



Issue Date March 18, 2011
Audit Report Number 2011-NY-1008

TO: Edward T. De Paula, Director, Office of Public Housing, 2FPH

*Joseph V. Moore*

For

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

SUBJECT: The Jersey City Housing Authority, Jersey City, NJ, Did Not Always Obligate or Disburse Replacement Housing Factor Capital Fund Grants in a Timely Manner

## **HIGHLIGHTS**

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

We audited the Jersey City Housing Authority's (Authority) administration of its Replacement Housing Factor (RHF) grants received under the capital fund program. This is the third 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 RHF grants in accordance with HUD regulations.

### **What We Found**

Authority officials did not always obligate or expend RHF funds in a timely manner. They failed to obligate at least 90 percent of the Authority's 2007 RHF grants within 24 months and disburse 100 percent of its 2004 RHF grants within 48 months of the date of availability of the funds. This deficiency was the result of a lack of adequate controls and procedures to ensure that RHF funds were obligated and expended within the prescribed time limits. Consequently, \$877,607 of the Authority's 2007 RHF funds was not obligated, and more than \$2.2 million of its 2004 RHF funds was not expended within the specified period.

according to HUD regulations. Therefore, not all needed capital improvements were accomplished within program time limits.

### **What We Recommend**

We recommend that the Director of HUD's New Jersey Office of Public Housing (1) recapture more than \$3.1 million in RHF capital funds or reduce future capital funds by this amount because of the delayed obligation and expenditure of these funds, and (2) direct Authority officials to establish and implement procedures to ensure that the Authority obligates and expends its capital fund grants within 24 and 48 months, respectively, from the date that funds become available to the Authority.

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 15, 2011, Authority officials provided their written comments and generally disagreed with the draft report findings. 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 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 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, obtained a \$10 million loan under the Capital Fund Financing Program in 2007, and received \$7.8 million in capital funds under the American Recovery and Reinvestment Act of 2009. We have audited the Authority's administration of these capital fund programs and issued two audit reports (Audit Report No. 2011-NY-1001 and 2011-NY-1007) in October 2010 and March 2011, respectively. This audit was a spinoff review based on the prior audits' results.

Replacement Housing Factor (RHF) grants are awarded through the capital fund program to public housing authorities that have removed their units from inventory for the sole purpose of developing new public housing units. A public housing authority may receive RHF grants for these removed units for a period of up to 5 years. Also, funding for an additional 5-year period can be awarded if HUD determines that the public housing authority has met HUD's requirements and made substantial progress for the projects funded by the end of the first 5-year RHF grant. During the past 10 years (2000–2009), more than \$10 million in RHF funds have been awarded to the Authority for redevelopment purposes.

The objective of this audit was to determine whether the Authority obligated and expended its RHF capital fund grants in accordance with HUD regulations.

## RESULTS OF AUDIT

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### Finding: Authority Officials Did Not Always Obligate or Disburse RHF Funds in a Timely Manner

Contrary to HUD regulations, Authority officials did not always obligate or expend RHF funds in a timely manner. They failed to obligate at least 90 percent of the Authority's 2007 RHF grants within 24 months and disburse 100 percent of its 2004 RHF grants within 48 months after the date of availability of the funds. This deficiency was the result of a lack of adequate controls and procedures to ensure that RHF funds were obligated and expended within the prescribed time limits. Consequently, \$877,607 of the Authority's 2007 RHF funds was not obligated, and more than \$2.2 million of its 2004 RHF funds was not expended within the period specified in HUD regulations. Therefore, not all needed capital improvements were accomplished within program time limits.

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#### **RHF Grants Were Not Obligated or Expended in a Timely Manner**

The regulations at 24 CFR (Code of Federal Regulations) 905.10 and 905.120 and various HUD Office of Public and Indian Housing notices required housing authorities to obligate at least 90 percent of their RHF grants within 24 months and disburse 100 percent of their grants within 48 months from the date of availability of the funds. The amendments to annual contributions contracts (contract) signed between the Authority and HUD also imposed this rule for the RHF grants received by the Authority. However, Authority officials did not always comply with HUD regulations and contract agreements while obligating and expending the RHF grants. Specifically,

- Grants number NJ39R009501-07 and NJ39R009502-07 were awarded to the Authority on September 13, 2007, with the amounts of \$145,494 and \$732,113, respectively. None of these funds was obligated until December 1, 2009, which was 2½ months after the obligation deadline of September 12, 2009, as indicated in the contract agreement. The aforementioned HUD regulations provide that housing authorities may request an extension from HUD of the time frame to obligate the funds. However, the Authority did not submitted such a request to HUD.
- Grant number NJ39R009501-04 was awarded to the Authority on September 14, 2004, with an amount of more than \$2.8 million. According to the contract agreement, the whole grant should have been disbursed by September 13, 2008. However, the Authority only disbursed

\$906,182 by the expenditure deadline, which represented only 32 percent of the total grant. Therefore, the remaining \$1.9 million was not expended in a timely manner.

- Grant number NJ39R009502-04 was awarded to the Authority on September 14, 2004, with an amount of \$330,011. According to the contract agreement, the whole grant should have been disbursed by September 13, 2008. However, the Authority did not disburse any of this grant until May 7, 2009, which was approximately 8 months after the expenditure deadline of September 13, 2008. Therefore, \$330,011 was not expended in a timely manner.

Thus, Authority officials did not have adequate controls and procedures in place to ensure that RHF funds were obligated and expended within the contract agreement deadlines. As a result, more than \$3.1 million in RHF grant funds was not properly obligated or expended within the specified period according to HUD regulations and contracts. Consequently, not all needed capital improvements were accomplished within program time limits.

## **Recommendations**

We recommend that the Director of the New Jersey Office of Public Housing

- 1A. Recapture \$3,118,327 in RHF capital fund grants or reduce future capital funds by this amount because of the delayed obligation and expenditure of the funds.
- 1B. Direct Authority officials to establish and implement procedures to ensure that the Authority obligates and expends its RHF funds within 24 and 48 months, respectively, from the date that the funds become available to the Authority.

## SCOPE AND METHODOLOGY

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Our review focused on whether the Authority obligated and expended RHF capital 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 HUD's monitoring report and independent accountant audit reports.
- Reviewed contracts signed between HUD and the Authority.
- Reviewed reports from HUD systems, such as the Line of Credit Control System (LOCCS). We also verified LOCCS information with the Authority and HUD Public Housing officials, as well as with source documentation such as contracts signed between HUD and the Authority. We determined that the dollar amount of obligations and disbursements in LOCCS was sufficiently reliable for purposes of our audit.

The audit initially covered the period from April 1, 2007, through December 31, 2009. We extended the period as needed to accomplish our objective. 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 conducted additional audit verification and confirmation from October through December 2010 at HUD's Newark, NJ, 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 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 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 the 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:

- The Authority did not implement effective controls to ensure that RHF grants were obligated and expended within specific time limits (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>
1A	<u>\$3,118,327</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

#### Auditee Comments



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February 15, 2011

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

Re: Draft Audit Report 2011-NY-10xx

Dear Mr. Moore:

We are writing to respond to the tentative audit finding sent to my office via email on February 4, 2011, regarding the review of Jersey City Housing Authority's ("JCHA") Capital Fund Replacement Housing Factor ("RHF") funds. Thank you very much for providing JCHA with the tentative audit finding and the chance to respond to it in writing. In this case in particular, JCHA appreciates the opportunity to correct the record because we at JCHA are extremely concerned that the Office of Inspector General ("OIG") concluded that "JCHA did not always obligate and expend RHF funds in a timely manner." This is alarming because JCHA has consistently obligated and expended RHF Funds within HUD designated timeframes established by the LOCCS system.

JCHA takes its reputation in the immediate community, with lenders, with funders, with HUD and with the OIG very seriously and any indication that the agency does not spend funds in accordance with rules and deadlines risks harming this reputation. It seems that what the auditors must have missed is that JCHA was accumulating the RHF funds, with HUD approval and consistent with the RHF regulations, for use in mixed finance development. We have gone through the draft report (the "Report") and below set out why JCHA maintains that our agency complied with HUD imposed expenditure and obligation dates for RHF Funds. Please consider these responses prior to issuing the Report because the current recommendations in the Report are drastic, ignore the fact that JCHA was in fact compliant with deadlines, and would dramatically impair JCHA's ongoing efforts to create and preserve housing for the residents of Jersey City.

#### *Scope and Methodology*

The Scope and Methodology section of the Report states that the auditors relied on LOCCS, in part, to conclude that JCHA did not meet its deadlines. We do not know what LOCCS report the auditors looked at because when JCHA looks at the LOCCS report, we see that both the 2004 and 2007 RHF funds described in the Report had a LOCCS obligation date of January 9, 2010 and a LOCCS expenditure date of January 9,

Comment 1

Comment 2

Comment 1

## Ref to OIG Evaluation

## Auditee Comments

### Comment 1

2012 (see [Attachment 1](#)). We are confused that the scope and methodology section of the Report cites that LOCCS was consulted, yet the primary finding seems to ignore the LOCCS report and instead relies on a sub-set of the rules regarding obligations and expenditures without applying the remaining portion of those rules, which permit HUD to approve housing authorities to accumulate funds as JCHA did here. We suggest that the auditors review the LOCCS report again as clearly there was an error made because the LOCCS Report does not show that JCHA failed to obligate or expend funds in accordance with RHF Fund requirements. In fact, the LOCCS shows that the opposite is true – JCHA is complying with HUD imposed deadlines.

#### *Obligation and Expenditure Deadline*

The Report provides that:

“Authority officials did not always obligate funds in a timely manner. They failed to obligate at least 90 percent of the Authority’s 2007 RHF grants within 24 months and disburse 100 percent of its 2004 RHF grants within 48 months of the date of availability of the funds.”

### Comment 2

While the above statement reflects one method for determining whether funds have been obligated on a timely basis, it ignores the more common method described in the RHF regulations used by many larger housing authorities, which is that housing authorities can accumulate RHF Funds until there is enough available to create new units. The specific language in the RHF regulation provides that “[w]ith specific HUD approval, 24 months from the date that the PHA accumulates adequate funds to undertake replacement housing.” See CFR 905.10(i)(7)(B) (“Accumulation Option”). The Accumulation Option is not cited in the Report in spite of the fact that HUD presumably relied on it to establish the January 9, 2010 obligation date and the January 9, 2012 expenditure date in LOCCS (the expenditure date was set 24 months from the end of the obligation period). The Authority subsequently relied on those deadlines in LOCCS for planning purposes to ensure that funds were expended in a timely manner. JCHA is surprised that the Report ignores and disregards HUD’s own established deadlines, especially when HUD’s action was authorized by statutory and regulatory flexibility and the JCHA simply acted in accordance with those deadlines. We hope this was an oversight and that the Report will be corrected to note that JCHA has complied with all obligation and expenditure dates for RHF Funds.

#### *Additional Documentation to Support HUD’s Obligation and Expenditure Dates*

### Comment 3

It is not the Authority’s responsibility to determine the methodology HUD employed to approve the accumulation of RHF funds, given the fact that the Housing Act of 1937, as amended (the “Act”), the regulations and the various notices permit such accumulation. Nevertheless, we do believe that it is significant that the 2004 RHF funds and the 2007 RHF funds were spent in accordance with mixed finance transactions carried out in accordance with 24 CFR 941 Subpart F (the “Mixed Finance Regulation”). Furthermore, each of these transactions was carried out in accordance with a proposal submitted to HUD in accordance with the Mixed Finance Regulation and subsequently commemorated by written agreement with HUD through Mixed Finance ACC Amendments. Specifically, the Mixed Finance ACC Amendments for the following

## Ref to OIG Evaluation

## Auditee Comments

### Comment 3

transactions, which represent all of the funds expended for NJ39R00950104, NJ39R00950204, NJ39R00950107 and NJ39R00950207 (with the exception of \$42,544, which was expended on planning costs for a future phase) were executed by HUD between January 28, 2008 and January 5, 2011: Gloria Robinson Court Homes Phases 1 (May 25, 2007) and 2 (June 17, 2008); Barbara Place Terrace (January 28, 2008); Ocean Pointe East & West (April 2, 2009); A. Harry Moore Phase III (November 16, 2010) and Glennview (January 21, 2011).

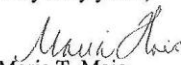
By way of illustration, Exhibit G of the Mixed Finance ACC Amendment for Gloria Robinson Court Homes Phase 2, which was executed on June 17, 2008, projects 2004 RHF funds being expended through Month 14 of construction, or August 2009, well beyond the September 13, 2008 expenditure date assumed in the Report. Similar construction schedules were projected for the various projects, both indicating HUD's intent to approve the accumulation of funds and also illustrating the reasonable basis therefore. While the HUD established LOCCS timeframes are sufficient to establish the fact that HUD approved JCHA's use of the Accumulation Option in accordance with CFR 905.10(i)(7)(B), the fully executed Mixed Finance ACC Amendments provide further proof of HUD's intent to permit, and approval of, such accumulation.

#### *Lack of Adequate Controls*

The Report determined that the Authority did not implement effective controls to ensure that RHF grants were obligated and expended within specific timeframes. In fact, the Authority regularly monitors its obligation and expenditure reports to ensure that funds are obligated in a timely manner and also has reports regularly circulated to development staff to ensure that the financial and development personnel are on the same page with respect to these activities. Nevertheless, all of these reports relied on and complied with HUD's established schedules. Clearly, the fact that the auditors missed the Accumulation Option influenced this finding and we believe that when the OIG looks at it again, taking into account what the obligation and expenditure dates actually were, this finding will be deleted.

Thank you so much for your attention to this matter. We look forward to discussing this issue with you during our exit interview on February 18<sup>th</sup> and hope that by then the auditors will have had the chance to review the accurate LOCCS schedules and substantially revise the Report.

Very truly yours,

  
Maria T. Maio  
Executive Director

## **OIG Evaluation of Auditee Comments**

**Comment 1** Authority officials stated that they had complied with the obligation and expenditure deadlines posted in LOCCS. However, the deadlines in LOCCS were different from those indicated in the Annual Contribution Contracts (ACC) Amendments, which were mutually agreed upon and signed by the Authority and HUD. The obligation and expenditure start dates were effective as of the dates HUD signed and executed the ACC Amendments. Authority officials did not provide any documentation that requested HUD officials to extend the obligation and expenditure deadlines. Therefore, the deadlines for obligating and expending funds in the ACC Amendments were still applicable. The Authority should have complied with the obligation and expenditure end dates established in the ACC Amendments instead of relying on the end dates in LOCCS. HUD explained these procedures in several notices including Notice 2003-10, 2003-19, 2004-15, 2005-22, and 2010-21. As a result, we recommend recovery of the funds as required in 24 CFR 905.120 for untimely obligation and expenditure.

To make the report clearer, we adjusted the scope and methodology section in the report to reflect that only the dollar amounts of the obligations and disbursements in LOCCS were sufficiently reliable.

**Comment 2** Authority officials stated that HUD regulations provide that a public housing authority (PHA) can choose to accumulate its replacement housing factor funds with HUD's approval, and the obligation deadline will be reset to be from 24 months from the date the PHA accumulates adequate funds to undertake replacement housing. Authority officials believed that HUD relied on this accumulation option to extend the obligation dates in LOCCS. Therefore, Authority officials concluded that they complied with all obligation and expenditure dates for RHF funds since they followed LOCCS information.

HUD regulations require that a PHA must submit an RHF plan if it wishes to accumulate one or more years of RHF funds. Without an RHF plan, the Authority has no authorization to accumulate funding. HUD issued numerous notices and published guidelines on the HUD website and provided detail instructions for the preparation of the RHF plan. During the audit Authority officials stated that they had not submitted a RHF plan to HUD requesting approval to accumulate funds. Review of the mixed-finance amendments to the consolidated annual contribution contracts for multiple projects, which were provided by Authority officials after the exit conference, disclosed that these amendments did not serve the same purpose as a RHF plan nor contained the necessary information required by HUD regulations for the accumulation option (see Comment 3). As a result, Authority officials did not submit the required RHF plans for HUD's approval as a means for justifying accumulating replacement funds, and were therefore required to obligate and expend the funds within 24 and 48 months respectively from the dates when the funds became available to the Authority. Thus, we recommend

recovery of the funds as required in 24 CFR 905.10 and 905.120 for untimely obligation and expenditure because funds were accumulated without a HUD-approved plan.

**Comment 3** Authority officials stated that HUD's approval of mixed-finance ACC amendments for various projects support that HUD approved the accumulation of RHF funds. However, review of the mixed finance ACC amendments revealed that these amendments did not specify (1) the Authority's intention to accumulate its RHF grants and why it needed to do so; (2) the number of years of grant funding the Authority would accumulate; and (3) the grants, including estimated amounts by fiscal year, the Authority would accumulate. In addition, these amendments inadequately included a grant already included in another approved amendment, and improperly mixed different increments of RHF funding, which is not in compliance with HUD requirements. Moreover, these ACC amendments were signed more than 24 months from the dates when the RHF funds became available to the Authority. As a result, these amendments cannot be regarded as a RHF plan. Without obtaining HUD's approval for the accumulation option, Authority officials were required to comply with the 24 and 48-month requirements respectively while obligating and expending the RHF grants.