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TO: Edward T. De Paula, Director, Office of Public Housing, 2FPH
Dane M. Narode, Associate General Counsel for Program Enforcement, CACC
Craig T. Clemmensen, Director of Departmental Enforcement Center, CACB

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

SUBJECT: The Jersey City Housing Authority, Jersey City, NJ, Had Administration Weaknesses in Its Capital Fund Programs

HIGHLIGHTS

What We Audited and Why

We audited the Jersey City Housing Authority's (Authority) administration of its 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 objectives were to determine whether the Authority (1) obligated and expended funds under the Public Housing Capital Fund program (CFP) and Capital Fund Financing program (CFFP) in accordance with HUD regulations, and (2) had a financial management system in place that complied with program requirements.

What We Found

The Authority did not always comply with HUD regulations while obligating and expending capital funds, and its financial management system did not always comply with program requirements. Specifically, the Authority (1) inadequately used capital funds for a development that was subject to be converted to tenant-based assistance, (2) drew down capital funds without proper supporting documentation, (3) inappropriately obligated bond proceeds under the CFFP, (4) inadequately disbursed CFFP bond proceeds for preaward costs, and (5) lacked a plan for using force account labor. Consequently, (1) more than $1.3 million in capital funds was inappropriately disbursed for a public housing development that was subject to be converted to tenant based assistance, (2) more than $2 million in drawdowns was not adequately supported, (3) $338,236 in CFFP bond proceeds was inappropriately obligated, (4) $53,452 of the CFFP bond proceeds was ineligibly disbursed for costs incurred before HUD's approval of this program, and (5) $1.1 million in force account labor charges was incurred without a plan or analysis of the cost effectiveness of the activities.

There were control weaknesses in the Authority's financial management system. Specifically, accounting records and financial reports were not complete, accurate, and current; and the obligation of funds cannot be effectively tracked and monitored. As a result, the Authority's internal controls were not sufficient to safeguard assets and ensure their use in accordance with applicable requirements.

What We Recommend

We recommend that the Director of HUD's New Jersey Office of Public Housing instruct the Authority to (1) provide supporting documents to HUD for the more than $3.3 million in capital funds spent on the Montgomery Gardens Development, and for unsupported draw downs, and reimburse any costs determined to be ineligible; (2) conduct the required annual reviews to identify developments that should be converted to the tenant based program; (3) deobligate $338,236 obligated for contingencies under the CFFP; (4) reimburse $53,452 in ineligible preaward costs to the CFFP bond proceeds from annual capital funds; (5) establish an adequate force account labor plan; and (6) develop procedures that will improve the accounting system and internal controls to ensure that accounting records and financial reports are accurate, current, complete, and adequately supported with source documents.

We also recommend that of HUD's Departmental Enforcement Center and Associate General Counsel for Program Enforcement determine whether further administrative actions should be pursued for not carrying out the actions certified to in the five year plans in relation to the conversion of Montgomery Gardens.

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 October 1st, 2010. On October 1st, 2010, 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 OBJECTIVES

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 operation 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. During the period from April 1, 2007 to March 31, 2009, more than $1.1 million of capital funds was expended for Montgomery Gardens Development, a public housing development, which should have been converted to tenant-based assistance and may be subject to demolition. In addition, operating subsidies were also used for this development; for instance, approximately $2.3 million in operating subsidies was disbursed for program year 2008.

In August 2007, the Authority incurred a $10 million long-term liability as part of the Capital Fund Financing Program (CFFP) to perform modernization work for its low-rent projects. Under this program, HUD recognizes that some authorities may not have enough funds in a single year to make all of the improvements necessary to adequately maintain their public housing. Therefore, it allows an authority to borrow private capital to make improvements and pledge, subject to the availability of appropriations, a portion of its future-year annual capital funds to make debt service payments for either a bond or conventional bank loan transaction. The Authority pays the debt service from the capital fund grants. More than $248,000[1] of the $10 million bond proceeds were allocated for the expenses associated with the Montgomery Gardens development.

The objectives of the audit were to determine whether the Authority (1) obligated and expended funds under the Public Housing Capital Fund program (CFP) and Capital Fund Financing program (CFFP) in accordance with HUD regulations, and (2) had a financial management system in place that complied with program requirements.

[1] This amount includes $5,867 and $242,179 expended for design services and replacement of an oil tank at the Montgomery Gardens development (see the sections "Inadequate Usage of Capital Funds" and "Inadequate Disbursement of CFFP Proceeds" in Finding 1).

RESULTS OF AUDIT

Finding 1: The Authority Did Not Always Comply With HUD Regulations While Obligating and Expending Capital Funds

The Authority did not always comply with applicable HUD regulations while obligating and expending capital funds. Specifically, it (1) inadequately used capital funds for a development that was subject to be converted to tenant-based assistance, (2) drew down capital funds without proper supporting documentation, (3) inappropriately obligated bond proceeds of the CFFP, (4) inadequately disbursed CFFP bond proceeds for preawarded costs, and (5) lacked a plan for using force account labor. This noncompliance occurred because Authority officials were unfamiliar with applicable HUD requirements and did not develop and implement adequate controls over the Authority's capital fund activities. As a result, (1) more than $1.3 million in capital funds was inappropriately disbursed for a public housing development that was subject to be converted to tenant-based assistance, (2) more than $2 million in drawdowns was not adequately supported, (3) $338,236 in bond proceeds was inappropriately obligated, (4) $53,452 in bond proceeds was ineligibly disbursed for the preaward costs, and (5) $1.1 million in force account labor charges was incurred without a plan or analysis of the cost effectiveness of the activities.

Inadequate Use of Capital Funds

The Authority inappropriately used more than $1.3 million on a development that should have been converted to tenant-based assistance and may be subject to demolition. Specifically, the Montgomery Gardens Development should have been mandatorily converted to the tenant-based assistance program, and its maintenance expenses should have been covered by the Authority's operating funds; thus, public housing capital funds should not have been used.

Regulations at 24 CFR (Code of Federal Regulations) 968.112(b) state that except in the case of emergency work, a housing authority shall only expend capital funds on a development for which it has determined and agreed that the completion of the improvements will reasonably ensure the long-term viability of the project at a reasonable cost or for reasonable nonroutine maintenance to keep the property habitable until the tenants are relocated or the development is demolished. Further, Section 968.112(o) states that the use of capital funds to provide public housing operating assistance is an ineligible cost.

In addition, regulations at 24 CFR 972.100 provide that public housing authorities are required to annually review their public housing inventories and identify developments or parts of developments, which must be removed from their stock of public housing operated under annual contributions contracts with HUD.

Public housing authorities must follow specific procedures to develop and carry out conversion plans to remove identified units from their public housing inventories.

The regulations at 24 CFR 972.139 also indicate that if a public housing authority fails to properly identify a development for required conversion or does not submit a conversion plan for a development, HUD will take actions described in paragraphs (b) and (c) of 24 CFR 972.139.

Moreover, on December 28, 2006, HUD notified the Authority that the Montgomery Gardens development was a potential required conversion candidate. The Authority acknowledged this notification and certified to HUD that it was going to conduct an assessment of the development in its 5-year and annual plans submitted and approved in 2007 and 2008 respectively.

However, the Authority did not (1) conduct an annual review of its public housing stocks to identify developments or parts of developments, which must be removed from its housing stock because they were not economically viable, and (2) develop and carry out a conversion plan to remove these identified housing units, including transitioning the residents to other affordable housing. Consequently, 435 units at the development continued to be operated under the low-rent public housing program, but should have been converted to tenant-based assistance due to a high vacancy rate of more than 40 percent. Authority officials stated that they were not aware of the requirement to mandatorily convert developments to the tenant-based assistance program. However, this explanation did not agree with the information submitted to HUD in the Authority's 5-year and annual plans for 2007 and 2008 as stated above.

Instructions at the Appendix for 24 CFR 971, entitled Methodology of Comparing Cost of Public Housing With Cost of Tenant-Based Assistance, provides the guidance on how to do the cost analysis. However, this analysis was not done.

As a result, the Authority had expended $429,561 and $682,769 of its annual CFP grants for the development during fiscal years ending March 31, 2008 and 2009, respectively. In addition, $242,179 in bond proceeds obtained through its CFFP was allocated to a contractor for replacing an oil tank at the development. As of December 31, 2009, $210,480 of the $242,179 had been expended, and the difference of $31,699 will be disbursed upon the completion of the project. Therefore, the total disbursement of more than $1.3 million from CFP and CFFP funds is considered to be unsupported pending an eligibility determination by HUD, and the remaining $31,699 contractual amount should be considered as funds to be put to better use if the obligation is canceled and the funds are used for other eligible purposes. In addition, the Authority expended over $2.3 million of operating subsidy during fiscal year 2008 for this project that was subject to mandatory conversion.

Unsupported Drawdowns

The Authority did not always maintain adequate and complete documentation to support drawdowns of capital funds. Office of Management and Budget (OMB) Circular A-87 states that allowable costs must be adequately documented. However, $1,658,259 in hard costs and relocation costs was not supported with proper documentation, such as contractors' requests for payments, vendors' invoices, and cancelled checks. The following schedule includes information regarding the source of funding associated with these drawdowns.

Year of funding	Drawdowns for hard and relocation costs
2003 CFP	$ 683,534
2005 CFP	$ 506,957
2006 CFP	$ 467,768
Total:	$1,658,259

In addition, HUD's Line of Credit Control System (LOCCS) indicates that the Authority drew down $972,755 for management improvement and administrative costs incurred from April 1, 2007, through March 31, 2008. However, the Authority's records and documents revealed that only $589,133 was expended for management improvements and administrative costs. Regulations at 24 CFR 85.20 require that grantees and subgrantees maintain records, which adequately identify the source and application of funds provided for financially assisted activities. According to Authority officials, the discrepancy might be due to the accounting procedures, which allowed the Authority to disburse the funds drawn down from LOCCS under the budget of management improvement and administrative costs for other expenses such as dwelling structure costs instead. However, the documentation provided did not support this explanation and the $383,622 discrepancy in the application of these funds.

We attribute these deficiencies to the Authority lacked adequate accounting controls to ensure that adequate and complete documentation was maintained to support the use of the capital funds. As a result, the more than $2 million for these drawdowns was not supported by source documents and is, therefore, considered to be questioned costs.

Inappropriate Obligation of Bond Proceeds Under CFFP

The Authority did not properly obligate bond proceeds under the HUD-approved CFFP. Within the CFFP, HUD permits a public housing authority to borrow private capital to make improvements at housing projects and pledge a portion of its future-year capital funds to make debt service payments. HUD approved the Authority's CFFP application in July 2007. In August 2007, the Authority obtained $9,635,997 in CFFP bond proceeds net of financing costs. The Authority reported that all of the $9.6 million in bond proceeds had been obligated as of September 30, 2009. However, $1,109,116 out of the $9.6 million was obligated as a contingency fund for construction cost overruns, which was $338,236 more than the maximum contingency amount allowed. Regulations at 24 CFR 968.325(a) state that contingencies shall not exceed 8 percent of the total grant. This deficiency was because Authority officials misinterpreted HUD regulations. Therefore, $338,236 in CFFP funds was not appropriately obligated and should be deobligated and used for other eligible activities.

Inadequate Disbursement of CFFP Proceeds

The Authority improperly disbursed $53,452 in CFFP bond proceeds to reimburse the costs incurred before HUD approved the CFFP. In late 2005 and the beginning of 2006, the Authority awarded three contracts for services related to its public housing projects. Since HUD did not approve this program until July 2007 and the bond proceeds were not received until August 2007, the Authority originally used 2005 CFP grant funds to pay the contractors and obtained reimbursement from CFFP bond proceeds when the funds became available.

OMB Circular A-87 indicates that the preaward costs are allowable only with the written approval of the awarding agency. The Authority did not notify HUD that CFFP bond proceeds would be used to cover the preaward costs. Authority officials explained that they had thought that because the annual statement submitted to HUD included the budget for all of the activities financed by the bond proceeds, no other notification was required. However, the annual statement did not identify the activities, which had incurred costs before HUD's approval of the program. As a result, $53,452 was ineligibly disbursed from CFFP proceeds and should be reimbursed from regular capital funds.

Contract	Contract signed	Contract work proceeded	Cost paid	Date paid to contractors	Date HUD approved program
1	10/19/05	01/02/06	$23,565	06/30/06 and 08/31/06	07/26/07
2	11/02/05	01/02/06	$24,020	02/28/06	07/26/07
3	01/11/06	03/13/06	$ 5,867	01/31/07	07/26/07
		Total	$53,452		

Lack of a Plan for Using Force Account Labor

The Authority did not develop and implement a plan for using its force account labor (its own employees) to perform capital improvements. Nevertheless, it used force account labor extensively for its capital improvement activities. The Authority's accounting data disclosed that during fiscal years 2008 and 2009 the Authority incurred a total of $2,218,424 in force account labor and materials costs with average annual costs of $947,112 and $162,100 for force account labor and material costs, respectively. The following schedule summarizes these costs.

Year of funding	Labor costs	Material costs	Total
2004 CFP	$19,957	$2,560	$22,517
2005 CFP	$161,344	$98,559	$259,903
2006 CFP	$547,072	$96,273	$643,345
2007 CFP	$713,028	$123,277	$836,305
2008 CFP	$452,824	$3,530	$456,354
Grand Total Costs:	$1,894,225	$324,199	$2,218,424
Average annual costs:	$947,112	$162,100	$1,109,212

Regulations at 24 CFR 968.120 state that a public housing authority may undertake the activities using force account labor only when specifically approved by HUD in the capital fund budget or annual statement. In addition, the instruction of the annual statement (form HUD-50075.1) requires public housing authorities to identify major work categories that will be accomplished by force account labor.

However, the Authority's annual plan submitted to HUD did not identify the activities that would be carried out by force account labor or provide the budget for the estimated labor and material costs for these activities. The Authority did not have an in-house plan either for using force account labor costs. The Authority's documentation consisted of a payroll budget, which only indicated annual salary and benefit costs of the employees and did not specify the funding source, or the activities that the employees would be assigned to. Moreover, there was no documented analysis, which showed that force account labor was more economical than contract labor. As a result, HUD was precluded from effectively monitoring the Authority's force account labor activities and may not be able to determine whether the CFP was carried out efficiently and effectively. In addition, due to the lack of an adequate audit trail it was not possible to determine which drawdowns were used to pay force account labor and material costs. However, the average annual amount of more than $1.1 million disbursed for force account labor and material cost for next year could be considered as funds to be put to a better use if the Authority establishes procedures and a plan for using force account labor to ensure that it is cost effective.

Conclusion

The Authority did not always comply with applicable regulations while obligating and expending capital funds. Consequently, (1) more than $1.3 million in capital funds was disbursed, which could have been saved if the public housing development had been converted to a tenant-based program, (2) more than $2 million in drawdowns was not adequately supported, (3) $338,236 of the bond proceeds was inappropriately obligated, (4) $53,452 of the bond proceeds was ineligibly disbursed for the preaward costs, and (5) HUD was precluded from effectively monitoring and evaluating the Authority's capital fund programs. We attribute these deficiencies to Authority officials' unfamiliarity with HUD regulations and the lack of adequate controls over capital fund activities.

Recommendations

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

1A. Provide documentation to HUD for the $1,322,810 in capital funds expended for the Montgomery Gardens Development so that HUD can make an eligibility determination, and any amounts determined to be ineligibile should be repaid from non-Federal funds.

1B. Provide documentation to HUD for the $31,699 in bond proceeds obligated for the Montgomery Gardens Development so that HUD can make an eligibility determination and deobligate any amount determined to be ineligible, thus putting these funds to better use.

1C. Conduct an annual review of its housing stock to identify developments or parts of developments, which must be removed from its housing stock, and develop and carry out a conversion plan for any identified developments or parts of developments.

1D. Submit to the Office of Public Housing supporting documentation for the $2,041,881 in unsupported drawdowns so that HUD can make an eligibility determination and reimburse HUD for any costs determined to be ineligible.

1E. Deobligate $338,236 of the bond proceeds under the CFFP, which is currently obligated as contingency funds, and use these funds for other eligible activities.

1F. Reimburse $53,452 in ineligible preaward costs to the CFFP bond proceeds from annual capital funds.

1G. Submit documentation to support the eligibility of $2,218,424 of force account labor and material costs incurred in program years 2008 and 2009 and repay any amounts determined to be ineligible from nonfederal funds.

1H. Establish an adequate force account labor plan and submit it to HUD for approval before using any additional force account labor. The plan shall identify the activities that would be carried out by force account labor and provide a budget for estimated labor and material costs for each activity, thus ensuring that $1,109,212 in annual force account labor and material costs will be put to better use.

We also recommend that HUD's Associate General Counsel for Program Enforcement and the Director of HUD's Departmental Enforcement Center

1I. Pursue appropriate administrative sanctions for failing to enforce HUD's requirements regarding the conversion of the Montgomery Gardens Development, as was certified to in the Authority's five year and annual plans.

Finding 2: There Were Weaknesses in the Authority's Financial Management System

The Authority had weaknesses in its financial management system. Specifically, (1) accounting records and financial reports were not complete, accurate, and current; and (2) the obligation of funds could not be effectively tracked and monitored. These deficiencies occurred because the Authority did not develop and implement effective controls to ensure that the financial information on its capital fund activities was complete and accurate. As a result, the Authority's internal controls were not sufficient to safeguard assets and ensure their use in accordance with applicable requirements.

Inaccurate Accounting Records and Financial Reporting

Although regulations at 24 CFR 85.20(b)(1) and (2) provide that housing agencies must maintain financial records that are accurate and current and that adequately identify the source and application of funds provided for assisted activities, the Authority's accounting records did not reflect current, complete, and accurate financial information for its capital fund-financed activities. For instance, HUD's Line of Credit Control System (LOCCS) reports disclosed that as of March 31, 2008, the Authority had drawn down more than $4.7 and $3 million from capital fund grants in 2005 and 2006, respectively; however, the Authority only recorded $3.7 and $2.8 million, respectively, in its accounting system. Authority officials explained that the discrepancies were caused by accounting mistakes and computer system errors. Several drawdowns from 2005 and 2006 grants were mistakenly recorded as having come from other years' grants. In addition, there was a computer system malfunction, which prevented the prior year's ending balance of drawdowns for soft costs from being transferred to the current year's beginning balance.

Further, Authority officials backdated the Authority's adjustment entries. For example, when we notified Authority officials in April 2010 that the Authority's journal entries related to the reimbursement of CFFP bond proceeds from the 2005 CFP grant contained errors, the Authority made an adjustment and backdated it to February 28, 2010. Authority officials stated that they tried to fix the errors before the fiscal year ending date of March 31, 2010, and that they were allowed to backdate transactions as long as the annual audit had not started.

Regulations at 24 CFR 85.20(b)(1) provide that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant. Regulations at 24 CFR 85.20(b)(3) require that effective control and accountability be maintained for all assets.

Therefore, the backdating of accounting transactions may violate the requirements for current and accurate records and the complete disclosure of the results of operations. Thus, the backdating of accounting entries could reduce accountability and is a control weakness.

Moreover, the Authority's accounting procedures allowed it to draw down capital funds from LOCCS for administrative and management improvement expenses but use the funds to cover other expenses such as dwelling structure costs, etc., (see finding 1). Proper accounting records were not maintained to track these transactions, and the budget in LOCCS was not revised to reflect the actual use of these funds. Therefore, there was a risk that certain expenses such as administrative costs may have exceeded the HUD-allowed threshold because the costs were not properly recorded. Consequently, financial reports submitted to HUD, such as financial data schedules and performance and evaluation reports may not have accurately reflected the results of the Authority's operations.

Other deficiencies were also noted in the financial reports. For example, (1) the financial data schedule for fiscal year 2008 provided a lump sum of less than $1.7 million for operating expenses without providing a detailed breakdown of the costs, (2) the Authority overlooked $32,064 in administrative costs and did not include it in the operating expenses reported in the financial data schedule for fiscal year 2008, and (3) the amount of CFFP bond proceeds obligated for fees and costs on the summary page of the performance and evaluation report did not reconcile with that on the supporting pages.

Ineffective Tracking System for Fund Obligation

Authority officials did not have an effective system for tracking and monitoring the obligation of capital funds. Regulations at 24 CFR 85.20(b)(2) and (6) provide that housing authorities must maintain adequate accounting records regarding obligated and unobligated balances and that the accounting records must be supported by source documents. The Authority maintained an Access database to track its contracts; however, the database did not reflect the funding sources for the contracts. Authority officials said that they had to refer to hard-copy contract files to identify the funding sources. As a result, it was difficult to track and monitor obligations by program and detect errors, especially when the contracts were financed by multiple years' grants and/or various programs. We attribute this issue to inadequate controls of the Authority's financial system.

Conclusions

The Authority had weaknesses in its financial management system. Specifically, (1) accounting records and financial reports were not complete, accurate, and current; and (2) the obligation of funds could not be effectively tracked and monitored. These deficiencies occurred because the Authority did not develop and implement effective controls to ensure that the financial information on its capital fund activities was complete and accurate. As a result, the Authority's internal controls were not sufficient to properly safeguard assets and ensure their use in accordance with applicable requirements.

Recommendations

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

2A. Develop procedures that will improve the accounting system and internal controls to ensure that accounting records and financial reports are accurate, current, complete, and adequately supported with source documents. At a minimum, the system should permit the tracing of funds at a level that ensures that such funds are not used in violation of the restrictions and prohibitions of applicable statutes.

SCOPE AND METHODOLOGY

Our review focused on whether the Authority obligated and expended capital funds in accordance with HUD requirements and had an adequate financial system in place. To accomplish our objectives, we

- Reviewed relevant HUD regulations, program requirements, and applicable laws.
- Obtained an understanding of the Authority's management controls and procedures.
- Interviewed appropriate personnel of HUD and the Authority.
- Reviewed reports from HUD systems, such as the Line of Credit Control System (LOCCS), the Financial Assessment Submission-Public Housing Authority System (FASPHA), and the Public and Indian Housing Information Center system (PIC).
- Reviewed the Authority's files and records, including performance and evaluation reports, financial data schedules, general ledgers, and bank statements.
- Reviewed HUD's monitoring report and independent accountant audit reports.
- Traced amounts included in financial data schedules to general ledgers.
- Analyzed the Authority's obligations and disbursements of annual grants of the CFP and bond proceeds of the CFFP.
- Selected and tested a nonrepresentative sample of $679,048 in drawdowns, which represents 6 percent of the Authority's total drawdowns of $11,119,980 for hard and relocation costs incurred during the audit period. Since there are several instances in which the Authority drew down funds twice for the same cost items within short periods, we extended our sample to include drawdowns beyond our audit period. Our total tested drawdowns amounted to $2,302,208.

The audit generally covered the period April 1, 2007, through December 31, 2009. We extended the period as needed to accomplish our objectives. We performed our audit fieldwork from January through June 2010 at the Authority's office located at 400 U.S. Highway #1, Jersey City, NJ.

We conducted our 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 objectives.

INTERNAL CONTROLS

Internal control is a process adapted 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.

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 effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe the following items are significant deficiencies:

- The Authority did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations while obligating and disbursing capital funds (see finding 1).

- The Authority did not implement effective controls to safeguard assets and ensure that the financial information on its capital fund activities was complete, accurate, and current (see findings 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A		$1,322,810	
1B			$31,699
1D		$2,041,881	
1E			$338,236
1F	$53,452		
1H			$1,109,212
Total	$53,452	$3,364,691	$1,479,147

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/ 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. In this instance, if the Authority implements our recommendation to establish and implement procedures that will ensure the adequate obligation and disbursement of CFFP bond proceeds and develop an adequate force account labor plan, HUD can be assured that these funds will be put to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Jersey City Housing Authority
Building Communities...Creating Opportunities...Transforming Lives

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Tel 201.547.6600 TDD 201.547.8989 Web www.jcha.us

October 1, 2010

Mr. Edgar Moore, Regional Inspector General for Audit
U.S. Dept. of Housing and Urban Development
26 Federal Plaza, Rm. 3830
New York, NY 10278 0068

Dear Mr. Moore:

Pursuant to the Department's Office of Inspector General draft audit report, attached please find the JCHA's responses.

We want to thank the Department for the opportunity to respond to the draft audit and will implement a number of recommendations made by your staff.

If you have any questions or require additional information, please do not hesitate to contact me at (201) 706-4601. Thank you.

Very truly yours,

Maria Maio

Maria T. Maio
Executive Director

MTM/aa

Ref to OIG Evaluation **Auditee Comments**

FINDING 1: THE AUTHORITY DID NOT ALWAYS COMPLY WITH HUD REGULATIONS WHILE OBLIGATING AND EXPENDING CAPITAL FUNDS

Item 1: Use of CFP funds for Montgomery Gardens that was subject to mandatory conversion to tenant-based assistance.

The JCHA has reviewed Section 33 of the U.S. Housing Act of 1937 which sets forth the requirements for the required conversions of developments from the public housing stock to tenant based assistance. The JCHA has also reviewed the PIH website for Required Conversion, and more specifically the Candidate Cluster Reports that list the developments that may require mandatory conversion.

The JCHA acknowledges that on December 28, 2006 Montgomery Gardens was a potential required conversion candidate. The JCHA further acknowledges that it certified to HUD that it was going to conduct an "assessment" of this development in its 5-year and annual plans of 2007 and 2008. However, the JCHA maintains that pursuant to its annual plan, it certified that it would conduct an assessment but it did not certify that it would submit a conversion plan.

Comment 1

Additionally, upon review of subsequent monthly Candidate Cluster Reports from January 29, 2007 to March 3, 2008 (the date of the last Candidate Cluster Report), Montgomery Gardens was not included. Pursuant to HUD directives, SAC will review the report and only if the cluster still appears on the next report will a cost viability test be required. Therefore it appears that Montgomery Gardens was taken off the Candidate Cluster Report after December 2007 and conversion is not mandatory.

It is important to note that the JCHA was cognizant of long-term management challenges experienced by this development, i.e. physical obsolescence, higher rates of vacancy, higher rates of turn-down by prospective tenants, increasing crime and vandalism, etc. Montgomery Gardens was the topic of extensive discussions among staff, Commissioners and residents which resulted in the Board of Commissioners approving a Resolution in Summer 2008 to initiate a voluntary relocation program and a Master Planning process to revitalize Montgomery Gardens to a mixed income community as certified in the JCHA's FY 2010 Agency Plan.

The JCHA acknowledges that it expended $429,561 and $462,256 (vs. $682,769) of its annual CFP grants for Montgomery Gardens during Fiscal Years ending March 31, 2008 and 2009 respectively.

Ref to OIG Evaluation	Auditee Comments

During this time Montgomery Gardens tenants were in occupancy at this site. (As of this date, of the 434 dwelling units, 203 are occupied.) Federal, State and local laws and codes require that certain physical standards be maintained in rental units that are occupied. Subsequently, the JCHA made considered asset management decisions to judiciously use CFP to maintain the property to minimum occupancy standards including: off-duty police patrols to combat the rising crime; using CFP-paid force labor and third-party contracts to respond to emergency work orders and to abate health and safety violations; funding voluntary relocation costs; and securing vacant apartments.

The JCHA acknowledges that it allocated $242,179 of the $10 million in CFFP to oil tank replacement at Montgomery Gardens.

These funds were utilized to replace a nearly 40 year old oil tank that was the primary source of heating for the six high-rise towers at Montgomery. Due to the out-dated heating system in place at Montgomery Gardens, the Asset Manager's Office at this site frequently receives complaints about there being too little heat in the winter months. Because the 15,000 gallon tank, originally installed in 1971, had been showing signs of corrosion on the exterior surface for many years, and was undersized for the out dated and aging heating system of which it was a vital component, replacement of the oil tank at Montgomery Gardens was a priority for capital improvements (for all our developments) that needed to be made.

Comment 1

What added to the complexity and cost of this particular contract was that the oil tank was situated in a bunker that was half underground; so in order to remove the oil tank and replace it with a new one, the roof from the existing structure had to be removed and rebuilt to make room for the newer, and significantly larger, replacement oil tank. It is also worth noting that at the time the JCHA made the decision to undertake this work, it was presumed that this replacement oil tank would last just as long as the tank it replaced (approximately 35+ years), as the future of the existing towers at Montgomery Gardens had not been determined. In addition, the condition of the old tank was such that the JCHA determined that this work was necessary to avoid any potential environmental hazard that would come with a failing or leaking oil tank.

Following the decision to create a revitalization plan, it was further determined that any phased revitalization plan would likely take a minimum of 10 years and during that time, as long as a single tenant remained in the towers, adequate heat would have to be provided through the centralized system. Further, upon the discontinuance of the need for heat, the oil tank would be available for re-use at another development.

The JCHA acknowledges that it expended over $2.3 million of operating subsidy during fiscal year 2008 for Montgomery Gardens but disagrees that it was subject to mandatory conversion as explained above. Once the JCHA, the City, and the residents agreed to begin a revitalization master plan, the JCHA worked closely with the HUD-Newark area office to track vacancies and determine appropriate subsidy funding levels in light of the increasing vacancy rate. (Note: In CY 2010, the JCHA and the HUD NJ Office of Public Housing used current occupancy levels in determining total unit months available in calculating public housing fund operating subsidy for this development.)

Item 2: CFP draw downs without supporting documentation

The JCHA maintains separate funds for its programs in the General Ledger and has used that as a source for draw downs from eLoccs. All CFP transactions, fund receipts, credits, accounts payable, payroll distribution, maintenance material distribution from the Central Warehouse, employee benefit distribution and any other required entries are posted to the General Ledger. All supporting documents are maintained within the JCHA's Accounting Department with reports being available through the in-house ECS system. Each posted transaction has a corresponding reference number assigned to it by the accounting module. As noted by the JCHA's auditor, this practice was acceptable during those fiscal years, but HUD issued revised procedures in March, 2010.

Comment 2

The CFP program does not operate on a "normal" fiscal year basis (April to March) because the funding starting dates vary year to year. It is common that programs incur expenses during one fiscal year with funding being received in the following fiscal year. The JCHA believes that the supporting documentation for CFP expenses are in the General Ledger and it subsidiary documents (Accounts Payable, Journal Vouchers, material Requisitions) and cites as an example the auditor's request for supporting documentation for ARRA costs as an example. The auditor made specific requests based on General Ledger entries to ARRA account numbers and was provided substantial backup documentation electronically in 4 large files.

Past JCHA audits have not noted any instances of inadequate documentation or any disallowed costs.

The JCHA has provided summaries of expenses vs. receipts for the fiscal years ending 3/31/08 and 3/31/09 for CFP programs 2003-2008. These summaries illustrate that the costs per grant were not exceeded and receipts to offset these costs were received after incurred. As stated above, the General Ledger has the expense details for all accounts including management improvements and administrative costs. As discussed with the auditors, the budgeted amounts for each line item in eLoccs were not revised to reflect the JCHA's submission of its CFP Annual Statements. If those revisions had happened, then the JCHA would be able to draw down funds for the corresponding work item expenses.

Ref to OIG Evaluation **Auditee Comments**

The JCHA will make very effort in the future to request eLoccs revisions as necessary so that HUD staff can redistribute per annual statements revisions.

Item 3: *Inappropriately* obligated bond proceeds

Comment 3

Per NJ Local Public Contracts Law, construction contracts may have a 20% contingency for "minor field modifications" encountered during the contract period. The JCHA awarded contracts under the CFFP program with contingencies up to 20% of the base contract and obligated that amount in the respective work item on the Annual Statement (Budget). HUD audit staff note that all contingencies should be no higher than 8% of the entire grant and that the JCHA should "deobligate" the amount over the 8%. Currently, the JCHA has completed 5 contracts under CFFP with a "surplus" contingency of approximately $145,728. In order to comply with the auditor's request, the JCHA will use this amount plus revise (lower) the contingency amounts in the uncompleted contracts to develop additional work items under CFFP. (Note: The JCHA has historically reallocated unused contract contingency balances to fund additional work items under CFP.)

Item 4: *Inadequate* disbursement of bond proceeds

Comment 4

The auditors stated that costs incurred prior to the effective date of the grant are not eligible to be funded unless HUD approves the "preaward costs". The JCHA had 3 contracts included in the approved CFFP Annual Statement: A/E Fees for Oil Tank Replacement at Montgomery, Site Survey at Booker T. Washington Apt., and A/E Fees for Apartment Window Replacement at Marion Gardens and Booker T. Washington Apts. All 3 contracts incurred costs before the closing date in August, 2007 and were paid by the JCHA's CFP which then was reimbursed for the costs from the CFFP Trustee. The contracts were expedited due to the nature of the work involved and the need to begin construction immediately after closing to meet obligation and expenditure deadlines.

Based on the above, the JCHA will submit a request for approval of these allowable costs incurred prior to the closing from HUD and the CFFP Trustee.

Item 5: *Lack* of a plan for using force account labor

Comment 5

As part of the preparation of the JCHA's annual budget, each Department and AMP draft their respective staffing patterns for review and approval by the Executive Director and Board of Commissioners. The JCHA utilizes skill trade labor to address both capital and routine maintenance needs and has developed a "fee for service" approach as part of its conversion to HUD's asset management model. The fee structure was developed by a 3rd party firm as part of the JCHA's "Year 2 Stop Loss" application which was approved by HUD. Prior to using the fee structure, skilled tradesmen were charged at their actual rates plus benefits to work items as reflected on time sheets.

Ref to OIG Evaluation | **Auditee Comments**

Comment 5

The JCHA is required to report on an annual basis, the "basic hourly wage rate" of all force account laborers and mechanics who perform at the JCHA. The JCHA has complied each year by submitting the hourly rates and benefit information to the Office of Labor Relations, NY State Office, and U.S. Department of Housing and Urban Development. The JCHA has received an approved "Maintenance Wage Rate Decision" form (HUD 52158) that certifies that: "*The following wage rate determination is made pursuant to section 12 (a) of the U. S. Housing Act of 1937, as amended, (public housing agencies).... . <u>The agency and its contractors</u> may pay maintenance laborers and mechanics no less than the wage rate(s) indicated for the type of work they actually perform.*"

The JCHA annually budgets capital work items to be completed by skilled trades which are submitted to HUD for approval. The JCHA will make every effort to note the force account work items so that HUD staff may be able to easily identify them. The JCHA will also investigate the most prudent method of developing an external plan to supplement the current internal plan for skilled trade labor and will seek the Department's technical assistance.

FINDING 2: THERE WERE WEAKNESSES IN THE AUTHORITY'S FINANCIAL MANAGEMENT SYSTEM

Item 1: Accounting records and financial reporting were not *complete, accurate, and current*

Comment 6

The JCHA maintains its accounting records in a manner that has been acceptable to both HUD and 3rd party auditors by using an in-house system with PHA software. If the records were not in compliance, then auditors would have a difficult time in issuing unqualified opinion audit reports which the JCHA received in both FY 2008 and FY 2009. Also, the JCHA's annual financial statements and FDS that are submitted to HUD's REAC would have not been approved for those years. The JCHA's total receipts for all CFP programs in 2008 and 2009 do agree with the eLoccs report for those years because if they did not REAC would have required an explanation as to the difference when submitting the year end financial reports. The JCHA does agree that some funds received by respective CFP program were posted to the incorrect grant account number in the general ledger, but notes that the total received per year for all CFP funds received agreed with eLoccs.

The JCHA will ask MIS staff to follow-up on the auditor's comment on the "computer system malfunction" comment included on page 14 of the draft regarding the transferring of soft costs draw downs to the current year's balance.

Ref to OIG Evaluation	Auditee Comments
Comment 6	The auditor did notify the JCHA in April, 2010, of the journal voucher error on the reimbursement of CFFP bond proceeds to CFP 2005. Since the month and year of the reimbursement was November, 2007, the JCHA corrected the error and dated it in February, 2010 in order to include it in FY 2010. This adjustment was made AFTER the actual date of the transaction; therefore, there was no "backdating" of an accounting transaction.
Comment 1	As noted in the JCHA's response to Finding # 1, Item 2, the JCHA will make every effort to request a realignment of eLoccs CFP draw downs to reflect the actual line item expense categories.
Comment 6	The JCHA requests a more detailed discussion regarding the comments on page 15 of the draft regarding "the FDS for FY 2008 provided a lump sum of less $1.7 million for operating expenses without providing a detailed breakdown of the costs" and "the authority overlooked $32,064 in administrative costs and did not include in the operating expense in the FDS for FY 2008".
Comment 6	The JCHA will insure that future CFFP P & E summary pages reconcile with the supporting pages in the report.
	Item 2: *Ineffective* tracking system for fund obligation
Comment 7	During the audit, the JCHA provided the auditors with a copy of the contract register which is complied and maintained by the JCHA Purchasing Department. The register lists the contract information including contract #, contractor's name, address, phone #, contact person, type of contract, contract amount, duration, proceed date, bid date, and expiration date (if applicable). The register does not contain the source of funds for each contract but that information is included in the actual contract document on the Certificate of Funds. This is the source of the CFP obligations for contracts if the scope has CFP work. The JCHA obligates force account work items as works begins or as materials are purchased for that type of work.
	The auditors stated that the JCHA's tracking system was inadequate because the contract data was in two places, the contract register and the Certificate of Funds. The JCHA believes this meets HUD requirements. However, the JCHA agrees that the contract register would facilitate a reviewer if it includes the fund source and will make every effort to include it in future registers.
	Copies of supporting documentation are available for your review.

OIG Evaluation of Auditee Comments

Comment 1 Authority officials stated that the conversion of the Montgomery Gardens development was not mandatory because it was not included in HUD's Candidate Cluster Reports from January 2007 to March 2008. We disagree with the Authority because the development suffered long-term high vacancy rates. The Cluster Reports indicated that the vacancy rates at the development were above 30 percent during October 2005 to November 2006. The vacancy report submitted by the Authority to the HUD field office disclosed the rate was more than 40 percent as of March 2010, which was quoted in our audit report. Currently, the vacancy rate reached 53 percent (only 203 out of 434 units are occupied as stated in the Authority's comments). HUD required housing authorities to review the cluster list to ensure that it is complete and accurate, including identifying any developments/units that should be included in the list as additional clusters. Since the Cluster Reports were generated based on the data provided by the housing authorities and Authority officials acknowledged the high vacancy issues at Montgomery Gardens development along with other problems such as physical obsolescence, higher rates of turn-down by prospective tenants, and increasing crime and vandalism, Authority officials should have contacted HUD to include the development into the cluster list and started the mandatory conversion process by conducting the assessment, and developing and implementing the conversion plan as prescribed in 24 CFR 972.106. Moreover, no evidence was provided that the Authority conducted the assessment as it certified to HUD in its 5-year and action plans of 2007 and 2008.

Authority officials also indicated that $462,256 of its annual CFP grant for the year ended March 31, 2009, had been expended for Montgomery Gardens and not the $682,769 cited in the report. However, no documentation was provided to support the amount quoted by the Authority in it comments, therefore, we will not change the amount in the audit report. The amount of CFP funds expended on Montgomery Gardens will have to be resolved as a part of the audit resolution process.

Further, Authority officials stated that they had initiated a voluntary relocation program and a mix-financing revitalization plan for the Montgomery Gardens development in the summer of 2008. However, regulations at 24 CFR 972.115 provide that developments without HUD-approved HOPE VI revitalization plans are fully subject to the required conversion standards. Therefore, since the Montgomery Gardens development did not have an approved Hope VI revitalization plan it was still required to be converted to tenant-based assistance. As a result, if the conversion had been carried out in a timely manner, as required by HUD regulations, more than $1.3 million in CFP and CFFP funds would have been saved.

Comment 2 Authority officials stated that the supporting documentation for CFP expenses were in the general ledger and its subsidiary documents, such as accounts payables, journal vouchers, material requisitions, etc. They state that it is common that programs incur expenses in one fiscal year with funding being received in the following fiscal year. Authority officials indicated that prior audits had not noted any instances of inadequate documentation or disallowed costs; they provided summaries of expenses vs. receipts showing that costs per grant were not exceeded and funds were received after the costs were incurred. Authority officials agreed that budgeted amounts for each line item had not been revised to reflect the financial information in the CFP annual statements. As such, they state that if the revisions had happened, they would be able to draw down funds for the corresponding work item expenses.

However, regulations at 24 CFR 85.20 state that fiscal control and accounting procedures of a grantee must be sufficient to permit the tracing of funds to expenditures, and grantees and subgrantees must maintain records that identify the source and application of funds provided for financially assisted activities. Furthermore, regulations at 24 CFR 85.20(b)(6) state that the accounting records must be supported by source documentation such as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc. However, draw downs of CFP funds were not traceable to the general ledger records. In addition, source documentation was not provided by Authority officials even after repeated requests.

Comment 3 Authority officials agreed that they did not limit contingency funding to be less than 8 percent of total CFFP bond proceeds. As such, Authority officials agreed to use $145,728 of surplus contingency funds from completed contracts for other CFFP work items and amounts from the revised (lower) contingency reserves for the uncompleted contracts to develop additional work items under the CFFP. Thus, the Authority officials' comments are responsive to the finding.

Comment 4 Authority officials indicated that the preaward costs incurred were allowable, therefore, they will submit a request for approval of these cost from HUD and the CFFP Trustee. However, since HUD had not approved the incurrence of these expenses, prior to the funds being awarded, the $53,452 of costs incurred is ineligible and should be reimbursed from the regular capital funds.

Comment 5 Authority officials stated that the hourly wage rate for its force account labor was approved by HUD and its annual budget was reviewed and approved by the executive director and board of commissioners. Authority officials indicated that they would make every effort to identify capital work items that will be done using force account labor for approval by HUD. Furthermore, Authority officials agreed to seek technical assistance from HUD to develop an external plan for skilled trade employees to supplement its current internal plan of force account labor.

However, HUD's approval of hourly wage rates and an annual budget does not preclude Authority officials from the responsibility for informing HUD of the specific activities that will be carried out by force account labor and seeking HUD's approval for these activities. In addition, as noted in the audit report, the Authority's current annual budget did not disclose the funding sources and activities to be completed by force account labor, and there was no documentation to show that the use of force account labor was more economical than contract labor; therefore HUD was precluded from effectively monitoring or evaluating the use of force account labor.

Comment 6 Authority officials state that the accounting records were maintained in a manner acceptable to both HUD and 3rd party auditors. Authority officials agreed that some of the CFP funds, which had been received, had been posted to the incorrect grant account number in the general ledger, but total CFP funds received each year agreed with LOCCS. Authority officials agreed to follow up regarding the computer system malfunction issue, realign LOCCS CFP drawdowns to reflect actual line item expenses, and ensure that future CFFP performance and evaluation report summary pages reconcile with supporting pages in the report. Lastly, Authority officials agreed that the correction of the reimbursement transaction was dated as of February 2010, although the correction was made in April 2010. However, they did not consider the adjustment as being "backdated" because the adjustment was made after the date of the reimbursement transaction.

Authority official's comments were generally responsive to the finding. However, HUD cannot identify financial discrepancies between the financial data submitted to HUD and supporting accounting records because the supporting documents are only maintained at the Authority, not in HUD's systems. Also, 3rd party audits are only designed to provide reasonable assurance about whether the financial statements are free of material misstatements and are not a guarantee that all costs are properly classified, eligible and supported; therefore, it is essential for procedures to be developed that will ensure that accounting records are accurate, complete and adequately supported by source documents. Further, generally accepted accounting procedures require that all the transactions, including corrective adjusting entries, should be recorded at the actual date of the transaction.

Authority officials were provided with additional information regarding the findings for the FDS reports and any questions should be resolved during the audit resolution process.

Comment 7 Authority officials indicated that the current system for tracking obligations was adequate and met HUD requirements, but agreed that if the contract register included the source of funds it would have facilitated the reviewer, therefore officials agreed to make every effort to include this information in the future. Based on these comments it's clear that the information maintained was not easily obtainable, therefore, the findings reflect that improvement is needed in this area. Nevertheless, regulations at 24 CFR 85.20 (b) (2) and (6) require that adequate accounting records be maintained to support obligated and unobligated balances.