonable, eligible, and adequately supported; and (3) procurement activities complied with HUD's regulations. The letter also identified the "survey" period as January 1, 2003 through December 31, 2004. At the entrance conference, held on August 28, 2007, the engagement team indicated that as the review progresses, the engagement team may request additional documentation to substantiate their findings, and may include an expansion of the engagement scope previously identified, if necessary.

The Report found that NYCHA (1) lacked adequate support that all funds were obligated within prescribed timeframes; (2) charged the capital fund for routine maintenance costs that should have been charged to its low-rent housing program; and (3) executed contracts with timeframes that exceeded those authorized by its procurement policy. The following sections respond to the findings and recommendations included in the Report.



## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

### Comment 1

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Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
August 12, 2008  
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#### Lack of Documentation Supporting Timely Obligation of Funds

##### *Observation 1:*

The Report states that NYCHA lacked adequate documentation to support that \$115.8 million of 2002 through 2005 capital grant funds were obligated within prescribed timeframes and that NYCHA initially was not able to provide consolidated lists of contracts for the grant years 2002, 2004 and 2005.

##### *HUD OIG Recommendation:*

NYCHA to provide support that \$115.8 million in capital funds were obligated within prescribed timeframes.

##### *NYCHA Response:*

On or about March 25, 2008, toward the conclusion of the audit, the engagement team requested that supporting documentation for capital fund years 2004 and 2005 be provided by April 11, 2008. Due to the short timeframe NYCHA's Finance staff was not able to provide all the documentation requested. However, NYCHA staff from both the Information Technology Department and the Capital Projects Division did provide documentation directly to the engagement team during the course of the audit. The full breadth of the documentation received by the engagement team is not reflected in the Report. Consequently, it is difficult to determine with any certainty whether or not the documentation received from other NYCHA program departments was evaluated for its adequacy, appropriateness and completeness before the engagement team's assessment that NYCHA lacked adequate documentation to support the obligation of \$115.8 million of 2002, 2004 and 2005 capital funds grants.

NYCHA's cited inability to provide a consolidated list of contracts was also due in part to the manner in which the information was communicated which led to misunderstandings among the participants in the audit. Relying on your initial letter dated August 17, 2007 NYCHA provided the engagement team with all of the originally requested data, including copies of all General Ledgers for capital fund program years 2000 through 2005. Subsequent to providing the HUD OIG engagement team with all of the items requested, the team asked for purchasing data on a calendar year basis even though NYCHA tracks grant funded purchases on a grant program basis. The audit's changing scope and methodology complicated the submission of appropriate, sufficient, and timely documentation to the engagement team and caused extensive delays in the HUD OIG review process.

NYCHA will be pleased to provide documentation for the remaining \$115.8 million of obligations given a reasonable timeframe.

##### *Observation 2:*

Some of the contracts were awarded prior to 2002, with some as early as 1994. Public and Indian Housing Notice 2000-22 cautions that fungibility can only be exercised between work items that are included in an authority's Annual or Five-Year Action Plan. Further, the HUD, Office of Public Housing, New York Regional Office advised that this concept would only permit a contract that was executed, at most, two years before the obligation start date of a particular capital grant fund.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

#### Comment 2

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*NYCHA Response:*

As set forth in NYCHA's letter of August 7, 2008 (copy attached), NYCHA exercises fungibility within established HUD guidelines and in accordance with 24 CFR 968.305. All Annual and Five-Year Action Plans are reviewed by the HUD New York City Regional Office, and all Capital Fund Program Annual and Five-Year Action Plans for the period under review (i.e. 2001 through 2006) have been approved by the New York Regional Office, which is responsible for oversight of NYCHA's operations and funding. Although the New York Regional Office purported to advise that "this concept would only permit using a contract that was executed, at most, two years before the obligation start date of a particular capital fund grant", this was never communicated to NYCHA and is not consistent with the governing regulations set forth in 24 CFR 968.305.

**Ineligible Costs Charged to Capital Funds**

*Observation:*

"A three year elevator service contract that was allocated to the capital fund program consisted of \$590,363 in costs that Authority officials stated included making service calls, repairing, replacing, and lubricating parts, and other preventative maintenance to maintain elevators in a safe operating condition. The New York City Office of Public Housing advised that these were routine maintenance items that should be charged to the low-rent program and not part of preventative maintenance under the capital fund program. Consequently, we regard the \$590,363 as an inappropriate charge to the capital fund program."

*HUD OIG Recommendation:*

The Authority should reimburse the capital fund program from low-rent program funds for the \$590,363 routine maintenance costs charged to the capital fund program.

*NYCHA Response:*

Routine maintenance is performed by NYCHA in-house personnel and purchases for parts, supplies and equipment necessary to perform routine maintenance is paid for from the low-rent program.

#### Comment 3

The contract in question was an elevator rehabilitation capital project. The contract had a duration of approximately 3 years due to the number of elevators involved and the extensive rehabilitation that was necessary. The Scope of Work for an elevator rehabilitation contract, including the one in question, covers equipment modernization, service and maintenance. During the rehabilitation phase(s), continued safety and reliable elevator service is paramount to the residents NYCHA serves. Therefore, the responsibility of providing elevator service and maintenance is assigned to the contractor performing the rehabilitation work. These steps are taken to prevent NYCHA and/or contractor staff from having dual responsibility for elevator operations within a single development. Coordinating elevator responses when two parties have shared responsibilities is not a desired situation and could lead to potentially hazardous conditions.

While modernization work is underway, it is essential that additional maintenance be performed on the existing elevators (those not currently being modernized) because of the increased usage and demand made upon them.

Capital funds are utilized for this type of work since NYCHA incurs these additional costs as a result of the rehabilitation contract.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

**Comment 3**

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All maintenance costs associated with this rehabilitation project meet the eligibility requirements as promulgated in 24 CFR 968.112(g) (2) (v), which states "eligibility costs include the establishment of a preventative maintenance system or improvement of an existing system." NYCHA's elevator rehabilitation program meets this definition. Therefore, the \$590,363 in question is not routine maintenance, but is part of a larger capital modernization program. Consequently no reimbursement is due to the capital program.

**Contract Terms in Excess of Prescribed Timeframes**

*Observation 1:*

Seven of fourteen contracts reviewed were executed with terms that exceeded the timeframe allowed by the NYCHA's procurement policy.

*NYCHA Response:*

NYCHA is in the process of updating its Contract Procedure Resolution ("CPR") to bring it into alignment with the current Annual Contribution Contract ("ACC"). Specifically, Section 116 of the CPR was passed on November 24, 1993 and reflected the terms of the ACC and applicable state and federal laws and regulations in effect at that time. Shortly thereafter the ACC was consolidated and amended so that HUD approval was no longer required for professional services contracts. When the ACC was consolidated and amended in 1994, NYCHA changed its practices and procedures, but did not amend its CPR to reflect this change in HUD requirements. A Resolution will be presented to the Board on August 20, 2008, to amend the CPR by deleting Section 116 to reflect current HUD requirements and current practices of NYCHA.

**Comment 4**

*Observation 2:*

The Authority executed a \$16.7 million architect and engineering consultant contract for a five year term; four separate construction management service contracts, each valued at \$89 million, for three year terms; a service contract for fire alarm systems valued at \$819,353 with a three year term and a \$6.6 million elevator service contract for a term of 2.4 years. No evidence of HUD approval as required or a rationale as to why the contracts exceeded the maximum contract term allowed.

*HUD OIG Recommendation:*

Strengthen controls to ensure that contract terms comply with its procurement policy.

**Comment 4**

*NYCHA Response:*

The terms of the contracts in question are in accordance with the ACC. As mentioned above, NYCHA is in the process of updating its CPR. Furthermore, the projects supported by these contracts were included in the NYCHA's Annual and Five-Year Action Plans which were approved by the HUD New York Regional Office.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

### Comment 5

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**Significant Weakness**

*HUD OIG Finding:*

The Authority did not ensure compliance with laws and regulation when it did not maintain adequate documentation to support that capital funds were obligated and disbursed in accordance with regulations.

*NYCHA Response:*

NYCHA has sufficient and appropriate procedures to ensure that adequate documentation is maintained to demonstrate that capital funds are obligated and disbursed in accordance with 24 CFR 905.120(a).

In 2002/2003 NYCHA implemented a state of the art enterprise-wide resource planning software solution ("Oracle") to improve controls and facilitate financial planning. In conjunction with the Oracle implementation, in September 2003 the Authority formed a Contract Registration Unit within the Accounting & Fiscal Services Department to administer a new contract registration process. The contract registration process requires that contracts be registered in the Oracle financial system prior to final execution. This means that work to be performed under the contract cannot commence until registration is completed. This control process ensures that sufficient funding exists to support the obligation associated with the contract, provides a central repository for contract documentation necessary to maintain an audit trail supporting the general ledger, and ensures the accuracy of accounting information posted in the Oracle financial system.

A hallmark feature of effective internal control is the segregation of duties. NYCHA's process in obligating a contract involves many departments and several levels of review. In fact, the obligation process begins with the Operations Department and Capital Projects Division working together to identify capital projects to be performed, and involves the Budget Department identifying appropriate sources of funding. All contracts in excess of certain dollar value thresholds prescribed in the CPR receive Board Approval prior to execution. The obligation process culminates in the registration of contracts over \$50,000 in the Oracle financial system by the Contract Registration Unit.

With regard to maintaining adequate supporting documentation, NYCHA has a formal document retention policy and maintains a central repository for all contracts. This is in addition to the copies of contracts kept in administrative department files, which the engagement team identified.

NYCHA's system of internal control is strong and is characterized by the implementation of preventative, detective and correcting measures to mitigate its exposure to financial and regulatory risks. NYCHA is committed to a process of continuous improvement with respect to its control environment and will likely identify and implement additional measures in the future. Based on the above, we request that the HUD OIG consider the retraction of the Significant Weaknesses finding.

In conclusion, we appreciated the time and effort of your staff in reviewing NYCHA's capital program. The review was beneficial to NYCHA in identifying a third party's perception of the administration of our programs and adherence to authoritative regulations.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

Mr. Edgar Moore  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
August 12, 2008  
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Thank you for your consideration in this matter. Should you wish to discuss any aspect of this letter, please do not hesitate to contact me.

Very truly yours,  
  
Doug Apple  
General Manager


Attachment

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

 <p>NEW YORK CITY HOUSING AUTHORITY</p>	<p>NEW YORK CITY HOUSING AUTHORITY 250 BROADWAY • NEW YORK, NY 10007 TEL: 212-306-3000 • <a href="http://nyc.gov/nycha">http://nyc.gov/nycha</a></p>
<p>TINO HERNANDEZ CHAIRMAN EARL ANDREWS, JR. VICE-CHAIRMAN MARGARITA LÓPEZ MEMBER VILMA HUERTAS SECRETARY DOUGLAS APPLE GENERAL MANAGER</p>	<p>August 7, 2008</p>
<p>Edgar Moore, Regional Inspector General for Audit U.S. Department of Housing and Urban Development 26 Federal Plaza, Room 3430 New York, NY 10278</p>	
<p>Re: Comments to Revised Draft Audit Report E-mailed to NYCHA on August 1, 2008</p>	
<p>Dear Mr. Moore:</p>	
<p>NYCHA appreciates your office's continued willingness to review the draft audit report concerning NYCHA's administration of its capital fund program. The additions and modifications incorporated into the current draft report reflect the professionalism of all involved.</p>	
<p>Consistent with this theme, there are two important matters of mutual concern that we must reconcile prior to the issuance of the report, namely, the inclusion of specific findings and conclusions that conflict with both legal and auditing principles and standards.</p>	
<p><b>Comment 6</b></p>	<p>First, NYCHA has consistently followed the practices of obligating and expending funds in the manner prescribed in 24 C.F.R. § 968.305 which provides that "[f]ungibility is a concept which permits a PHA to substitute any work item from the latest approved Five-Year Action Plan to any previously approved CIAP budget or CGP Annual Statement and to move work items among approved budgets without prior HUD approval." As the recent modification to the draft report correctly notes, the guidance set forth in PIH Notice 2000-22, reiterates that fungibility can be exercised among work items that are included in an Authority's Annual or Five-Year Action Plan.</p>
<p>Historically, these legally sanctioned substitutions among the Annual Plans and Five-Year Plans under the fungibility concept have been the consistent and approved practice between NYCHA and the New York HUD Regional Office, which is responsible for oversight of NYCHA's operations and funding. As the regulations make clear, identified fungible work items can be legally substituted for each other within a five year time period framework.</p>	
<p>Consequently, this longstanding practice of fungibility substitution by NYCHA coupled with approval by</p>	

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

Comment 6

Edgar Moore, Regional Inspector General  
U.S. Department of Housing and Urban Development  
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HUD's New York Regional Office as the oversight body, constitutes, without exception, a textbook example of consistency which is one of the fundamental principles of Generally Accepted Accounting Principles (GAAP).

However, according to the draft audit report, unidentified staff members in the New York HUD Regional Office advised you that the fungibility concept permits the substitution of a contract that was executed, at most, two years before the obligation start date of a particular capital fund grant. The draft audit report makes no reference to any written instructions, notices or written examples of disapproval or other material supplied to the auditors for review in support the New York HUD Regional Office concept of fungibility.

This "testimonial evidence" and/or "oral explanation" is contrary to both the regulations and the consistent, legal practice of NYCHA in obligating and expending its capital funds with the New York HUD Regional Office's continual approval.

According to the draft report, these discussions, which constitute at best "testimonial evidence" and "oral explanations" are the sole basis upon which the determination of findings and conclusions that NYCHA provided approximately \$33.7 million of unsupported costs "that is applicable to obligations for which the contract dates were prior to the allowable obligation period."

Comment 7

Reliance on such unsubstantiated "oral testimony" is an unsanctioned departure from auditing standards. While Generally Accepted Government Auditing Standards (GAGAS) 7.61 and Statement of Auditing Standards (SAS) 103 respectively provide that testimonial evidence and oral explanations "... *may* be useful in interpreting or corroborating documentary or physical information," these pronouncements emphatically state that "auditors should evaluate the objectivity, credibility, and reliability of the testimonial evidence." The exclusive use of testimonial evidence and oral explanations without adequate and sufficient alternative physical and documentary evidence **can not be a reasonable basis** for an audit exception (finding). Consequently, the \$33.7 million cited in the audit report as an audit exception may not be properly justified as an audit exception under GAGAS 7.61 and SAS 103.

Comment 6

The Authority's consistent actions in obligating and expending the funds in its capital program have been, and continue to be, compliant with all applicable statutes and regulations and written official notices, and remains consistent with its past practices. The Authority therefore requests that this exception that NYCHA is non compliant with the HUD New York Regional Office's unsubstantiated two year limitation on fungibility be removed because that limitation is contrary both to HUD regulations and to prior consistent practices of that office.

Comment 8

The second important matter concerns the Scope and Methodology section of the report. The fourth bullet in this section states that the HUD audit team "conducted interviews with the Authority's audit, budget, and finance staff to gain an understanding of the internal controls related to the administration of the capital fund program." This is factually incorrect. The audit team spent considerable time interviewing staff and reviewing records of both the Capital Projects Division and Information Technology Department. The Capital Projects Division and the Information Technology Department play important roles in the control environment of NYCHA. The Capital Projects Division, for instance, is the organizational entity responsible for managing and administrating most projects funded by the Capital Fund Program as well as authorizing vendor payments associated with capital projects. The exclusion of both the Capital Projects



## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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Division and Information Technology Department from the scope and methodology of the audit suggests that the audit team encountered a scope limitation, when, in fact, the audit team actively engaged both of these organizational units in the execution of audit procedures. As such, the Authority requests that the scope section of the draft report be corrected to include both the Capital Projects Division and the Information Technology Department.

Please note that by close of business Tuesday August 12, 2008, we will provide your office with additional information on other issues in the audit report.

Thank you for your consideration of these important issues.

Sincerely,



Doug Apple  
General Manager

## OIG Evaluation of Auditee Comments

**Comment 1** Auditee officials maintain that they were not provided sufficient time to provide supporting documentation that funds were obligated in a timely manner, the audit's changing scope and methodology complicated the submission of documentation, and the full breadth of the documentation received is not reflected in the report. An objective of the audit was to determine whether capital grant funds were obligated within timeframes prescribed by regulation, and documentation to support obligations was requested of the auditee beginning in November 2007 through the internal audit department in accordance with the protocol established by the auditee.

The lack of adequate documentation was discussed during the course of the audit, and was raised as a potential reportable issue at a pre-exit conference on January 28, 2008. The issue was discussed again at subsequent conferences requested by the auditee on March 18, 2008 and March 25, 2008. Subsequent to the latter conference, and in response to a series of revised lists of contracts provided by the auditee, we established a cutoff to accept additional documentation of April 11, 2008. Further, although the auditee had opportunity to continue to gather needed documentation, no additional documentation was provided at the exit conference held on July 30, 2008. Accordingly, the auditee will have the opportunity to provide additional supporting documentation to HUD during the audit resolution process; and as recommended if adequate documentation is not provided, HUD needs to take appropriate action in accordance with 24 CFR (*Code of Federal Regulations*) 905.120.

**Comment 2** The auditee maintains that it has implemented fungibility within established HUD guidelines and in accordance with 24 CFR (*Code of Federal Regulations*) 968.305, and that the HUD field office's interpretation of this regulation is not consistent with the regulation. Regulations at 24 CFR (*Code of Federal Regulations*) 968.305 define fungibility as a concept which permits a public housing authority to substitute any work item from the latest approved five-year action plan to any previously approved budget and to move work items among approved budgets without prior HUD approval. Finding that there was little written guidance on implementing this concept, we sought guidance from HUD field office officials as to how they administer this concept. As noted by the auditee, the assertion that fungibility would permit the use of contracts executed, at most, two years before the obligation start date of a grant represents an interpretation by the HUD field office. Consequently, we recognize that there is a need for HUD to more clearly define and promulgate guidance on the implementation of fungibility. As a result, we obtained guidance from HUD's Office of General Counsel, which provided that the auditee can substitute costs from the five year action plan

provided that evidence shows (1) that when the contract was entered into there were available capital funds to carry out the contract work and (2) how each year of capital fund grants met the two year obligation and four year expenditure requirement. As such, we have deleted reference to unsupported obligations based upon the two year parameter. However, we still conclude that the documentation provided by the auditee is not adequate to support a determination that obligations were made in a timely manner. First, contracts without execution dates in the amount of \$2.5 million, \$58.2 million and \$21.3 million were provided to support the obligation of 2002, 2004 and 2005 capital grant funds, respectively. Without an execution date, one cannot determine if these contracts did in fact represent obligation of funds in a timely manner. Additionally, auditee officials could not ensure that the contracts provided as support, which were executed prior to the date grant funds were made available, were not previously used to obligate prior years' grants. Consequently, we have adjusted the report to reflect these facts and we cite \$82 million as unsupported obligations associated with contracts without an execution date.

**Comment 3** The auditee cites 24 CFR (*Code of Federal Regulations*) 968.112(g)(2)(v), which states “eligible costs include the establishment of a preventative maintenance system or improvement of an existing system, and concludes that the elevator maintenance costs are not routine maintenance but are part of a larger capital modernization program. However, 24 CFR (*Code of Federal Regulations*) 968.112(g)(2)(v) also states that a preventive maintenance system must provide for regular inspections of building structures, systems and units and the auditee must distinguish between work eligible for operating funds (routine maintenance) and work eligible for modernization funding (non-routine maintenance). Therefore, the auditee needs to provide documentation to show that the elevator contract was part of a preventative maintenance system developed to provide regular inspections of its buildings systems and that the maintenance and service portion of the contract was not work eligible for operating funds (routine maintenance) but for work eligible for modernization funding (non-routine maintenance). Otherwise, as recommended, the low-rent housing program should reimburse the capital fund program.

**Comment 4** The auditee’s planned actions are responsive to our recommendations. Note, however, that HUD’s approval of the action plan in no way represents approval of contract terms.

**Comment 5** The auditee maintains that it has sufficient and appropriate procedures to ensure that adequate documentation is maintained to demonstrate that capital funds are obligated and disbursed in accordance with 24 CFR 905.120 (a), and hence, disagrees that it had significant weakness in compliance with laws and regulation. However, the auditee’s lack of

available documentation to support that obligations were made in a timely manner as stated in the finding represents a weakness in internal controls.

**Comment 6** Auditee officials state that they have consistently followed the practices of obligating and expensing funds over a five year period in a manner prescribed in 24 CFR (*Code of Federal Regulations*) 968.305 under the concept of fungibility substitution. They state that this longstanding practice of fungibility substitution was approved by the HUD New York Regional Office. Further, they state that the audit's sole reliance on testimonial evidence of a field office official using a two year period is contrary to regulations and makes no legal reference to written instructions.

We recognize that there is a need for HUD to more clearly define and promulgate guidance on the implementation of fungibility. As a result, we sought guidance from HUD's Office of General Counsel, which clarified the issue (see comment 2). Accordingly, we have deleted reference to unsupported obligations based upon the two-year parameter as was contained in our discussion draft. Nevertheless, fungibility was not the sole basis for the finding, nor is whatever timeframes HUD determines are appropriate to apply based upon fungibility substitution. As such, we have adjusted the finding to reflect our concern about the contracts that did not have execution dates and those contracts provided as support, that was executed prior to the date capital funds were made available, without assurance that these contracts were not already used to obligate capital funds from earlier years. As mentioned in comment 2 above, the lack of execution dates, etc., supports our analysis that adequate evidence was not provided to ensure that capital funds were obligated in a timely manner in accordance with regulations.

**Comment 7** The auditee states that the \$33.7 million cited as an audit exception may not be properly justified because the "exclusive use of testimonial evidence and oral explanations without adequate and sufficient alternative physical and documentary evidence cannot be a reasonable basis for an audit exception". In this case, the oral explanation represented HUD field office guidance as to how the field office administers its programs, and as such, is a reasonable basis for establishing criteria in the absence of alternative physical evidence. Nevertheless, based upon guidance from HUD's Office of General Counsel, we have adjusted the finding and the dollars in the report to clarify why the auditee's support that capital funds were obligated in accordance with regulations is still an exception (see comment 6).

**Comment 8** As requested by the auditee, we have noted in the scope and methodology that we conducted interviews with the officials of the Capital Projects Division and Information Technology Department.