
AUDIT REPORT



The Housing Authority of the City of Newark
Bond Financing Activities and Section 8 Housing Choice
Voucher Administrative Fee Reserves
Newark, New Jersey

2005-NY-1005

May 26, 2005

OFFICE OF AUDIT
New York/New Jersey Region



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Audit Report Number 2005-NY-1005

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

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

SUBJECT: The Housing Authority of the City of Newark, Newark, New Jersey, Improperly Used \$6.5 Million from Bond Financing Activities and Section 8 Housing Choice Voucher Administrative Fee Reserves

HIGHLIGHTS

What We Audited and Why

Pursuant to a November 7, 2004, request from the former U.S. Department of Housing and Urban Development (HUD) New York/New Jersey regional director, who was concerned with media reports of questionable business practices, we initiated a comprehensive survey of the Housing Authority of the City of Newark (Authority). After commencing our survey we focused our objectives on determining whether the Authority (1) complied with HUD requirements for the disposition of proceeds from the redemption of tax-exempt bond financing, and (2) properly expended its Section 8 (housing choice voucher) administrative fee reserves.

What We Found

The Authority did not comply with HUD requirements when it improperly allowed its Housing Finance Corporation to retain more than \$2.5 million in funds remaining after the redemption of the Authority's 1980 tax-exempt mortgage revenue bonds.

The Authority improperly used its housing choice voucher administrative fee reserves by committing over \$4.4 million and expending more than \$3.9 million to

acquire properties related to a hockey arena. These expenses had previously been charged to its urban renewal program and were not housing related.

The Authority's improper use of its administrative fee reserves caused an underreporting of its administrative fee reserve balance as of January 31, 2003. Consequently, \$729,423 in administrative fee reserves should have been subject to recapture by HUD.

What We Recommend

We recommend that HUD require the Authority and its Housing Finance Corporation to pay HUD the \$2,533,536 in funds that remained after the Authority's 1980 mortgage revenue bonds were redeemed. We also recommend that HUD ensure that the Authority reimburses the housing choice voucher administrative fee reserve account the \$3,991,350 expended for the acquisition of properties related to a hockey arena. Furthermore, we recommend that HUD recapture \$729,423 of the housing choice voucher administrative fee reserves that exceeded the allowable level for January 31, 2003. In addition, we recommend that controls be established to ensure the proper (1) disposition of the proceeds from bond redemptions, and (2) use and reporting of housing choice voucher administrative fee reserves.

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

Officials of the Authority generally disagreed with our findings, however, they did agree to reimburse the questioned \$3,991,350 expenditure of administrative fee reserves.

We provided a copy of the draft audit report to Authority officials on April 21, 2005, and discussed its contents with them at an exit conference on May 5, 2005, at which time the officials provided their written comments. The complete text of the Authority's response, along with our evaluation of that response, can be found in Appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Newark Housing Authority (Authority) was established in 1938 after the passage of the Federal Housing Act of 1937 to build and manage public housing developments for residents of the City of Newark. Currently, the Authority owns approximately 7,800 low-income housing units, assists an additional 6,700 families through the Section 8 program, and operates various urban renewal programs. In addition, the Authority's board of commissioners established the Housing Finance Corporation to sponsor the issuance of tax-exempt bonds to finance the construction of Section 8 housing. The Authority reported total operating revenue of more than \$185 million for the period ending March 31, 2004.

The Authority's board of commissioners is comprised of seven members, who serve five-year terms; one member is appointed by the mayor, five members are appointed by the mayor with city council approval, and one member is appointed by the New Jersey Department of Community Affairs as delegated by the governor. The executive director of the Authority is Mr. Harold Lucas.

The former HUD regional director had requested a full operational audit of the Authority because of media allegations of questionable business practices. As a result, we initiated a comprehensive survey to address the allegations and determine whether an audit was warranted. We anticipate that we will issue multiple reports addressing the operations of the Authority. After commencing our survey we focused our objectives on determining whether the Authority (1) complied with HUD requirements for the disposition of proceeds from the redemption of tax-exempt bond financing, and (2) properly expended its Section 8 (housing choice voucher) administrative fee reserves.

RESULTS OF AUDIT

Finding 1: The Authority Improperly Retained Proceeds from Bonds That Had Been Redeemed

Contrary to HUD requirements, the Authority allowed its Housing Finance Corporation to retain \$2,533,536 of the funds remaining after the redemption of the Authority's 1980 tax-exempt mortgage revenue bonds. Authority officials advised that they interpret section 413 of the indenture of trust as permitting the Authority to retain any funds that remained after the bonds had been redeemed, however this is contrary to Federal regulations. As a result, HUD was deprived of the use of these funds.

The Authority Improperly Retained Bond Proceeds

On July 31, 2002, the trustee for the Authority's financing of four 1980 Section 8-assisted Federal Housing Administration-insured projects notified the Authority that its \$9.6 million mortgage revenue bonds had been called in full as of July 19, 2002, and that the mortgage had been terminated. The trustee also requested instructions for the transfer of funds remaining in the redemption account. On August 1, 2002, the Authority instructed the trustee that all funds remaining after payment of bond principal, interest, and other obligations should be paid to the Housing Finance Corporation in accordance with section 413 of the indenture of trust. Consequently, on August 1, 2002, the trustee transferred \$2,533,536 to the Authority. The Authority credited this amount to its Housing Finance Corporation as unrestricted funds. However, Authority officials failed to recognize that these proceeds should have been returned to HUD in accordance with 24 Code of Federal Regulations Part 811.

24 Code of Federal Regulations Part 811.105(a)(2)(iii)(b) provides that the applicant shall receive no compensation in connection with the financing of a project, except for its expenses... Should the applicant receive any compensation in excess of such expenses, the excess is to be placed in the debt service reserve. In addition, 24 Code of Federal Regulations Part 811.108(b)(3), which relates to debt service and reserves, provides that upon full payment of the principle and interest on the obligations (including that portion of the obligations attributable to the funding of the debt service reserve), any funds remaining in the debt service reserve shall be remitted to HUD.

We found that on March 13, 1980 the Housing Finance Corporation certified that the terms of the financing, the amount of the obligations issued with respect to the projects, and the use of the funds raised would be in compliance with applicable HUD regulations in 24 Code of Federal Regulations Part 811. Officials of the Authority advised us that they complied with section 413 of the indenture of trust, dated February 15, 1980 and 24 Code of Federal Regulations Part 811. However,

compliance with 24 Code of Federal Regulations Part 811 would require the remittance of excess proceeds to HUD. In response to a prior Office of Inspector General (OIG) audit of the Authority (Report No. 92-NY-204-1009, dated September 24, 1992), HUD's chief counsel of the Newark Office concluded that the Housing Finance Corporation was bound by the provisions of 24 Code of Federal Regulations Part 811. As a result, Authority officials need to ensure that they and the Housing Finance Corporation are in compliance with federal regulations when redeeming its bonds and they should remit the residual bond proceeds amounting to \$2,533,536 to HUD, as required.

Recommendations

We recommend that the Director, Office of Public Housing, instruct:

- 1A. The Authority and its Housing Finance Corporation to pay HUD the \$2,533,536 in funds that remained after the 1980 mortgage revenue bonds were redeemed.
- 1B. The Authority and its Housing Finance Corporation to establish controls and procedures that will ensure that all bond financing activities are in compliance with federal regulations and to ensure that the proceeds from bond redemptions are remitted to HUD as required.

Finding 2: The Authority Improperly Used Its Housing Choice Voucher Administrative Fee Reserves

The Authority improperly committed \$4.4 million, and subsequently expended, more than \$3.9 million in administrative fee reserves that had previously been charged to its urban renewal program. In addition, the Authority improperly committed another \$220,000 for previously expended security and HOPE VI-related costs. This occurred because the Authority did not have adequate internal controls over the use of administrative fee reserves. As a result, the administrative fee reserves were underreported at January 31, 2003, and \$729,423 in administrative fee reserves should have been subject to recapture by HUD.

Administrative Fee Reserves Were Used for Ineligible Costs

Our review disclosed that the Authority had committed \$4.4 million, and actually expended \$3,991,350 in administrative fee reserves for expenses previously charged to the Authority's urban renewal program. These expenses funded the acquisition of property for resale to a corporation that would use the land to build a hockey arena, which is not housing-related as required by HUD regulations.

In May 2001, the Authority entered into an agreement to purchase 12 properties within an area of Newark proposed for the development of a professional hockey arena. Authority officials noted that the Authority would gain by this agreement, regardless of whether the arena was built. If the land was developed into an arena, the Authority was assured a 4-percent return on its investment, and the money could then be used to develop other housing units. If the arena did not materialize, the Authority would have ownership of prime property, which could be developed into low-income housing units. However, the agreement did not contain any provision for housing.

The Authority authorized these expenses to be paid from urban renewal funds in 2001. However, on January 1, 2003, the Authority charged the housing choice voucher administrative fee reserves for these costs, and the board of commissioners authorized this transfer on March 27, 2003. While the \$3,991,350 spent for urban renewal project-related expenses was an appropriate use of urban renewal program funds, it represents an unallowable use of administrative fee reserves. According to 24 Code of Federal Regulations Part 982.115, administrative fee reserves must be used for housing-related expenses. Consequently, the \$3,991,350 should be reimbursed to the housing choice voucher administrative fee reserve account.

The Authority Underreported Its Administrative Fee Reserves

Because of the above improper use and/or commitment of administrative fee reserves, the Authority has underreported its administrative fee reserve balance as of

January 31, 2003. Accordingly, HUD was not aware that \$729,423 in administrative fee reserves was available to be recaptured.

As of January 31, 2003, the Authority reported an administrative fee reserve balance of \$474,808. Adjusting for \$379,602 in net fixed assets incorrectly included in the balance by the Authority yields a balance of \$95,206. However, as noted previously, as of January 31, 2003, the Authority had improperly committed \$4,400,000 in administrative fee reserves to the hockey arena project. If the \$4,400,000 is considered an unallowable use of reserve funds and added to the January 31, 2003 available balance, the adjusted balance is \$4,495,206 (\$95,206 plus \$4,400,000). Further, on March 27, 2003, the board of commissioners approved the use of \$3,928,396 in administrative fee reserves for security and HOPE VI-related costs that already had been expended. These costs were allowable uses of administrative fee reserves; however, we found that this authorization exceeded the previously authorized amount by \$220,000. Accordingly, since this \$220,000 was authorized after January 31, 2003, it should be added to the amount considered available as of January 31, 2003, and thus subject to recapture.

As shown below, if the \$4,400,000 and \$220,000 are added back to the available administrative fee reserves, the Authority's reserve balance at January 31, 2003 should have been \$4,715,206.

January 31, 2003, administrative fee reserves reported by the Authority	\$ 474,808
Less: OIG adjustment for erroneously included net fixed assets	<u>\$ (379,602)</u>
Adjusted balance	\$ 95,206
Add: OIG disallowance of questionable funds for the hockey arena project	\$ 4,400,000
OIG disallowance of funds used in excess of authorized commitment	<u>\$ 220,000</u>
OIG computed balance at January 31, 2003	<u>\$ 4,715,206</u>

Administrative Fee Reserves Should Have Been Recaptured

The Consolidated Appropriations Resolution of 2003 provides that HUD, among other things, should reduce administrative fees paid in fiscal year 2003 to any agency whose available reserve amount¹ was more than 105 percent of the fees earned in fiscal year 2002 and recapture any fees paid in fiscal year 2003 that exceeded actual administrative expenses. Further, Public and Indian Housing Notice 2003-23, issued September 20, 2003, provides for reducing a housing authority's ongoing administrative fee by the amount that the available administrative fee

¹ As reported by the Government Accountability Office (GAO-05-30), the lack of a clear definition of "available" resulted in housing authorities using varying interpretations to calculate the reserve balance subject to recapture.

reserve balance as of January 31, 2003, exceeded 105 percent of its fiscal year 2002 administrative fees earned.

As a result, in accordance with Public and Indian Housing Notice 2003-23, we determined that the Authority's administrative fee reserves in excess of \$3,985,783 should have been subject to recapture. This amount is calculated by taking 105 percent of the \$3,795,984 in administrative fees earned for federal fiscal year 2002. Consequently, \$729,423, which is the amount in excess of 105 percent of the Authority's fiscal year 2002 balance (\$4,715,206 less \$3,985,783), should be subject to recapture by HUD.

Recommendations

We recommend that the Director, Office of Public Housing,

- 2A. Ensure that the Authority reimburses the housing choice voucher administrative fee reserves for the \$3,991,350 improperly expended for the acquisition of properties related to a hockey arena.
- 2B. Recapture \$729,423 in administrative fee reserves that exceeded the allowable "available" administrative fee balance as of January 31, 2003.
- 2C. Direct the Authority to establish controls to ensure that housing choice voucher administrative fee reserves are used for allowable purposes and reported accurately.

SCOPE AND METHODOLOGY

Our review was conducted at the Newark Housing Authority located at 500 Broad Street Newark, New Jersey. To accomplish our objectives we interviewed HUD officials and officials of the Authority and its Housing Finance Corporation. In addition, we reviewed the following:

- Applicable laws, regulations, and other HUD program requirements;
- The Authority's annual contribution contracts and trust indenture; and
- HUD and the Authority's program files for the low-rent housing and Section 8 programs.

We reviewed various documents including financial statements; general ledgers; bank statements; invoices; purchase orders; contracts; check vouchers; and prior OIG, General Accountability Office, and HUD reports on the Authority. We also reviewed the Authority's financial and administrative records related to its Housing Finance Corporation and its Section 8 administrative fee reserve account. In addition, we reviewed the Authority's audited financial statements for project years 2002, 2003, and 2004.

We performed the audit from October 2004 through March 2005. The audit covered the period from January 1, 2003, through December 31, 2004, but we extended the period as necessary.

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

INTERNAL CONTROLS

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

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

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

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 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, the following items are significant weaknesses:

- The Authority did not have a system to ensure compliance with laws and regulations related to the disposition of the proceeds of bond financing activities and the use of housing choice voucher administrative fee reserves (findings 1 and 2).
- The Authority did not have a system to ensure resources were properly safeguarded when it used its Section 8 housing choice voucher administrative fee reserves to pay for non-housing-related expenses (finding 2).

Appendix A

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

<u>Recommendation Number</u>	<u>Ineligible 1/</u>	<u>Funds to be Put to Better Use 2/</u>
1A	\$2,533,536	
2A	\$3,991,350	
2B		\$729,423

- 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/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Harold Lucas, Esq.
Executive Director



COMMISSIONERS
Zinnerford Smith
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Ida Clark
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Treasurer
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Donald Bradley
Lynell Robinson

May 4, 2005

Mr. Edgar Moore
Regional Inspector General for Audit
US Department of HUD
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278-0068

RE: Response to the Findings in the Draft Audit Report

Dear Mr. Moore:

We are in receipt of the draft Audit Report that was forwarded to me on April 21, 2005. After a thorough review and analysis of the findings, comments, and recommendations in the report, we have compiled our response, which is attached for your consideration.

We would certainly like our written comments to be made part of the final report.

If you have any questions on this, please contact Mr. Shaye S. Araromi of my staff at (973) 273-6410.

Very truly yours,


Harold Lucas
Executive Director

Attachments

CC: Shaye S. Araromi, Asst. Executive Director

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"IMPROVING NEWARK'S NEIGHBORHOODS"

Newark Housing Authority
Response to IG's Audit Findings
in the Report of April 21, 2005

I Use of Bond Proceeds

Finding 1: *The Authority improperly retained proceeds from Bonds that had been redeemed.*

"Authority officials failed to recognize that these proceeds should have been returned to HUD in accordance with 24 CFR Part 811". (Page 1 Finding 1)

NHA's Response:

It is incorrect to state that the Authority officials failed to recognize the guidelines of 24 CFR Part 811. The Authority's decision to retain the proceeds from the bonds that had been redeemed was not a capricious or arbitrary decision, but one based on the express terms as outlined in the 24 CFR Part 811 and the Trust Indenture.

IG refers to 24 CFR Part 811 Sec. 108 (b) (3) which states that "...any funds remaining in the debt service reserve shall be remitted to HUD". However, it stops short of the additional rules contained in 24 CFR Part 811 section 110(f) which state as follows:

"In particular, HUD review should be obtained for the release of reserves from the trust indenture of the outstanding 11(b) bonds that are being refunded, defeased, or pre-paid. A proposal to distribute to a non-Federal entity the benefits of a refinancing, such as debt service savings and/or balances in reserves held under the original Trust Indenture, should be referred to the Office of Multifamily Housing for further review. In proposals submitted for HUD approval, **HUD will consent to release reserves, as provided by the Trust Indenture**, in an amount remaining after correction of project physical deficiencies and/or replenishment of replacement reserves, where needed." (see ATTACHMENT A)

The Project Bond Documents include a Letter of Determination from HUD (Item #51 of Index – see ATTACHMENT B), which states in Paragraph 3 that HUD reviewed and duly approved these documents (including indenture of trust) pursuant to pertinent regulations. Paragraph 4 states that "based on the above determinations and the approval of the final proposals for these projects, the terms and conditions of the financing are approved".

Comment 1

Under the Trust Indenture, the Trustee, Wachovia Bank, is authorized to return excess reserves to Housing Finance Corporation. Sec. 413 of Indenture of Trust states as follows:

“Payment to the Corporation upon Payment of the Bonds. After payment in full of the principal or Redemption Price of and interest on all the Bonds or after provision for the payment thereof has been made in accordance with Article VII of this indenture, and after payment in full of the fees, charges and expenses of the Trustee and any Paying Agents and all other amounts required to be paid hereunder, and the fees, charges and expenses of the Corporation and all other amounts required to be paid under the Owner’s Notes, all amounts remaining in any Fund established by Section 401 or otherwise held by the Trustee and by any additional Paying Agent for the account of the Corporation hereunder shall be paid to the Corporation.” (see ATTACHMENT C)

Comment 2

Based on the rules in the 24 CFR and the terms of Trust Indenture referenced above, the General Counsel of the Authority opined that the funds could be transferred to the HFC, and advised the bank to do so. It is our firm belief that HUD has consented to the release of reserves to HFC through the Letter of Determination signed by Mr. James P. Sweeney, Area Manager, HUD Newark Office on March 30, 1980, which is included in the Trust Indenture. By signing the document, HUD consented to the release of excess reserves without any additional approval.

IG’s Comment: *“Officials of the Authority advised us that they complied with section 413 of the indenture of trust, dated February 15, 1980, under the belief that the Housing Finance Corporation did not have to comply with 24 Code of Federal Regulations Part 811”. (Page 5 Finding!)*

Comment 3

NHA’s Response:

This is a misstatement. The officials of NHA never believed that it did not have to comply with 24 CFR Part 811. NHA officials have always considered 24 CFR to be the guiding tool for all actions.

Comment 4

NHA’s Plan on expending Bond refunding savings:

NHA sought and obtained HUD approval to expend the bond refunding savings on security-related expenses at the low-income housing developments of the Authority, to better serve the resident population. It is our plan to expend the funds received by HFC on security-related expenses for low-income housing developments. Attached is the copy of the approval letter from HUD in this regard. (see ATTACHMENT D)

As per HUD approval, we have included the utilization of up to \$1 million in our 3/31/2006 budget. Returning this fund to HUD would create undue hardships for the NHA at this time of dwindling subsidies.

It may be noted that the amount of funds available in this account as of 3/31/2005 is more than the amount noted in the approval letter, as additional funds received from the Trustees and income generated from investments are added to the account, and available for the same purpose. As per HUD approval letter, NHA will be sending a Certificate of total available funds and funds expended and balance available as of 3/31/2005 to the HUD office in Washington by 5/31/2005, and every year thereafter.

It is our opinion that the HFC bond refunding savings should be retained by HFC and utilized for Low Income Housing security-related expenses, as per HUD approval.

IG's Recommendation:

We recommend that the Director, Office of Public Housing, instruct:

1A. The Authority and its Housing Finance Corporation to pay HUD the \$2,533,536 in funds that remained after the 1980 mortgage revenue bonds were redeemed. (Finding 1 Page 6)

Comment 1

NHA's Response:

The Authority strongly disagrees with the recommendation to pay back to HUD \$2,533,536. We firmly believe that the action to retain the funds was in line with the terms and intentions of both 24 CFR Part 811 and the Trust Indenture, to which HUD is a signatory.

Comment 4

HFC/NHA considers all bond refinancing savings balance as being available for the Low Income Housing security-related purposes. HUD has consented to the expenditure of available bond savings on Low Income Housing security services, as per the letter of approval cited previously.

IG's Recommendation:

1B. The Authority and its Housing Finance Corporation to establish controls and procedures that will ensure that all bond financing activities are in compliance with federal regulations and to ensure that the proceeds from bond redemptions are remitted to HUD as required. (Finding 1 Page 6)

Comment 5

NHA's Response:

NHA has strong controls and procedures in place to ensure that all bond financing activities are in compliance with federal regulations. The Authority always goes through the due process of obtaining the necessary legal opinions and HUD approvals on all aspects of the income and expenses from bond financing.

Comment 6

II Section 8 Administrative Fee Reserves:

Finding 2: *The Authority improperly used its Housing Choice Voucher Administrative Fee Reserves (Page 7)*

IG's Comment: *"Administrative fee reserves were used for ineligible costs."*

"Since, in our opinion, it is uncertain whether these reserves were used for housing-related expenses, HUD should obtain legal opinion as to whether the \$3,991,350 should be reimbursed to the housing choice voucher administrative fee reserve account."

NHA's Response:

NHA strongly believes that the Section 8 Administrative fee reserves were expended in conformity with HUD regulations. The U.S. Government Accountability Office (GAO) who performed a detailed review of the transactions in the Section 8 Administrative Fee Reserve account, and the reporting of the Section 8 Administrative Fee reserve as of January 31, 2003, stated in their report that the five housing agencies that they visited, including Newark Housing Authority, had "calculated their reserves available as of January 31, 2003 in a manner consistent with HUD's guidance". (see ATTACHMENT E)

The resolution authorizing the utilization of Section 8 Administrative Fee reserves to reimburse the expenses from the Redevelopment Account on the purchase of twelve parcels of land in Newark had a qualifier that the utilization would be "subject to HUD approval." (see ATTACHMENT F)

Despite the GAO report that supports the NHA's position in this matter, HUD in its review report of April 22, 2005, questions the utilization of \$3,991,350. Since HUD did not approve of the utilization of funds as per the resolution cited above, (Attachment F), the Board of Commissioners of the Authority passed a resolution on April 28, 2005 to reimburse the amount to the Section 8 Administrative Fee Reserve account (see ATTACHMENT G).

IG's Comment: *"The Authority under-reported the Administrative Fee reserves." (Page 8 para 1) " ... as of January 31, 2003, the Authority had improperly committed \$4,400,000 in administrative fee reserves for the hockey arena project. If the \$4,400,000 is considered unallowable use of the reserve funds and added to the January 31, 2003 available balance, the adjusted balance is \$4,495,206 (\$95,206 plus \$4,400,000) Further, on March 27, 2003, the Board of commissioners approved the use of \$3,928,396 in administrative fee reserves for security and HOPE VI-related costs that had already been expended. These costs were allowable uses of administrative fee reserves; however, we found that this authorization exceeded the previously authorized amount by \$220,000. Accordingly, since this \$220,000 was authorized after January 31, 2003, it should be added to the amount considered available as of January 31, 2003, and thus subject to recapture."*

Comment 7

IG's Recommendations:

2A/2B "Obtain legal opinion as to whether expending \$3,991,350 in housing choice voucher administrative fee reserves for the acquisition of a hockey arena was an allowable use of these reserves."

"If the expenditure of \$3,991,350 represents an unallowable use of the reserves, instruct the Authority to reimburse its housing choice voucher administrative fee reserve account for the \$3,991,350 and recapture the resulting \$729,423 in administrative fee reserves that exceeded the allowable "available" administrative fee balance as of January 31, 2003." (Page 9)

NHA's Response:

NHA's Board of Commissioners passed a resolution on April 28, 2005 to reimburse \$3,991,350 to the Section 8 Administrative Fee Reserve Account.

Though the Board authorization was to utilize \$4.4 million of the reserves, the actual amount utilized to reimburse Redevelopment account was \$3,991,350.

Based on the above the amount available as of January 31, 2003 has to be recalculated as follows:

	<i>Per IG</i>	<i>Per NHA</i>
January 31, 2003 administrative fee reserves reported by the Authority	\$ 474,808	\$ 474,808
Less: OIG adjustment for erroneously Included net fixed assets	\$ (379,602)	\$ (379,602)
Adjusted balance	\$ 95,206	\$ 95,206
Add: OIG Disallowance of questionable funds For the hockey arena project	\$ 4,400,000	\$3,991,350
OIG disallowance of funds used in Excess of authorized commitment	\$ 220,000	\$ 220,000
OIG Computed balance at January 31, 2003	\$ 4,715,206	\$ 4,306,556

However, the expenditure of \$220,000 was authorized by the Board on 3/27/2003 for 'allowable uses of administrative fee reserves', as rightfully stated in the IG's report. This was done well before the issuance of PIH Notice 2003-23 dated 9/22/2003, wherein PHAs are advised not to spend for other purposes those available administrative fee reserve balances that exceed 105% of their FFY 2002 fees earned (see ATTACHMENT H). The expenditure of \$220,000 also falls

within the 105% rule. (NHA earned administrative fee of \$4,034,137 during fiscal year ended 3/31/03. 105% of this amount equals \$4,235,844)

IG's Recommendation:

2C *Direct the Authority to establish controls to ensure that housing choice voucher administrative fee reserves are used for allowable purposes and reported accurately. (Page 9)*

Comment 5

NHA's Response:

The Authority has always scrupulously followed HUD guidelines. As in all cases, the Authority obtains legal opinion from its General Counsel before any decision to expend such funds is taken.

Significant Weaknesses:

IG's Comment: *"The Authority did not have a system to ensure compliance with the laws and regulations." (Page 12)*

Comment 5

NHA's Response:

This statement is again incorrect. NHA has a well-established system in place to ensure compliance with laws and regulations. All issues related to expenditure of funds are discussed in detail at the senior management level, and legal opinion is obtained before any action is taken.

IG's Comment: *"The Authority did not have a system in place to ensure resources were properly safeguarded when it used Section 8 housing choice voucher administrative fee reserves to pay non-housing related expenses."*

Comment 5

NHA's Response:

As stated above, the Authority does have a system to ensure that the actions taken are in compliance with HUD guidelines and the relevant CFR. Legal opinion is sought and obtained before any decision is made regarding the use of Section 8 administrative fee reserves.

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OIG Evaluation of Auditee Comments

- Comment 1** The additional provisions of 24 Code of Federal regulations Part 811 section 110 (f), referred to by the Authority pertain to refunding obligations issued to finance Section 8 projects, and provide that a HUD review should be obtained for the release of reserves from the trust indenture for outstanding bonds that are being refunded, defeased, or prepaid... However, the documentation provided by the Authority did not demonstrate that HUD approval had been sought nor obtained for the retention of the funds held by the trustee under the trust indenture for the 1980 bonds.
- Comment 2** The Letter of Determination signed by Mr. James P. Sweeney, Area Manager, HUD Newark Office, on March 30, 1980 refers to the designation that the bonds issued under the 1980 financing comply with the requirements for Section 11(b) of the United States Housing Act of 1937. This Determination provides that the bonds issued will be designated as tax-exempt securities. Accordingly, this document does not refer to the release of excess reserves without HUD approval as indicated by the Authority. Consequently, without evidence of HUD approval for the retention of the residual funds, 24 Code of Federal Regulations Part 811 requires that the excess proceeds from the bond redemption should be returned to HUD.
- Comment 3** We have removed the statement that officials of the Authority advised us that they complied with section 413 of the indenture of trust, dated February 15, 1980, under the belief that the Housing Finance Corporation did not have to comply with 24 Code of Federal Regulations Part 811. Nevertheless, it is our belief that, the Authority did not comply with 24 Code of Federal Regulations Part 811 section 108 by allowing the Housing Finance Corporation to retain the funds remaining after the bond redemption.
- Comment 4** The documentation provided by the Authority to support its position that HUD approved the use of funds for Low-Income Housing security-related purposes pertained to funds resulting from a 1994 bond refinancing. This approval does not pertain to the disposition of the funds from the redemption of the 1980 bonds in question. Accordingly, the Authority has not documented HUD approval to retain the 1980 bond redemption proceeds.
- Comment 5** It is our opinion that the Authority did not have a system in place to ensure compliance with applicable HUD regulations, and that consequently, it's resources were not properly safeguarded. This opinion is supported by our finding and the Authority's own admission that HUD did not approve the utilization of these funds as per the resolution passed by the Board.
- Comment 6** The GAO report referred to by the Authority noted that for the housing agencies visited, the agencies calculated their reserves in a manner consistent with HUD guidance. However, the GAO report also notes that GAO did not perform a financial audit of the housing agencies' administrative fee reserves. As such, the GAO report does not state whether the Authorities' administrative fee reserves were expended in accordance with HUD requirements.

In our draft report, issued to HUD and the Authority on April 20 and 21, 2005, respectively we originally recommended that the HUD field office obtain a legal opinion to determine whether spending the housing choice voucher administrative fee reserve funds for the purchase of the arena-related land was an allowable use. However, since the Assistant Secretary for Public and Indian Housing released its report on the Authority on April 22, 2005 that concluded that the expenditure was an unallowable use of the reserves, we have revised our recommendation to state that the HUD field office should ensure that the reserve funds are reimbursed.

Comment 7 The Authority has incorrectly computed the amount of housing choice voucher administrative fee reserves subject to recapture as of January 31, 2003 for several reasons. First, the analysis of the administrative fee reserve balance available as of January 31, 2003 should be based on the total reserve as of that date less funds that were committed for allowable costs. When the Authority reported its January 31, 2003 administrative fee reserve balance, it was reduced by the \$4.4 million committed to the arena project. Consequently, the \$4.4 million committed for the unallowable arena-related expenditure, not just the \$3,991,350 actually expended, should be added back to determine available reserves as of January 31, 2003. Second, the additional \$220,000 for security and Hope VI-related costs should not have been included in the amount that was committed as of January 31, 2003 because these commitments were not authorized by the board until March 21, 2003. Third, the basis for the recapture is the amount of any reserves in excess of 105 percent of administrative fees earned in federal fiscal year 2002.