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| Issue Date<br>February 18, 2010 |
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| Audit Report Number<br>2010-BO-0001 |
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TO: Donald Lavoy, Acting Deputy Assistant Secretary for Office of Field Operations, PQ  
Donna Ayala Director, Office of Public Housing, Boston Hub, 1APH  
Henry S. Czauski, Acting Director, Office of the Departmental Enforcement Center, EC

FROM:   
John A. Dvorak, Regional Inspector General for Audit, Region 1, 1AGA

SUBJECT: HUD Was Not Effective in Recovering the New London Housing Authority From  
Troubled Status and Did Not Take the Required Regulatory or Statutory Action

## **HIGHLIGHTS**

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

We initiated the audit of the U.S. Department of Housing and Urban Development's (HUD) efforts to recover the City of New London, CT, Housing Authority (Authority) due to its longstanding troubled status. The Authority has had significant management deficiencies for more than 10 years, and HUD identified the Authority as "overall troubled" in May of 2004. Our objective for this audit was to evaluate HUD's effectiveness in identifying and helping to correct deficiencies at the Authority.<sup>1</sup>

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<sup>1</sup> We also recently completed an audit of the Authority's Public Housing Capital Fund program, which found that the Authority did not properly administer its capital funds (report number 2009-BO-1010).

## What We Found

HUD had detected significant deficiencies but had not been effective in recovering the Authority from its longstanding troubled status. Although HUD provided extensive technical and monetary assistance and entered into a number of binding memorandums of agreement requiring improvement, the Authority's condition continued to decline, it could not meet its debt obligations, and it remained troubled. The Authority has been troubled primarily due to the poor management of its Federal and State housing programs. In addition, its Federal housing projects did not meet HUD's minimum housing standards.

HUD failed to take action in a timely manner when the Authority failed to make substantial progress in correcting its deficiencies. As a result, the Authority's financial condition declined, creditors were not paid, liens were placed on its housing projects, and its rent receipts may be placed in receivership unless more than \$1.7 million in unpaid utility bills is paid by January 2010. In addition, the Authority improperly used more than \$524,000 in Federal funds for State programs, \$105,000 for unsupported payments in lieu of taxes, \$99,000 in Federal capital funds for State security patrols, and \$97,000 for unsupported and unreasonable renovations and painting.

## What We Recommend

We recommend that the Director of HUD's Boston Office of Public Housing ensure that the Authority (1) establishes and implements a financial/business plan to pay its creditors, avoid having a local receivership lien placed against its rents, and remove liens; (2) enters into an agreement to repay more than \$900,000 in water and sewer bills; (3) properly accounts for its revolving account, stops using Federal funds for State programs, and repays its Federal programs an estimated \$524,879; (4) repays or supports \$97,106 paid for unreasonable and unsupported contract maintenance costs; and (5) repays or supports \$99,939 in Federal funds paid for State security patrols.

We recommend that the Director of the Office of Field Operations (1) implements a formal process to report troubled housing agencies to the Assistant Secretary for Public Housing for a determination of the corrective actions required by HUD regulations and Federal statutes and (2) notifies the Deputy Assistant Secretary for Public Housing that the Authority is in danger of having a local receivership lien placed against its rents.

We recommend that the Director of the Departmental Enforcement Center pursue all administrative and/or civil monetary penalties for the regulatory agreement violations disclosed in this finding.<sup>2</sup>

In addition, the Authority has exceeded the maximum statutory recovery period, and our prior audit report number 2009-BO-1010, issued August 7, 2009, recommended that the Deputy Assistant Secretary for Field Operations inform the Assistant Secretary for Public and Indian Housing of the Authority's inability to improve its score or meet the goals of the memorandum of agreement with HUD and determine the statutory remedies required under section 6(j) of the U.S. Housing Act of 1937. Therefore, the findings in this report should also be considered when implementing that recommendation.

For each recommendation in the body of the report 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 provided the Deputy Assistant Secretary for Field Operations, the Director of the Boston Office of Public Housing, and the Acting Director of the Departmental Enforcement Center with a draft audit report on December 10, 2009, and requested a response by January 21, 2010. We held an exit conference with HUD officials on December 22, 2009, to discuss the draft report. The Boston Public Housing Director coordinated with the Office of Field Operations and provided HUD's written comments on January 21, 2010.

The complete text of the auditee's and HUD's responses, along with our evaluation of these responses, can be found in appendix B of this report.

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<sup>2</sup> In implementing this recommendation, the Deputy Director should consider all of the issues discussed in this report and audit report 2009-BO-1010.

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## BACKGROUND AND OBJECTIVE

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The City of New London, CT, Housing Authority (Authority) provides low-income public housing for qualified individuals under an annual contributions contract with the U.S. Department of Housing and Urban Development (HUD). The Authority has contracted with HUD for financial assistance pursuant to the United States Housing Act of 1937, as amended, and the State of Connecticut, Department of Economic and Community Development, for financial assistance for elderly housing projects in the form of capital grants and/or loans. The contractual obligations of the Authority under sections 4 and 5 of the annual contributions contract are “to provide decent, safe and sanitary housing for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic social well-being of the tenants.” Section 5 states, “the HA [housing agency] shall develop and operate all projects covered by this ACC [annual contributions contract] in compliance with all the provisions of this ACC and all applicable statutes, executive orders, and regulations issued by HUD.”<sup>3</sup> The Authority administers approximately 838 housing units (331 Federal housing units and 507 State housing units). During 2007,<sup>4</sup> the Authority received more than \$4.6 million to operate its housing programs as follows:

- \$2.13 million from its State programs,
- \$1.45 million from its low-income public housing program,
- \$ .86 million from its Section 8 Housing Choice Voucher program, and
- \$ .18 million from its Public Housing Capital Fund program.

The State program units are two-thirds of the Authority’s portfolio, and HUD has no oversight of these State programs, nor does it have responsibility for the continued operations of State programs. HUD only has control over and responsibility for the overall financial health of this agency as it relates to federally funded programs. However, the Authority has had significant deficiencies regarding federally funded programs for more than 10 years and has been operating under a memorandum of agreement with HUD’s Troubled Agency Recovery Center/Recovery Prevention Corps (Corps) since 1998. HUD identified the Authority as “overall troubled” in May 2004.

The Corps is organized under the Office of the Deputy Assistant Secretary for Field Operations. The Corps’s mission is to support the Office of Public Housing field offices to prevent at-risk housing authorities from becoming troubled and facilitate their recovery from troubled status. The Corps executes this mission by providing technical assistance, training, and consulting services to hubs/program centers and troubled housing agencies. The Corps had been primarily responsible for the Authority’s recovery until August 5, 2003. In 2003, the Director of HUD’s Boston Office of Public Housing became responsible for monitoring, oversight, and recovery of “troubled” public housing agencies in its area and ensuring that agencies that did not recover

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<sup>3</sup> In addition, all other pertinent sections of the annual contributions contract that are applicable to the Authority’s administration of HUD funds, including but not limited to section 6 – Cooperation Agreement; section 7 – Covenant Against Disposition and Encumbrances; section 8 – Declaration of Trust; section 10 – Pooling of Funds; and section 15 – Books of Account, Records, and Government Access

<sup>4</sup> Its last audited financial statements

within 2 years were either referred to the Departmental Enforcement Center and declared in substantial default <sup>5</sup> or referred to the Assistant Secretary for a determination of whether to pursue receivership of all or part of the public housing agency under section 6(j)(3) of the United States Housing Act.

The Office of Field Operations oversees the Director of the Office of Public Housing and the Corps.

The Assistant Secretary for Public Housing oversees the Office of Field Operations and is responsible under HUD's delegation of authority to issue a notice of substantial default or to petition for a receiver when agencies do not meet the requirements of their annual contributions contracts or memorandums of agreement, fail to make substantial progress toward remedying their troubled status, and fail to recover from troubled status within the maximum recovery period.

Our objective was to evaluate HUD's effectiveness in identifying and helping to detect and correct deficiencies at the Authority.

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<sup>5</sup>As required by 24 CFR (Code of Federal Regulations) 902.75(b) and (g) and 902.79 - Final Rule

## RESULTS OF AUDIT

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### Finding 1: HUD Was Ineffective in Recovering the Authority From Troubled Status and Did Not Take the Required Regulatory or Statutory Action

Over the past 10 years, HUD had not been effective in recovering the Authority from its longstanding troubled status. Although HUD provided extensive technical and monetary assistance, the Authority's condition continued to decline. It could not meet its debt obligations and remained troubled. The Authority was troubled due to the poor management of its Federal and State housing programs as evidenced by its improperly awarding and administering contracts, high vacancy rates, low rent collection rates, and insufficient State rents to fund operations. In addition, the Authority's Federal housing projects did not meet HUD's minimum housing standards.

HUD did not take timely action when the Authority's board of commissioners and executive directors failed to make substantial progress to correct its deficiencies. As a result, the Authority's financial condition continued to decline, creditors were not paid, liens were placed on its housing projects, and projects' rents may be placed in receivership unless more than \$1.7 million in utility bills is paid. In addition, the Authority used more than

- \$524,000 in Federal funds for State programs,
- \$105,000 for unsupported payments in lieu of taxes,<sup>6</sup>
- \$99,000 in Federal capital funds for State security patrols, and
- \$97,000 for unsupported and unreasonable renovations and painting.

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#### **The Authority Had Longstanding Deficiencies**

HUD first advised the Authority of its troubled status in 1998 and officially designated it as an "overall troubled" agency in May of 2004 under HUD's Public Housing Assessment System (PHAS). The troubled status resulted primarily from the Authority's failing scores in the financial and physical components of the PHAS. The failed score for the financial component indicated the Authority's inability to effectively manage and administer its housing program funds. Its failed score for the physical component indicated that the general condition of the

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<sup>6</sup> A payment in lieu of taxes made to compensate a local government for some or all of the tax revenue that it loses because of the nature of the ownership or use of a particular piece of real property. Usually it relates to the foregone property tax revenue.

properties resulted in units' not being safe, sanitary, and decent. Appendix C provides a history of the Authority's PHAS scores.

### **The Authority Failed To Improve After HUD Provided Substantial Technical and Monetary Assistance**

The Corps provided extensive technical assistance by telephone, e-mail, letters, and hands-on assistance during on-site reviews. The hands-on assistance included developing sample policies and procedures for the Authority to incorporate into its operations. More than \$830,000 was also provided for services that included contracts to prepare the Authority's annual and 5-year plans, increase management proficiency and efficiency, improve housing structures, and evaluate and improve tenant security.

Despite HUD's assistance and a number of memorandums of agreement requiring improvement, the Authority's board of commissioners and executive directors failed to substantially improve its performance, and it remained troubled. The Authority was troubled primarily due to poor management, which was further compounded by its diversion of Federal funds to its State housing program with high vacancy rates, low rent collection rates, and insufficient rents to fund operations. In addition, the Authority's Federal housing projects failed three physical inspections including its most recent physical housing inspection in February of 2009. Although the Authority had made some progress toward reducing vacancy rates, collecting rents, and reducing costs, it continued to operate at a deficit and improperly used Federal funds to support its State programs.

### **HUD Did Not Take the Required Action in a Timely Manner**

The Authority's failure to meet its memorandum of agreement requirements and recover from troubled status within 2 years constituted a substantial default and required the Director of the Boston Office of Public Housing to recommend to HUD's Assistant Secretary for Public and Indian Housing that the Authority be declared in substantial default.

Federal regulations and statutes require the Assistant Secretary to take specific actions when troubled agencies fail to meet their memorandum of agreement requirements, substantially improve after 1 year, and recover from troubled status within 2 years. These actions may not be delegated.



HUD officially designated the Authority as “overall troubled” on May 26, 2004, when the Authority scored only 38 of 100 possible PHAS points for 2003. The Authority achieved the required improvement in 2005, its first full year of recovery. However, it scored only 40 points in 2006, its second year of recovery. Thus, on December 12, 2007, the Authority should have been referred to the Assistant Secretary for Public Housing, and the Assistant Secretary should have either (1) declared the Authority in substantial default and referred it the Departmental Enforcement Center or (2) taken possession of any or all of the Authority’s projects or programs or initiate actions to appoint a receiver to assume the responsibilities of the Secretary. Under a regulatory declaration of default, HUD and the Authority could jointly manage operations after issuing the notice of default. Further, the regulation does not contain a time limit for remedying the agency problems, and the process may continue indefinitely.

Under the statutory provision, HUD would petition the court to appoint a receiver for the Authority. The receiver would not manage the operations but, rather, implement the statutory corrective actions to either sell the assets, divide the agency into smaller entities, combine the agency with another nearby agency, or sell the agency assets to a nonprofit. The statutory remedy results in the reorganization of the entity in a short amount of time with limited HUD resources being consumed.

### **The Authority’s Financial Condition Continued To Decline**

The Corps and the Boston region took some corrective action when they directed the Authority to contract for the administration of its Section 8 program. However, HUD did not declare the Authority in substantial default, appoint a receiver, or take possession of the Authority’s public housing programs primarily due to its decision not to employ scarce resources for a small housing authority. In addition, HUD was reluctant to separate management of the Federal and State programs due to the negative effect it would have had on the State programs. Instead, the Director of the Boston Office of Public Housing issued another directive for improvement that was not effective, as evidenced by the Authority’s declining financial and physical condition.

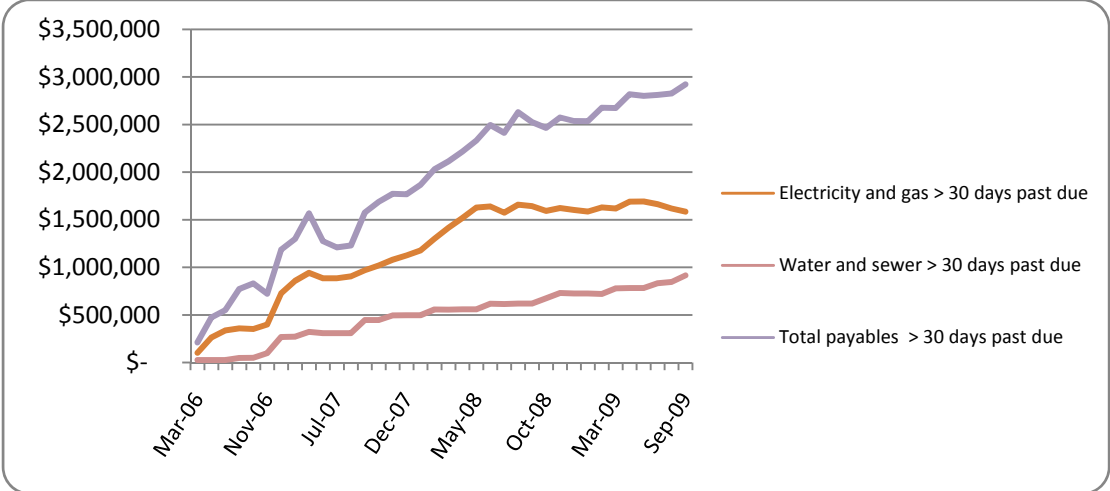
Further, neither the Boston Public Housing Director nor the Deputy Assistant Secretary for Field Operations formally referred the Authority to the Assistant Secretary for corrective action, and the Authority was not declared in substantial default or placed in receivership.

The Authority’s monthly board minutes provided to HUD showed that its bills past due more than 30 days had increased steadily from \$210,000 in January 2006 to more than \$2.9 million in September 2009.<sup>7</sup> This increasing failure to meet its

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<sup>7</sup> The \$2.9 million was owed by the Authority’s State and Federal programs.

financial responsibilities clearly showed that the Authority’s financial condition was not improving. The HUD Boston Office of Public Housing reported to HUD’s Office of Field Operations that the Authority’s financial condition continued to decline. The following graph shows the growth of accounts payable past due more than 30 days.



In a March 29, 2009, letter, the HUD regional field office suggested that the administration of all of the Authority’s Federal housing programs should be contracted for, and the Authority’s board of commissioners agreed. HUD stated:

“Despite our efforts, the NLHA [Authority] has continued on a steady financial decline, management practices have not improved, and the Authority has failed to maintain acceptable physical conditions in its public housing portfolio. Based on this extended history of poor performance and lack of improvement, we do not believe that the Authority has the management capacity to successfully operate its federal public housing programs in the best interests of its residents and HUD. Consequently, we strongly urge the Board to contract out management of its low rent public housing programs...”

**The Federal Projects’ Rents May Be Placed in Receivership**

On January 23, 2009, the Connecticut Superior Court appointed an inactive receiver of rents for the Authority’s housing projects and established the utility company’s right to record liens on the projects for the estimated \$1.7 million in past-due bills. The inactive receivership was conditioned on full repayment by January 2010. The potential liens and receivership of rents were prohibited by the Authority’s contracts with HUD<sup>8</sup> and would be detrimental to operating the Federal housing projects. HUD was aware that some utility bills had not been

<sup>8</sup> Annual contributions contract and declaration of trust

paid, and the Authority had entered into a repayment agreement. However, it did not review the agreements and was not aware of the court-appointed receiver or the large amount of unpaid Federal utility bills. HUD and the Authority started to take action after we informed them of the potential receivership in September 2009. Although the Authority did not have the \$818,000 owed to the utility company for Federal projects, it expected to receive \$3.1 million from the redevelopment of its State housing projects starting in April 2010. Therefore, in January 2010 if the utility company exercises its rights and invokes active receivership, the Authority will lose the control and use of its rental income to pay its operating expenses.

The Authority also failed to pay the City of New London (City) more than \$914,000 for water and sewer services. The City initiated a forbearance agreement in November 2008 that would have required the Authority to pay its current utility bills and an additional \$5,000 per month until the debt was retired. However, the Authority did not sign the agreement and made only two payments during 2009 totaling \$10,004. As a result, its Federal programs owed the City more than \$342,000 for unpaid water and sewer bills, and the City placed liens against the Authority's housing projects.

### **The Authority Lacked an Adequate Plan To Repay Its Creditors**

The Authority did not have an adequate strategic or cash-flow plan for meeting its short-term and long-term financial responsibilities. For the short term, each week the Authority prioritized its bills and paid as many as possible. For the long term, the Authority expected to receive around \$2.1 million from redeveloping its State properties in February 2010. However, the \$2.1 million, if received, would not be enough to repay the more than \$3.7 million required to bring its Federal and State payables current.

### **The Authority Used More Than \$500,000 in Federal Funds for State Programs**

The Authority's annual contributions contract with HUD prohibits using low-income public housing funds for other programs. However, the Authority reported in its financial statements that it used Federal funds for its State housing programs, with more than \$224,000 used in 2006 increasing to more than \$524,000 by the end of 2007. However, we were unable to determine the extent of the use of Federal funds for State programs for 2008 or 2009.

The Authority's general ledger will require significant adjustment before the amount of Federal funds used for State programs during 2008 or 2009 can be verified. The failure to adequately account for funds occurred due to inadequate financial controls, the lack of formal accounting procedures, and the lack of an effective financial manager since February of 2008. Therefore, we could only identify the improper use of Federal funds from the most recent audited financial statements, which reported that \$524,879 in Federal funds had been used for State programs as of December 31, 2007.

### **The Authority Could Not Support \$105,000 in Payments**

The Authority could not locate supporting documents for the payment of \$105,000 in Federal funds paid in lieu of taxes.<sup>9</sup> Therefore, these payments were unsupported. The Authority also signed an agreement with the City in September 2006, agreeing that it owed the City \$500,000 for payments in lieu of taxes and would make quarterly payments of \$6,250 until the debt was paid. However, the Authority did not maintain documentation to support how much of the \$500,000 was owed by Federal programs and how much was owed by State programs.

### **The Authority Paid \$97,106 for Questionable Contract Costs**

The Authority paid a contractor for painting, cleaning, and renovations that exceeded the contract price and were not properly supported or reasonable. The contractor routinely overcharged for contract-related work, submitting invoices for hundreds of dollars above the allowable contract price, invoicing for the wrong bedroom size, routinely charging for additional work without itemizing the costs, and failing to detail the time spent or identify the materials used. This abuse occurred because the former executive director did not take corrective action when his staff informed him that the contractor was overcharging for work. As a result, we identified \$56,516 in unsupported costs and \$40,590 in unreasonable costs that must be repaid to the Federal programs.

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<sup>9</sup> For the period of January 1, 2006, through September 16, 2009. A payment in lieu of taxes made to compensate a local government for some or all of the tax revenue that it loses because of the nature of the ownership or use of a particular piece of real property. Usually it relates to the foregone property tax revenue.

## **The Authority Improperly Used \$99,939 in Capital Funds**

The Authority improperly used \$99,939 in Federal capital funds for security patrols at its State housing projects. This noncompliance occurred because the State did not have sufficient funds to pay for security patrols and the former executive director disregarded the prohibition against using Federal funds for State programs. This problem continued to occur because HUD did not review the invoices supporting police reports, which clearly showed that patrols were being conducted on State sites. Our review identified \$84,624 in ineligible payments made for State security patrols, \$14,306 in unpaid invoices for security patrols performed at State sites, and \$1,009 in payments that were not supported by a police report showing where the patrols were conducted.

## **Conclusion**

HUD was not effective in recovering the Authority from its longstanding troubled status. Despite additional monitoring and assistance over the past 10 years, the Authority's financial condition continued to deteriorate, and it improperly used \$721,924 in Federal funds. The Authority's condition continued to decline due to its poor management and HUD's failure to take timely action to obtain effective management for the Authority's Federal programs. As a result, the condition of the housing did not meet HUD's minimum standards, creditors were not paid, and the Authority continued to improperly use Federal funds. The Authority needs to be formally reported to the Assistant Secretary for Public Housing for a determination of the corrective actions required by HUD regulations and Federal statutes.<sup>10</sup>

In addition, the Authority had exceeded the maximum statutory recovery period, and our prior audit report, number 2009-BO-1010, issued August 7, 2009, recommended that the Deputy Assistant Secretary for Field Operations inform the Assistant Secretary for Public and Indian Housing of the Authority's inability to improve its score or meet the goals of its memorandum of agreement with HUD and determine the statutory remedies required under section 6(j) of the U.S. Housing Act of 1937. Therefore, the findings in this report should also be considered when implementing that recommendation.

HUD should either declare the Authority in default of its contact with HUD or pursue receivership. If HUD declares a substantial default, the agency will have more time to remedy its problems. However, HUD must be committed to expending more of its limited resources on this small housing authority. HUD

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<sup>10</sup> We made this recommendation in our related audit report, 2009-BO-1010.

may pursue receivership due to intentional violations of the contractual requirements; the Authority's failure to provide decent, safe, and sanitary housing to tenants over an extended period; and the amount of resources HUD has already committed to this agency.

## Recommendations

We recommend that the Director of HUD's Boston Office of Public Housing require the Authority to

- 1A. Establish and implement a formal written short- and long-term financial/business plan with measurable milestones to pay its creditors, avoid having a local receivership lien placed against its rents, and/or remove the lien.
- 1B. Establish and enter into a formal repayment agreement with the City to repay past-due Federal water and sewer bills.
- 1C. Strengthen and implement controls over the tracking and reporting of Federal public housing operating funds to ensure that the Authority is using these funds for this Federal program only.
- 1D. Correct its revolving account balances and obtain an independent audit of the balances to verify that the account balances are accurate.
- 1E. Determine the amount and repay the Federal programs for the amount of ineligible Federal funds used for non-Federal programs, estimated to be at least \$524,879 at the end of 2007, and determine whether any Federal funds were used for non-Federal programs during 2008 and 2009 and repay these funds.
- 1F. Establish and implement accounting controls to ensure that payments in lieu of taxes are properly accounted for and recorded on its books and records.
- 1G. Support or repay \$105,000 to its public housing operating fund for unsupported Federal payments in lieu of taxes.
- 1H. Repay \$40,590 to its public housing operating fund for unreasonable contract maintenance costs.
- 1I. Support or repay \$56,516 to its public housing operating fund for unsupported contract maintenance costs.

- 1J. Support or repay the Public Housing Capital Fund \$1,009 for unsupported security patrol costs.
- 1K. Repay the Public Housing Capital Fund \$84,624 for ineligible security patrol costs.
- 1L. Implement controls to ensure that capital funds are used for Federal projects only, thereby avoiding \$14,306 in future payments already owed for security patrols performed at State projects.

We also recommend that the Director of the Office of Field Operations

- 1M. Establish and implement a process by which the Deputy Assistant Secretary of Field Operations can formally report troubled housing agencies to the Assistant Secretary for Public Housing for a determination of the corrective actions required by HUD regulations and Federal statutes.
- 1N. Notify the Deputy Assistant Secretary for Public Housing that the Authority's rents are in danger of receivership.

We also recommend that the Director of the Departmental Enforcement Center

- 1O. Pursue all administrative and/or civil monetary penalties for the regulatory and contract violations disclosed in this finding.<sup>11</sup>

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<sup>11</sup> In implementing this recommendation, the Deputy Director should consider all of the issues discussed in this report and audit report 2009-BO-1010.

## SCOPE AND METHODOLOGY

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We conducted our audit between January and November 2009. We completed our fieldwork at our office in Hartford, CT, and at the Authority's offices located at 78 Walden Avenue, New London, CT. Our audit covered the period January 1, 2006, through December 31, 2008, and was extended when necessary to meet our audit objective.

To accomplish our audit objective, we

- Reviewed relevant HUD regulations, including
  - 24 CFR (Code of Federal Regulations) Part 902 - Public Housing Assessment System, Final Rule;
  - 24 CFR Parts 968, 901, 902, and 907 - Proposed Rule;
  - 42 U.S.C. (United States Code) 1437.6(j)(3) - The United States Housing Act of 1937; and
  - The Authority's annual contributions contract with HUD
- Interviewed and e-mailed key officials and staff including the Director of Field Operations, the Director of the Boston Office Public Housing, the Corps's Deputy Director, and the Authority's executive director(s) to determine what controls were in place to monitor and assist the Authority and ensure compliance with 24 CFR Part 902 and 42 U.S.C. 1437.6(j).
- Reviewed the memorandums of agreement, corrective action plans, and HUD directives for corrective action.
- Interviewed the Authority's staff and reviewed supporting documentation to verify that
  - a. Federal funds were not used for other programs;
  - b. Operating funds used for painting, cleaning, and maintenance were in accordance with the contract and properly supported; and
  - c. Capital funds used for security patrols were not used for State housing projects.
- Reviewed the Authority's board minutes, accounting records, and supporting records to verify its financial condition and the status of its accounts payable.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.



# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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:

- Controls over identifying and monitoring deficiencies.
- Controls over taking corrective actions when the Authority did not recover from troubled status.

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 review, we believe that the following item is a significant weakness:

- Controls over identifying and monitoring deficiencies. HUD's procedures did not ensure that effective and timely action was taken when the Authority failed to recover from troubled status within 2 years (see finding 1).

## APPENDIXES

### Appendix A

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

The total questioned cost of \$826,924 consists of the following:

| Recommendation number | Ineligible 1/ | Unsupported 2/ | Unreasonable or unnecessary 3/ | Funds to be put to better use 4/ |
|-----------------------|---------------|----------------|--------------------------------|----------------------------------|
| 1E.                   | \$524,879     |                |                                |                                  |
| 1G.                   |               | \$105,000      |                                |                                  |
| 1H.                   |               |                | \$40,590                       |                                  |
| 1I.                   |               | \$56,516       |                                |                                  |
| 1J.                   |               | \$1,009        |                                |                                  |
| 1K.                   | \$84,624      |                |                                |                                  |
| 1L.                   |               |                |                                | \$14,306                         |

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

4/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. For this report, these amounts include reductions in outlays for security patrols conducted at State housing sites.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments




New England

#### U.S. Department of Housing and Urban Development

Office of Public Housing  
Boston Hub  
Thomas P. O'Neill, Jr. Federal Building  
10 Causeway Street  
Boston, Massachusetts 02222-1092

JAN 21 2010

Memorandum For: John Dvorak, Regional Inspector General for Audit, IAGA

  
From: Donna J. Ayala, Director, Office of Public Housing, Boston HUB, 1APH

Subject: Discussion Draft Audit Report  
2010-BO-0001  
Recovery Efforts at the Housing Authority of New London

Thank you for the opportunity to discuss the subject audit report. Please consider these comments when finalizing the report.

### Comment 1

The report seemingly implicates HUD as a contributor in the failures of the recovery efforts of the Housing Authority of New London, CT (NLHA) while the focus should be on the NLHA's actions or inactions. The report should more appropriately focus on the NLHA's inability to recover in spite of all the resources and technical assistance provided by HUD.

#### Finding 1

### Comment 2

The Finding seems to indicate that HUD's failures contributed to the precarious financial condition when the primary responsibility for any PHA's administration of any program resides with its Board of Commissioners. This Audit Finding has not carefully examined the course of actions necessary to actually achieve a recovery of the performance of this PHA, which is to redevelop the State portfolio, so that it no longer constitutes a drain to this PHA's resources. When the Department came to the end of the two year statutory recovery period, it had considered the options, and decided that any HUD intervention would be counter-productive.

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**Comment 3**

The third heading in this section that states **HUD Did Not Take the Required Action in a Timely Manner** is inaccurate or misleading since it is acknowledged 2 pages after this statement that the HUD regional office as recently as March 29, 2009, was proactively engaged with the NLHA to compel a wholesale management change. In further support please consider the language below that comes from the recommendation made on this matter, by the Public Housing Hub Director to the Deputy Assistant Secretary for Field Operations, on this matter:

SUBJECT: Recommendation of Alternative Strategy to the Declaration of Substantial Default for the Housing Authority of New London, CT022

It is the recommendation of the Office of Field Operations that the Assistant Secretary of Public and Indian Housing (Assistant Secretary) not declare the Housing Authority of the City of New London (NLHA) in substantial default of their Annual Contributions Contract, in accordance with 24 CFR Part 902.79(a)(4), for failure to operate in compliance with the terms of the Annual Contributions Contract (ACC), at this time, with endorsement of an alternative approach which we believe will produce results, more readily than would a declaration.

Multiple deficiencies affect New London's Public Housing Program, including but not limited to: poor governance and record-keeping, inadequate training for staff, poor communication, weak policies and procedures, poor Internal Control, and no program-wide quality control (especially in the areas of capital funds administration and financial management). The Memorandum of Agreement developed by HUD and NLHA staff addressed all of these deficiencies, and has made progress.

The key matter at the heart of this recovery is the failure to control use of Federal resources carefully. A lack of adequate internal control permitted the use of Low Rent Public Housing program assets for ineligible items outside the program, did not ensure the quality of program performance, etc.

**Comment 3**

The New London Housing Authority has long been in and out of HUD performance designations as a Troubled performer, for both its Low Rent Public Housing and Section 8 Housing Choice Voucher programs. Even though the recovery period allowed has been exceeded, many internal discussions of HUD intervention, such as takeovers/receiverships, have consistently been denied (primarily due to its small size, and the fact that HUD can pursue the ultimate solution, which is separation of the State developments from the HUD programs, outside a HUD takeover). An important issue has been the lack of effective leadership, both in the Boards of Commissioners and at the Executive level. Former Commissioners have used their NLHA position to leverage other political agendas, and been unwilling to focus on NLHA needs. The NLHA has gone

through several Executive Directors and financial oversight arrangements, none of which have been effective, but recent arrangements had shown promise, with full occupancy of units, improved maintenance, and a Section 8 HCVP fully out of a troubled status. This was resolved during 2006, by contracting out program administration, which resulted in passing SEMAP scores for 2007 and 2008. The OIG recently completed an investigation of the Section 8 Housing Choice Voucher program, which resulted in the arrest of an individual formerly employed by the NLHA, and her husband, employed in the NLHA's Low Rent Public Housing program.

The Executive Director who came on in 2005 dealt with basic issues of property management (maintaining and filling units and making a better effort at collecting rents) as his predecessors never did, but has been challenged by an ever-increasing operating deficit and high accumulated debts. The overall deficit is sourced primarily in the State program, but affects finances for the Low Rent Public Housing program, as it was recently confirmed that restricted Federal funds have been misappropriated for the State Moderate Income Housing programs, during 2008. Complicating matters is the challenge of the Connecticut State low income housing, which is not supported with operating or capital funding.

The NLHA and HUD entered into several Memoranda of Agreement (MOA) over the years, which each listed strategies that the NLHA was to implement in order to become a standard performer. Through this process, the Management scorings improved. Current NLHA leadership has filled units and begun dealing with the issues of its State of CT portfolio, and finally agreed to contract out administration of the Section 8 HCV program. However, the financially substandard status has not been overcome, due to the demands of the unfunded State programs, which has been allowed to affect finances for the Low Rent Public Housing program; as it was recently confirmed that restricted Federal funds have been misappropriated for the State Moderate Income Housing programs, during 2008.

**Comment 4**

Therefore; the substantial and critical nature of this breach created an emergency situation precipitating the agreement by NLHA's Board of Commissioners to turn to an Alternative Management Entity, so as to simultaneously deal with all remaining unresolved issues. The alternative procedure of the Board employing an Asset Manager to provide ongoing performance testing of a private Property Manager, who will assume possession and operational responsibility for all of the public housing administered by the Housing Authority of New London is in the process of implementation.

**Comment 5**

Therefore, the institution of the requested alternative to a HUD direct intervention will allow the NLHA to correct all substantial deficiencies and bring the NLHA into compliance with mandatory statutes, regulations and directives. Drastic

improvements in the internal controls of Federal funding, the financial management operations, and procurement and contracting practices, will be accomplished in a short time span of one year or less. With the completion of these improvements, the NLHA will be recovered, and the NLHA Board of Commissioner will be able to consider its options for the organization of future program management, with a well-run agency which operates with no additional cost over programs with traditional management.

HUD's Recovery and Prevention Corps has provided guidance, assistance and technical assistance, and has determined that remaining NLHA staff (its Executive Director has resigned) and its Board have now been cooperative and diligent in their attempts to operate and fulfill their mission, however, the NLHA lacks the capacity and ability at this time. Although the NLHA has produced slight improvements in its ability to operate the agency, particularly in the areas of unit leasing and maintaining occupancy and rental collections, this PHA requires in-depth leadership on a day-to-day basis, to reverse the deficit in its operations and guard against further misuse of Federal funds.

**Comment 3**

Therefore, in view of the emergency situation that presented itself, as well as the NLHA's inability to improve their PHAS FASS scores, we believe it is in the best interest of the NLHA to proceed with the plan for alternative management. Therefore, we recommend that the Housing Authority not now be declared in substantial default for failure to comply with the terms and intent of the ACC and the regulations issued by HUD for the modernization and operations of public housing projects as contained in Title 24 of the Code of Federal Regulations.

**Comment 6**

Further, any HUD intervention would have disrupted the partnership between the NLHA and the developer partner who is engaged in the redevelopment of 2 state properties. For HUD to take the decision to intervene, with a takeover or other serious intervention, there must be a viable plan for succeeding in the ultimate recovery. The intervention itself, had it been pursued, would have eliminated the most likely source of resources for this recovery, or delayed it by significant periods of time. The Department must remain focused on the outcome sought (the full recovery of this PHA), and not put process before that prime outcome.

**Comment 7**

Page 11 of the report discusses rents being placed in receivership as a result of unpaid bills. We request your office to revise this discussion or eliminate it entirely. The discussion suggests that the NLHA did not pay \$818,000 (of the \$1.7 million outstanding) it owed to the electric and gas utility companies for its federal properties, when in fact the NLHA has been paying a portion of the debt owed since January 2009. What is unknown at this time however is how the ongoing payments are carried against the debts owed and how those payments are attributed to federal properties. HUD provides annual funding to the NLHA based on the consumption used at both of its

federal properties and it is expected that the subsidies provided are used for that express purpose as well as all utilities, including water and sewer that the NLHA consumes. Further, please be advised that HUD has proposed no objection for the NLHA to extend for six months the abeyance of the orders appointing receivers and the parties have agreed to extend the order. In any case we believe that the NLHA has failed to use these funds to pay the utility bills.

**Comment 8**

From page 11 and with regard to the observation that **The Authority Lacks an Adequate Plan to repay its Creditors** please consider that for the long term, the Authority expects to receive around up to \$3.2 million from the redevelopment of its state properties sometime in the Spring of 2010, and the NLHA does have a plan to repay creditors with the proceeds including the \$500,000+ owed to the federal programs by the State Moderate Rental program to the federal programs. Much of the \$1.4 million payable from the federal program to creditors can be paid, if this is an accurate number, when the funds are realized from the State redevelopment closing. Most remaining payables reside in the State programs.

**Comment 9**

The IGA has spent many months at the NLHA and has successfully recreated books of account that were not kept current during 2007 and 2008. We have no comment on the accuracy of the accounting of NLHAs Accounts Payable except as follows:

**Pilot Payments:** These payments were forgiven by the City of New London for years, until the City began having financial problems. At that time 2005 or 2006, then Executive Director, Joe Abrams advised that he could not find anything in writing to prove the NLHA had an agreement with the City for no payments of PILOT. Against HUD's advice, Mr. Abrams agreed to pay all back PILOT for all the previous years it had not been paid – without asking for forgiveness of the old debt. As is mentioned in the draft audit it is undetermined how the PILOT is attributed or applied.

## OIG Evaluation of Auditee Comments

**Comment 1** The Authority's deficiencies and mismanagement have been long known to HUD and the community; thus, our audit focused on evaluating HUD's effectiveness in identifying and helping to correct them. We disagree that the report implicates HUD as a contributor to the Authority's failures and reported that "The Authority has been troubled primarily due to the poor management of its Federal and State housing programs."<sup>12</sup> The report credits HUD for detecting significant deficiencies and providing extensive assistance. Nonetheless, HUD's assistance was not effective or vigilant enough, and the Authority has remained in various stages of troubled status for more than 10 years.

Further, although HUD did not contribute to the Authority's problems, HUD is responsible for oversight and compliance with Federal regulations that require the Assistant Secretary for Public Housing to either issue a notice of substantial default or petition for a receiver when agencies do not comply with their annual contributions contracts and memorandums of agreement, fail to make substantial progress toward remedying their troubled status, and fail to recover from troubled status within the maximum recovery period. However, HUD has neither declared the Authority in substantial default nor taken possession of any or all of the Authority's projects or programs or petitioned for the appointment of a receiver as required by HUD regulations and Federal statute.

**Comment 2** HUD does not have the authority or responsibility for oversight of the Authority's State programs; thus, our report did not and would not address recovery efforts for State responsibilities in this area. HUD correctly identified the Authority's State programs as a drain on its resources. However, HUD did not take appropriate action to safeguard Federal program funds when the Authority reported that it used more than \$224,000 in Federal funds for its State programs in 2006 and that the amount had grown to more than \$524,000 by the end of 2007. Had HUD focused on protecting the Federal programs and proceeded to intervene at the end of 2006 based on the misappropriated funds or replaced management in December of 2007 as required by statute and regulation, the misappropriation of Federal funds might have stopped. As a result, these funds would have been available for Federal expenses, liens would not have placed against Federal projects, and the Federal programs might not be facing potential receivership through the State courts.

**Comment 3** The report accurately states that HUD did not take the required action in a timely manner. On December 12, 2007, HUD was required to either (1) declare the Authority in substantial default and refer it the Departmental Enforcement Center, as required by 24 CFR 902.79(a)(3), or (2) take possession of any or all of the Authority's projects or programs or initiate actions to appoint a receiver to assume the responsibilities of the Secretary, as required by The United States Housing

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<sup>12</sup> See "What We Found."



Act of 1937, 42 U.S.C. 1437.6(j)(3). Therefore, we considered HUD's March 29, 2009, recommendation to be too late and that its alternative solution and recommendation not to declare the Authority in substantial default or not to take possession of any or all of the Authority's projects or programs or pursue a receivership was not in compliance with Federal regulations or the statute. HUD did not fulfill its oversight responsibilities when it did not take appropriate action to safeguard Federal program funds when the Authority repeatedly reported that it used Federal funds for its State programs. HUD must either declare a substantial default or a violation of 6(j). However, if HUD declares a substantial default, it has unlimited time in which to rectify the default.

**Comment 4** We disagree that an emergency situation arose in 2008 from the use of Federal funds for State programs. The Authority's 2006 and 2007 financial statements clearly reported that hundreds of thousands in Federal project funds was used for State programs. HUD did not fulfill its oversight responsibilities when it did not take appropriate action to safeguard Federal program funds when the Authority repeatedly reported that it used Federal funds for its State programs. We believe that had HUD intervened in a timely manner, these funds would have been available to pay Federal expenses, thus avoiding property liens and the potential receivership of rents for nonpayment of utility expenses.

**Comment 5** HUD's alternative solution may have been effective had it been timely. However, HUD did not take appropriate action to safeguard Federal program funds when the Authority reported that it used more than \$224,000 in Federal funds for its State programs in 2006 and that the amount had grown to more than \$524,000 by the end of 2007. In addition, the failure to declare the Authority in substantial default leaves the board of commissioners in place, thus risking continued mismanagement and poor decision making that may lead to further misappropriation of Federal program funds. Therefore, to fully protect the Federal projects' interests and comply with Federal regulations and statutes, we recommend that HUD either declare the Authority in substantial default of its annual contributions contract and take actions available to the Secretary under 24 CFR Part 902 or take possession of any or all of the Authority's projects or programs or pursue receivership under 42 U.S.C. 1437.6(j)(3).

**Comment 6** HUD's statement that "Any HUD intervention would have disrupted the partnership between the NLHA [Authority] and the developer partner" is speculative and, thus, cannot be confirmed. The State redevelopment project has proceeded since HUD intervened in March of 2009 and convinced the Authority to begin the process of contracting out the management of its Federal and State programs. Thus, we could find no credible evidence to support HUD's justification for not intervening and taking action.

**Comment 7** We did not remove or revise our discussion of unpaid utility bills because as HUD conceded, they were not paid and the Authority's books and records showed that its accounts payable to the utility company totaled \$818,716 as of September 9,

2009. HUD is correct to note that the actual amount credited to the Authority's Federal utility accounts by the utility company differs from the Authority's books and records and, thus, must be reconciled before the actual amount can be determined. Therefore, this reconciliation should be completed as part of recommendation 1A.

**Comment 8** The Authority revised the estimated proceeds from the redevelopment of its State projects from \$2.1 million to \$3.1 million. Thus, we updated the report to reflect the higher expected proceeds. However, during the audit, neither HUD nor the Authority had a written plan or budget to show how the Authority would manage and meet its long-term and short-term obligations. In addition, we did not consider the statements in HUD's response to be adequate or accurate. First, HUD acknowledged that it did not know the full extent of the Federal programs' liabilities. Also, HUD's statement that the Authority expects to receive \$3.2 million sometime in the spring of 2010 is not accurate. Documents provided by the Authority's attorney showed that the Authority expects to receive only \$1.3 million in the spring of 2010 (see the complete schedule below). In addition, the State redevelopments and proceeds are contingent on State bonding, which, although approved by the Connecticut Housing Finance Authority, has not been passed in the State budget and, thus, is not assured at this time. Thus, our report and recommendation 1A remain unchanged and recommend that HUD establish and implement a formal written short- and long-term financial/business plan with measurable milestones to pay its Federal creditors, remove liens, and avoid receivership of rents for nonpayment of utilities.

|            |             |
|------------|-------------|
| 4/1/2010 - | \$1,394,000 |
| 1/1/2011 - | \$1,226,000 |
| 9/1/2011 - | \$324,000   |
| 1/1/2014 - | \$216,000   |
| Total      | \$3,160,000 |

**Comment 9** OIG did not and would not recreate the Authority's books and records during an audit. We based our conclusions on the Authority's existing books and records as verified by the supporting source documents and independently audited financial statements.

HUD provides operating funds for payments in lieu of taxes to reimburse cities for the substantial cost of providing services to tenants and their children. Thus, payments in lieu of taxes [PILOT] expenses are valid expenses that must be paid. Further, with no signed agreement to show that the payments were forgiven, we considered it unreasonable to suggest that the Authority should not have agreed to pay past-due PILOT payments and should have shifted the burden to the taxpayers of New London for the full cost of services provided for these tenants.

## Appendix C

### AUTHORITY PHAS SCORES

| Authority PHAS status |                    |                              |        |         |          |           |            |
|-----------------------|--------------------|------------------------------|--------|---------|----------|-----------|------------|
| Fiscal year           | Status/designation | REAC* PHAS notification date | PASS** | FASS*** | MASS**** | RASS***** | Total PHAS |
| 1998                  | Advisory           | 10/16/2000                   | 18     | 18      | 18       | 10        | 64         |
| 1999                  | Advisory           | 4/4/2001                     | 15     | 3       | 17       | 9         | 44         |
| 2000                  | Advisory           | 12/31/2001                   | 11     | 11      | 25       | 4         | 48         |
| 2001                  | Substd financial   | 1/16/2004                    | 28     | 11      | 26       | 9         | 74         |
| 2002                  | Substd financial   | 8/28/2003                    | 28     | 0       | 25       | 8         | 61         |
| 2003                  | Overall troubled   | 5/26/2004                    | 14     | 2       | 13       | 8         | 37         |
| 2004                  | Overall troubled   | 7/12/2005                    | 24     | 0       | 20       | 9         | 53         |
| 2005                  | Overall troubled   | 6/17/2006                    | 22     | 0       | 22       | 6         | 50         |
| 2006                  | Overall troubled   |                              | 14     | 0       | 20       | 6         | 40         |
| 2007                  | Overall troubled   |                              | 21     | 0       | 27       | 4         | 52         |
| 2008                  | Suspended          |                              |        |         |          |           |            |

\* REAC = Real Estate Assessment Center

\*\* PASS = Physical Assessment SubSystem

\*\*\* FASS = Financial Assessment SubSystem

\*\*\*\* MASS = Management Assessment SubSystem

\*\*\*\*\* RASS = Resident Assessment SubSystem

| Authority SEMAP* (Section 8) status |                    |             |
|-------------------------------------|--------------------|-------------|
| Fiscal year                         | Status/designation | Total score |
| 2000                                | Troubled           | 12          |
| 2001                                | Troubled           | 28          |
| 2002                                | Troubled           | 4           |
| 2003                                | Troubled           | 58          |
| 2004                                | Standard performer | 81          |
| 2005                                | Troubled           | 15          |
| 2006                                | Troubled           | 26          |
| 2007                                | Standard performer | 89          |
| 2008                                | High performer     | 100         |

\* SEMAP = Section Eight Management Assessment Program

Note - Yellow highlights indicate failing PHAS scores