AUDIT REPORT

The Housing Authority of the City of Newark
Controls Over Bond Financing Activities, Obtaining Supporting Documentation, and Legal Settlements Require Improvement

Newark, New Jersey

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

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

SUBJECT: The Housing Authority of the City of Newark, Newark, New Jersey, Controls Over Bond Financing Activities, Obtaining Supporting Documentation, and Legal Settlements Require Improvement

HIGHLIGHTS

What We Audited and Why

Pursuant to a request from the former U.S. Department of Housing and Urban Development (HUD) New York/New Jersey regional director, we performed a second audit of the Housing Authority of the City of Newark (Authority) to cover areas of concern, identified in our first audit as being high risk. The objectives of this audit were to determine whether the Authority's (1) Housing Finance Corporation conducted its operations in accordance with HUD regulations, (2) payments made to the City of Newark in addition to the payments in lieu of taxes for municipal services were allowable, (3) costs for legal settlements were properly authorized, and (4) self-insurance program is cost effective.

What We Found

In our opinion, the Authority did not conduct its bond financing activities in accordance with HUD requirements. It did not ensure that its Housing Finance Corporation (1) placed all excess funds for specific projects into the debt service reserves, (2) remitted amounts to HUD when required, (3) properly certified and reported its McKinney Act activities to HUD, and (4) disbursed all McKinney Act funds in a timely manner and/or made disbursements only for eligible items. As a

result, more than $1.8 million was either not placed into project's(s') debt service reserves or remitted to HUD as required. In addition, more than $1.9 million in McKinney Act funds were not spent in a timely manner for proper purposes.

Contrary to the requirements of its annual contribution contract, cooperation agreement, and federal regulations, the Authority did not maintain adequate documentation to support various payments made to the City of Newark. It could not substantiate that the services the Authority paid for were in addition to those services that the City was obligated to provide under the cooperation agreements the Authority has with the City, or that the payments made were reasonable. As a result, Authority officials cannot substantiate that the $6.9 million paid to the City of Newark was necessary.

Contrary to HUD requirements, the Authority settled general liability claims without obtaining prior written HUD approval. As a result, HUD could not be assured that more than $1.2 million in legal settlements paid under the self-insurance program were processed in a cost-effective manner.

What We Recommend

We recommend that HUD obtain a legal opinion as to whether the citations of 24 CFR [*Code of Federal Regulations*] 811.105 and 811.108 are applicable to the projects in question and as to the disposition of $3.7 million in funds being retained by the Authority and its Housing Finance Corporation. If it is determined that the cited regulations are applicable then the Authority should deposit $1.5 million into the debt service reserves of the applicable projects and HUD should determine whether $320,859 should be recaptured and the proper disposition of the $1.9 million in McKinney Act savings/funds being held by the Authority and its Housing Finance Corporation. The Authority should establish controls to ensure that McKinney Act Savings/funds are disbursed and reported in accordance with applicable requirements, and the Authority should also provide documentation or reimbursement for the $67,524 in questioned disbursements made by the Housing Finance Corporation. We further recommend that HUD review the documentation provided to determine if the evidence supports that city services were provided that exceeded the services that were to be provided in accordance with the cooperation agreement and seek reimbursement for any amounts not supported. In addition, we recommend that procedures be established to ensure that a) service agreements with the city are properly executed and monitored, services are provided, and costs are reasonable, b) prior HUD approval is obtained for general liability settlements, and c) contract services are provided as required.

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. They stated that the regulations cited (24 CFR [Code of Federal Regulations] 811.105 and 811.108) are not applicable to the projects in question and that there is no provision in the old regulations that require unspent McKinney Act savings/funds to be returned to HUD. As a result, we added a recommendation for HUD to obtain a legal determination to identify the regulations that are applicable, and to determine the proper disposition of the funds being retained by the Housing Finance Corporation. Authority officials believe that they provided enough evidence to substantiate the issues in finding two, and they agreed with finding three and have begun making corrective actions by developing procedures to request HUD approval before settling general liability claims.

We discussed the results of our review with Authority officials during the audit and at an audit exit conference held on January 5, 2006. Authority officials provided their written comments on January 10, 2006. The complete text of the Authority's response, along with our evaluation of that response, can be found in appendix B of this report. The Authority's response included a number of exhibits and documents that were too voluminous to be included in our final report, but were provided to your office.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Newark (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, New Jersey. The Authority owns approximately 7,800 low-income housing units, assists an additional 6,383 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 $150 million for the period ending March 31, 2005.

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 U.S. Department of Housing and Urban Development (HUD) regional director had requested a full operational audit of the Authority as a result of media allegations of questionable business practices. We performed an audit and issued an audit report on May 26, 2005. This is our second audit of the Authority, which is being performed to address the issues that were identified in the initial audit as high risk but not reported on. Our objectives for this audit were to determine whether the Authority's (1) Housing Finance Corporation conducted its operations in accordance with HUD regulations, (2) payments made to the City of Newark in addition to the payments in lieu of taxes for municipal services were allowable, (3) costs for legal settlements were properly authorized, and (4) self-insurance program is cost effective.

RESULTS OF AUDIT

Finding 1: In Our Opinion, the Authority Did Not Conduct Its Bond Financing Activities in Accordance with HUD Regulations and Requirements

The Authority did not ensure that its Housing Finance Corporation (1) placed all excess funds for specific projects into the debt service reserves, (2) remitted amounts to HUD when required, (3) properly certified and reported its McKinney Act activities to HUD, and (4) disbursed all McKinney Act funds in a timely manner and/or made disbursements only for eligible items. As a result, more than $1.8 million was either not placed into the project's (s') debt service reserves or remitted to HUD as required. In addition, more than $1.9 million in McKinney Act funds were not spent in a timely manner or properly used to provide decent, safe, and sanitary housing to very low-income persons. These problems occurred because the Authority did not have controls in place to ensure that all bond-financing activities were conducted in accordance with applicable regulations. Further, Authority officials believe that the regulations were not applicable to the projects in question since the effective date of the regulations was after the bond issue dates, and that the regulations allowed them ten years to disburse McKinney Act Savings. Consequently, to ensure that the Authority complies with the regulations, we recommend that HUD obtain a legal determination as to the proper disposition of funds being retained by the Housing Finance Corporation.

Criteria

Federal regulations at 24 CFR [*Code of Federal Regulations*] 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 CFR [*Code of Federal Regulations*] 811.108, which relates to debt service reserves, provides that the debt service reserve and its investment income shall be available only for the purpose of paying principal or interest on the obligations. Upon full payment of the principal 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.

Funds Were Not Placed into the Debt Service Reserve

During the period April 1, 1978, to March 31, 2005, the Authority's Housing Finance Corporation earned management service and interest income from various activities. The source of most of the management service income was not identified. The Authority's staff believed that the income was the result of financing services the

Housing Finance Corporation provided to Section 8 projects. They stated that the financing services may have included bond floating, short-term financing, or conduit bond financing. The Housing Finance Corporation generated interest income by investing the management service income in various short-term financing instruments; nevertheless, net income from management services plus applicable interest income amounted to $1,865,103 as of March 31, 2005. Although the *Code of Federal Regulations* provides that the Housing Finance Corporation may not receive any compensation in connection with the financing of a project except for its expenses and that the excess compensation should have been placed in the debt service reserves of the individual projects, these funds were not placed into specific projects' debt service reserves. As a result, debt service reserves for specific projects were under funded, and these projects were deprived of the use of funds that could have been used for the payment of principal and interest on the projects' obligations.

Funds Were Not Remitted to HUD as Required

Part of the above management service income and interest, which was not placed into debt service reserves, is applicable to financing activities for four of the Authority's projects that had their 1980 bonds redeemed in 2002. One of the projects whose bonds were redeemed, Livingston Homes, has $59,450 of the $1,865,103. If these funds had been properly deposited in the debt service reserve for Livingston Homes, they would have been remitted to HUD as required by federal regulations when the bond issue that financed the project was redeemed or paid off in 2002; consequently, HUD was deprived of the use of $59,450.

In addition, $261,409 of the $1,865,103 pertains to three projects (Fairview, Saint Mary's Villa, and Broadway Manor) that had their bond issues refinanced under the McKinney Act. After the refinancing, HUD generated refunding agreements for these projects, which may be inaccurate since the $261,409 was not available or deposited into the individual projects' debt service reserves. Therefore, HUD may have inaccurately determined the amount needed to pay off the outstanding bonds and fund the debt service reserves before approving the refunding agreements. Accordingly, HUD needs to review the debt service reserves and refunding agreements for these three projects and determine whether any funds should be recaptured.

To properly account for the above management service interest and income, HUD needs to review and make a determination on how to handle the $261,409, while the Authority needs to remit the $59, 450 to HUD and ensure that the remaining $1,544,244 is deposited into the project's (s') debt service reserve, which would represent funds being put to better use .

McKinney Activities Were Not Certified in a Timely Manner and Reported to HUD

The Stewart B. McKinney Act was designed to provide funding for housing related to the homeless and very low-income persons. McKinney Act savings are defined as savings resulting from the reduction in Section 8 contract rents related to project bonds that have been refinanced. Regarding the Authority and its Housing Finance Corporation, HUD approved refinancing of four bond issues under the provisions of the McKinney Act between 1993 and 1995. HUD determined the amount of savings on the Section 8 contract rents that resulted from the refinancing and approved refunding agreements, which provided for semiannual payments to the Housing Finance Corporation for 50 percent of the Section 8 savings resulting from the refinancing.

The refunding agreements provide that the Housing Finance Corporation must submit a written requisition to the trustee and HUD stating that the refunding payments (together with any interest earned) have been expended or are expected to be expended within the next six months. Further, the Housing Finance Corporation must provide annual certifications to HUD that the refunding payments are being used in accordance with their approved housing plan, together with a report setting forth the uses of the refunding payments and the nature of the assistance provided, within 90 days of the end of its fiscal year.

From April 1, 1994, to March 31, 2005, the Housing Finance Corporation received financial adjustment factor refunding payments (also known as McKinney Act savings) of $2,289,284 and earned interest income of $469,444 by investing the funds. Thus, the total amount of the refunding payments and applicable interest was $2,758,728 through March 31, 2005. Yet despite having received this funding since 1994, the Authority did not submit its initial report to HUD until May 31, 2005. This report provided that the McKinney Act savings/fund balance was $2,950,991 as of March 31, 2005. However, this balance was overstated and was later corrected by the Authority during our review on October 12, 2005. The Authority did not certify that the funds had been used in accordance with the refunding agreements and inform HUD on what these funds would be used for (in this case the funds were supposed to be used for security costs) until May 2005. Thus, the Authority did not report or certify to HUD in a timely manner.

McKinney Act Funds Were Not Disbursed in a Timely Manner

By not providing the above reports in a timely manner, HUD was not made aware that the Housing Finance Corporation was not disbursing these funds in a timely manner. Further, from the $2,758,728 balance of McKinney Act savings/funds or refunding payments received, the Housing Finance Corporation had disbursed a total

of $802,299 through March 31, 2005, leaving $1,956,429 of McKinney Act savings/funds that had not been disbursed as of March 31, 2005. Since the Housing Finance Corporation did not expend these funds for eligible purposes within six months of receiving them as required, it was not in compliance with the requirements of the refunding agreements. Consequently, HUD needs to determine the proper disposition of the remaining McKinney Act funds.

Questionable Disbursements

The Authority's Housing Finance Corporation inappropriately disbursed $67,524 on costs not related to the corporation's mission and not in accordance with federal regulations. These funds were used to reimburse the Authority's operating account for legal costs stemming from litigation and for consulting services in connection with real estate acquisitions. Contrary to the requirements, these costs were not related to financing or refinancing the debt obligations of Section 8 projects or to providing housing for low-income families.

The refunding agreement provides that McKinney Act funds should only be used in the city of Newark, New Jersey, to provide decent, safe, and sanitary housing affordable to very low-income families or persons. Such funds may be applied (i) directly to assist very low-income families or persons or (ii) to pay the development costs of dwelling units to be occupied by persons and families of very low income but only to the extent that these costs would be chargeable to the project's capital account for income tax purposes. The refunding agreements also state that McKinney Act funds shall not be used to pay administrative costs of the corporation.

Further, 24 CFR [*Code of Federal Regulations*] 811.108 provides that non-McKinney-Act funds (which were received before April 1, 1993) should all have been deposited in debt service reserves and only used for the payment of principal or interest on the obligations. Costs that are not related to the financing of the bond issues would not be eligible costs .

The $67,524 in questioned disbursements is considered unsupported as follows:

Legal fees	**Date of disbursement**	**Amount**	
Lawsuit Authority vs. City Construction	Mar. 27, 1992	$13,312.78	**1/**
"	Aug. 27, 1992	$12,722.59	**1/**
Consultant fees			
Feasibility study Section 8 project acquisition	Nov. 14, 2000	$9,786.75	**1/**
"	Aug. 13, 2000	$20,833.33	**1/**
"	Feb. 21, 2003	$10,868.45	**1/**
Total		**$67,523.90**	

1/ These items are considered unsupported because there was insufficient documentation to determine whether the costs were eligible and reasonable or could be considered allowable development costs that would be charged to the project's capital account for income tax purposes.

Conclusion

Authority officials submitted comments (see Appendix B) that state that the criteria cited in this finding is not applicable to the projects in question because the bonds for these projects were issued before the effective date of the regulations, and therefore, the Housing Finance Corporation was entitled to the payments per the indenture of trust. In a prior OIG audit (92-NY-204-1009), HUD's legal counsel ruled that the cited regulations are applicable and the Authority and its Housing Finance Corporation agreed to abide by all regulations; however, to date the legal opinion could not be located. As a result, to clarify this issue HUD needs to obtain a new legal opinion on whether the regulations are applicable and to determine the proper disposition of these funds.

Nevertheless, based on the above deficiencies, and the prior legal opinion, it is clear that the Authority needs to strengthen its controls over bond financing activities to ensure that its Housing Finance Corporation is following all applicable regulations. As such, not until all bond-financing funds are placed into the debt service reserves in a timely manner as required, disbursed for eligible items in accordance with the housing plan, and certified and reported to HUD in a timely manner will the Authority's bond program be efficiently managed.

Recommendations

We recommend that the director of HUD's Office of Public Housing

1A. Obtain a legal opinion to determine whether the citations of 24 CFR [*Code of Federal Regulations*] 811.105 and 811.108 are applicable to the projects in question and to determine the proper disposition of the funds being retained by the Housing Finance Corporation.

If it is determined that the cited regulations are applicable, we recommend that the director of HUD's Office of Public Housing instruct the Authority to

1B. Deposit $1,544,244 into the debt service reserves of the individual projects from where the funds originated .

1C. Remit $59,450 to HUD for the funds that were applicable to the bond issue for Livingston Homes, which was redeemed in 2002.

1D. Submit information to HUD regarding the underfunding of debt service reserves for the three projects (Fairview, Saint Mary's Villa, and Broadway Manor) amounting to $261,409 so that HUD can determine whether these funds should be recaptured and the refunding agreements should be adjusted for these three projects.

1E. Provide direction to its Housing Finance Corporation (based on the legal determiniation) as to the proper disposition of the $1,956,429 in McKinney Act savings/funds that was not disbursed in a timely manner, per the refunding agreements.

We also recommend that the director of HUD's Office of Public Housing require the Newark Housing Authority to:

1F. Establish controls to ensure that McKinney Act savings/funds are disbursed and reported in accordance with the applicable requirements.

1G. Provide documentation to the Office of Public Housing regarding the questioned disbursements amounting to $67,524 so that an eligibility determination can be made. The cost of all ineligible disbursement should then be repaid to the applicable project's(s') debt service reserve .

1H. Establish procedures to ensure that its Housing Finance Corporation conducts it operations in accordance with all federal regulations .

Finding 2: The Authority Did Not Maintain Adequate Documentation to Support Payments to the City Of Newark

Contrary to the requirements of its annual contribution contract, cooperation agreement, and federal regulations, the Authority did not maintain adequate documentation to support various payments made to the City of Newark. It could not substantiate that the services the Authority paid for were in addition to those services that the city was obligated to provide under the cooperation agreements the Authority has with the city, or that the payments made were reasonable. This occurred because the Authority did not have a signed agreement in place that set forth, in sufficient detail, the quantity and cost of the additional services to be performed, nor did it have controls in place to ensure that proper supporting documentation was obtained before making the payments. As a result, Authority officials cannot substantiate that $6.9 million paid to the City of Newark was necessary.

Criteria

The annual contribution contract requires the Authority to operate in an economical and efficient manner. It requires the Authority to perform and comply with all the applicable provisions of the cooperation agreement including the making of payments in lieu of taxes and to at all times enforce its rights under the cooperation agreement and not terminate or amend the agreement without the prior written approval of HUD. The annual contributions contract also requires the Authority to maintain records in a manner that permits HUD to determine whether all funds have been expended in accordance with each specific program regulation and requirement.

The cooperation agreement between the Authority and the City of Newark states that the Authority will pay 10 percent of the annual shelter rent to the city as a payment in lieu of taxes and that the city will provide, without additional charge to the Authority and its tenants, public services and facilities as furnished from time to time without charge to other dwellings and inhabitants in the municipality.

Payments Made in Addition to Payment in Lieu of Taxes

The Authority said they entered into two memorandums of understanding with the City of Newark whereby the city agreed to provide special services to the Authority and its residents. These memorandums of understanding, which were not signed, provided that the City would provide special services to the Authority in excess of the City's responsibility under various cooperation agreements. Such services were to include:

- Services and facilities related to supervision of special police officers employed by the Authority.

- Services for manning two stabilization vans owned by the Authority and used to provide around the clock patrolling at the housing sites of the Authority.
- Special police services during the implosion/demolition of major housing complexes owned by the Authority.
- Additional police services at various low rise and high rise developments and buildings.
- Additional police services at large common areas of the Authority etc.

The agreements did not specify the quantity and cost of the additional services to be provided at each project nor what constituted normal services. We requested additional information and supporting documents to determine the eligibility and reasonableness of the costs. Although the Authority officials provided additional information, we could not determine from the documents that the services provided were in addition to the level of services the the City was already obligated to provide under the cooperation agreements. Moreover, since the Authority was unable to provide signed copies of the agreements, HUD lacks assurance that formal agreements were made.

The Authority said they entered into these memorandums of understanding because Authority and city officials believed that a combination of high density and poverty in the Authority's developments exerted greater than normal demands on city departments, especially for the police and the health and human services departments. This was intended to be in addition to what services are normally required by other apartment dwellings and residents throughout the city. The agreements called for the Authority to make a one-time "up front" payment to the city, reflecting the expected reasonable cost of said services. The agreements further provided that the Authority could conduct an audit of the costs of the services and facilities provided by the city within six months of the commencement of the agreement. If the services were determined to not benefit the Authority and its residences, the city was to return a prorated amount to the Authority.

On August 14, 2001, the Authority paid the City of Newark $1.4 million for additional services. Further, without conducting an audit to determine if the initial payment was reasonable, on April 9, 2002 the Authority made another payment of $5.5 million to the City, bringing the total of the payments to $6.9 million. These payments were in addition to the $884,074 payments in lieu of taxes that the Authority paid the City between April 2001 and March 2004 for baseline services. Moreover, Authority officials paid the $6.9 million without documentation to substantiate that the costs were for services specified in the memorandums of understanding.

Health and Human and Emergency Service Costs.

Authority officials provided documents indicating that the city incurred $778,508 in costs by the Department of Heath and Human Services and Emergency Medical Services for health care services; meals provided seniors and children, and ambulance services. A supporting schedule reflected that these costs were derived by taking the percentage of Authority residents in relation to the percentage of the total population of the city of Newark and applying it to the city's total cost for health and human services and emergency medical services for the year. However, without providing statistics on the number of Authority residents who received these services, the appropriateness of this amount cannot be determined, especially since under the cooperation agreement, the city, in exchange for payments in lieu of taxes, was required to provide the Authority and its residents at no additional charge the same services and facilities that it provided to other dwellings and inhabitants.

Police Services

The Authority also provided documents reflecting $6,393,346 in costs for additional police services purportedly provided to the Authority. This included a schedule showing summary salary and benefit costs for 85 police officers who purportedly provided police coverage at four low-income housing projects from September 1, 1998, through September 1, 1999. However, another schedule from the city provided as support for the total payments indicated that the services were for the years 2000 and 2001. Moreover, the term of the unsigned memorandum of understanding agreements provided to us was from April 1, 2001 to March 31, 2003. After we requested explanations for the above discrepancies, on July 18, 2005 the Authority's board of commissioners approved amended resolutions that after the fact asserted that the services were provided from 1998 to 2003.

Monitoring and Audits

Although the memorandums of understanding allowed the Authority to audit and monitor charges for services provided, monitoring reports provided by the Authority did not indicate that additional services were provided. Further, there was no indication that a cost benefit analysis was performed six months after commencement of the service agreements, as set forth in the memorandums of understanding and the Authority's resolution No. 01-08-22. Authority officials stated that the benefits received from such services are intangible, and, therefore, they did not have any physical records of the benefits received. We disagree that the Authority does not have or could not obtain physical records to show the benefits of the services. Arrest records, complaint logs, service calls, etc could all be used to evaluate the need for and frequency of the special services.

Conclusion

The former executive director and the board of commissioners did not provide proper oversight over initiation and implementation of service agreements with the City of Newark. Because the Authority failed to maintain adequate supporting documentation, monitor the services provided, or audit the support when received, HUD can not be assured the $6.9 million paid to the City of Newark was for special services provided in addition to what should have been provided under the cooperation agreements or whether the payments were reasonable.

Recommendations

We recommend that the director of the HUD Office of Public Housing

2A. Review the documentation provided by the Authority, determine if the evidence supports that services were provided that exceeded the services that were to be provided in accordance with the cooperation agreements and seek reimbursement of any amounts that are not supported.

We recommend that the director of the HUD Office of Public Housing require the Authority to:

2B. Establish procedures that will ensure that service agreements with the City of Newark are properly executed and monitored to ensure that services have been provided, and that costs charged to the Authority are reasonable, necessary, and properly documented.

Finding 3: The Authority Settled General Liability Claims without Obtaining HUD's Written Approval

Contrary to HUD requirements, the Authority settled general liability claims without first obtaining written approval from HUD as required. This occurred because Authority officials believed that HUD approval had already been obtained since insurance settlements are a line item in the Authority's budget, which HUD approved. As a result, HUD could not be assured that legal settlements amounting to more than $1.2 million were processed in the most cost-effective manner. Further, the Authority contracted with a firm to review the settlements and provide an assessment of settlement levels and litigation management but only received the services for the first year of a three-year contract.

No HUD Approval for Legal Settlements

The Authority has a self-insurance program through which it pays up to the first $200,000 of general liability and workman's compensation claims, with an insurance company paying the claim amounts in excess of $200,000. We examined Authority claims paid in excess of $10,000 and found that from April 1, 2001, through March 31, 2005, the Authority paid $1,233,735 to settle 17 general liability claims. However, the Authority entered into settlement agreements for these claims without obtaining the prior written approval of the HUD regional counsel .

HUD Litigation Handbook 1530.01, REV-5, paragraph 5-3(c), states that a public housing authority shall accept no settlement arising out of litigation without the prior written concurrence of HUD. The terms of any such offer shall be communicated in writing to the regional counsel together with the recommendations of the public housing authority for disposition and the arguments in support of those recommendations.

Paragraph 5-3(c) further states that if the opportunity for a settlement arises in the course of a trial, counsel for the public housing authority shall inform the court of these requirements and, in an appropriate case, shall respectfully move for a continuance to allow for an opportunity to obtain HUD concurrence in the terms of the proposed settlement .

Authority officials stated that local HUD field office approval is not required or sought during the process of settling claims since the costs for insurance settlements are included in the Authority's HUD-approved annual budget. However, local HUD officials informed us that although the Authority's overall expenditures or funding level is approved for performance funding, HUD does not review the general line items in the budget; therefore, approval was not obtained.

The HUD regional counsel indicated that the requirements for prior written approval by HUD for general liability claims are applicable. The consolidated annual contributions contract, part A, section 5, requires the Authority to comply with all applicable statutes, executive orders, and regulations issued by HUD. Since advance written approval from the HUD regional counsel was not sought or obtained, HUD was not able to provide guidance on how to defend or settle various law suits, and could not be assured that these cases were resolved in the most economical or efficient manner.

Contracted Reviews Were Not Performed

On January 31, 2002, the Authority entered into a two-year contract with a consulting firm to provide broker consulting services for the purpose of enhancing the Authority's loss control services under its property and casualty insurance program at a total cost of $151,450. The contract was later renewed for a third year for $78,200, and the consultant was paid $229,650. The contract required the consultant to perform an annual claims audit of the self-insured workers' compensation and general liability claims operations. However, the claims audit was only performed for the first year. The audit's scope should have included assessments of litigation management and settlement levels and identification of opportunities for improvement. The audits were not provided for the second and third years of the contract although the full amount of the contract was paid. This occurred because the Authority lacked controls to ensure that contractor complied with all requirements of the contract before being paid. However, Authority officials state (see comments in Appendix B), that although the audits were not conducted other services were provided that can substitute for the audits; further, since the audits were only valued at $7,000 per year only $14,000 should be at issue. Nevertheless, not only did HUD not review the claim settlements made, but the Authority's hired consultant also did not review the claim settlements; therefore, HUD could not be assured that settlements were reasonable.

Conclusion

Due to the lack of controls, HUD could not be assured that the Authority's self-insurance program was cost effective as prior approval from HUD was not obtained and risk management audits were not conducted. Therefore, procedures should be established to ensure that contracted services for risk management are provided, and the Authority should either seek the contracted risk management audits from the consultant, submit evidence to HUD so that HUD could determine whether the additional services provided were adequate in lieu of the claims audits, or obtain a price adjustment/refund for this contract. In addition, HUD needs to review the support for the 17 claims paid to ensure that the settlements were proper.

Recommendations

We recommend that the director of HUD's Office of Public Housing instruct the Authority to

3A. Establish procedure to ensure that HUD approval is obtained before settling general liability claims.

3B. Submit support for the 17 general liability claims amounting to $1,235,735 to the HUD regional counsel for review and approval. If any of the claims are determined to be unallowable, the amount of that claim should be repaid from nonfederal funds.

3C. Establish procedures that will ensure the contracted services for loss control are provided in accordance with terms of the broker/consultant contract.

3D. Either seek performance of the loss control audits that are required to be performed by the loss management-consulting contractor, submit evidence to HUD so that HUD could determine whether the additional services provided by the contractor were enough to forgo the two claims audits that were not performed, or obtain a refund for the services not performed in accordance with the contract.

SCOPE AND METHODOLOGY

Our review was conducted at the the Housing Authority of the City of Newark 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, trust indentures, and cooperation agreements; and
- HUD's and the Authority's program files for the low-rent housing and Section 8 programs.

We reviewed various documents including financial statements, ledgers, bank statements, invoices, purchase orders, contracts, check vouchers, and prior Office of Inspector General (OIG) and HUD reports on the Authority. We reviewed documentation regarding service agreements with the City of Newark, including activity reports and other supporting documents furnished by the Authority and the city. We also reviewed the Authority's financial and administative records related to its Housing Finance Corporation, including bond trust indentures and refunding agreements, cooperation agreements and the memorandums of understanding with the City of Newark, and documentation related to liability claims that were paid by the Authority.

We performed the audit from May through October 2005. The audit covered the period from April 1, 2001, through March 31, 2005, but was extended as necessary to periods before and after these dates.

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 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, we believe the following items are significant weaknesses:

- The Authority did not have an adequate system to ensure compliance with laws and regulations related to the disposition of the proceeds of bond financing activities, obtaining support for payments made to the City of Newark, complying with cooperation agreements, and obtaining HUD approval for legal settlements (see findings 1, 2, and 3).

- The Authority did not have an adequate system to ensure that resources were properly safeguarded when its Housing Finance Corporation made questionable payments of $67,524, it paid $6.9 million to the City of Newark for services provided under the cooperation agreements, it did not obtain HUD approval for legal settlements, and it did not ensure that risk management services were provided (see findings 1, 2, and 3).

FOLLOWUP ON PRIOR AUDITS

Report No. 2005-NY-1005
Dated: May 26, 2005

We issued the above audit report entitled "The Housing Authority of the City of Newark Bond Financing Activities and Section 8 Housing Choice Voucher Administrative Fee Reserves." The report contained two audit findings with recommendations for corrective action. The finding involved the Authority's retaining of funds remaining after a bond issue had been redeemed and the use of housing choice voucher administrative fee reserves for ineligible purposes. The Authority has reimbursed the housing choice voucher administrative fee reserve account for the $3,991,350 expended for the acquisition of properties; however, the recommendations are still open. The Authority is appealing the recommendation that HUD be paid the $2,533,536 in funds that remained after the Authority's 1980 mortgage revenue bonds were redeemed. The Office of Public Housing has established December 31, 2006, as the target date for the Auditee to complete its corrective actions and for HUD to verify the corrective actions taken.

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/
1B			$1,544,244
1C			$59,450
1D		$261,409	
1E			$1,956,429
1G		$67,524	
2A		$6,900,000	

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 polices 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 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/ "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

January 10, 2006

Mr. Edgar Moore
Regional Inspector General for Audit
New York/New Jersey
26 Federal Plaza, Room 3430
New York, New York 10278-0068
Via Facsimile (202-401-5978)

RE: Response to OIG's Draft Audit Report of December 16, 2005

Dear Mr. Moore:

The Newark Housing Authority (NHA) submits the following comments on the draft audit report by the Office of Inspector General (OIG) entitled "The Housing Authority of the City of Newark, Newark, New Jersey, Controls Over Bond Financing Activities, Obtaining Supporting Documentation, and Legal Settlements Require Improvement." That report was provided to us by you under cover of a letter dated December 16, 2005.

Comment 1

At the outset, it should be noted that this report covers the period going back to April 1978, which represents a time span of over 27 years. The lengthy period covered by this audit should be given far greater recognition in the final report than it received in the draft. First, and most important, the management and staff of NHA have changed over this period. Current management and staff of NHA have been working diligently to remedy any performance deficiencies and should not be maligned by a report which incorrectly implies that they are at fault.

Second, this lengthy time period made it difficult to retrieve relevant documents, and even more difficult, to interview people who could shed light on the issues involved. This creates uncertainty as to the appropriate legal regime applicable to those facts, an uncertainty that the draft report fails to reflect.

Comment 2

This time issue is particularly worrisome in view of some of the findings in the draft report. For example, the section on "Internal Controls" identifies two "significant weaknesses" at p. 22. Even if the underlying findings on which these two findings are based were correct, which we vigorously dispute, these two findings speak to the distant past. Moreover, the OIG reviewed these facts in 1992 and based on the review of NHA's implementation of the OIG's recommendations, HUD office closed out the issue in September 1993. OIG has not presented any evidence that would establish that these alleged weaknesses still exist. In these circumstances, these two findings should be deleted, since there is no indication of present weakness.

500 Broad Street, Newark, New Jersey 07102 · (973) 273-6600 · Fax (973) 642-1242
"IMPROVING NEWARK'S NEIGHBORHOODS"

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 3

Comment 4

Comment 5

Comment 6

Similarly, the finding concerning payments to the City of Newark refers to the "Executive Director" and "Board of Commissioners." Again, this refers to the past and that language should be corrected to refer to the "**former** Executive Director." Further, oversight of contracts and agreements is not the responsibility of the Board of Commissioners, which is concerned with NHA policies. The initiation, drafting, and oversight of this agreement were the responsibility of the **former** Executive Director.

Finding 1

Debt Service Reserves

The OIG choosing to audit the flow of funds related to certain bonds issued by the Housing Finance Corporation (HFC) of the City of Newark is somewhat surprising inasmuch as the OIG previously audited the same matter in 1992. Audit No. 92-NY 204-1009. Finding 4 from that audit stated "The HFC did not use excess compensation to fund debt service reserves." This finding was closed out by HUD's office on September 29, 1993 based on its conclusion that NHA and HFC had complied with all OIG's recommendations. See Tab A for Finding 4 and HUD's closeout letter. NHA submits that this should resolve the matter and that OIG should not reopen it some twelve years later, especially since all its previous recommendations were adopted. Auditees should be entitled to finality, absent extra-ordinary circumstances not present here.

Despite this, the draft report identifies $1,865,103 which it asserts should be placed in the debt service reserve of several projects. It then asserts that these funds should (or possibly should) be remitted to HUD. It bases these conclusions on the current version of 24 C.F.R. § § 811.105(b) and 811.108.

At the outset, please note that these two provisions are not applicable to bond issues under the "old" regulations. The "old" regulations did not require that surplus funds in the debt service reserve be remitted to HUD. See 42 Federal Register 39205 et seq (August 3, 1977). "These ["new"] regulations are effective with respect to projects for which the Section 8 notification of selection of the preliminary proposal is issued on or after the effective date of these regulations…," which is April 5, 1979. 44 Federal Register 12360 (March 6, 1979). We have carefully searched our files, but have been unable to locate these notifications of selection for any of the projects at issue. Since these notifications of selection, by definition, must precede the bond issue, we are quite interested to know how OIG determined that the "new" regulations are applicable. Please provide us with OIG's basis for this determination, so that NHA has a meaningful opportunity to comment on OIG's conclusions.

For the Aspen Temple project, it is obvious that the "old" regulations are applicable since this bond issue was closed on November 21, 1978, well before the effective date of the "new" regulations. Accordingly, 24 CFR §§ 811.105(b) and 811.108 of the new regulations are inapplicable, and the HFC is entitled to retain the payments in question because such payments are permitted by the "old" regulations and the governing Trust Indenture. It should be noted that Aspen Temple accounts for well over one half of the amount questioned by OIG.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 6

Even if 24 CFR § 811.105 (b) is applicable to some of these bond issues, it explicitly permits reimbursement of expenses. With the exception of Fairview Homes, these funds (other than those related to Aspen Temple) were for reimbursement of expenses or for bond issuance fees, which were used as an approximate means of reimbursing expenses. The difficulty of an audit going back 27 years is especially apparent as the documentation concerning these receipts is very sketchy, and no one having knowledge of the relevant facts is available.

Comment 7

The Fairview Homes involves two "income" items of $50,778.00 and $125,800.49. The former shows again the difficulty of auditing over such an extensive period. The only documentation concerning this receipt are two memoranda, one from William Reid, NHA Director of Housing Production, and one from Shub Hegde, who was NHA Director of Finance. Both memos, which are dated July 18, 1985 and September 12, 1985, respectively, state that this $50,778.00 was for "Development of Norfolk Square." Current NHA staff and management are unaware of any connection between Norfolk Square and Fairview Homes. Norfolk Square is the name of a different affordable housing project. In these circumstances, it does not appear to be "compensation in connection with the financing of …" the Fairview project.

The other receipt that concerns Fairview Homes is for $125,800.49. In its 1992 audit, the OIG concluded that NHA owed this $125,800.49 to HFC and recommended that NHA be instructed to reimburse HFC this amount. Finding 4F. NHA did so and submits that this should be the final resolution of this matter. OIG should not, many years later, attempt to revise its previous recommendations, especially those that have been fully complied with.

Thus, Recommendations 1A, 1B, and 1C are inappropriate. NHA requests that these recommendations be deleted.

McKinney Act Savings

Comment 8

The draft report asserts that the Housing Finance Corporation was not disbursing these funds in a timely manner and that the remaining McKinney Act funds should be repaid to HUD. It asserts that the HFC was required to expend these funds for eligible purposes within six months of receipt. The basis for OIG's assertion that the funds must be remitted to HUD if not expended within six months of receipt is a mystery. While Section 8 of the form FAF Refunding Agreement (RA) requires the HFC to state that it will expend the funds within six months of requisitioning them, it does not provide that the remedy for failure to do so is to remit the funds to HUD. Contrary to the language in Recommendation 1D, the RAs do not require that the funds be remitted to HUD.

Nor does the statute or the regulations require remitting of McKinney Act funds to HUD, if not expended within six months. Section 1012 (b) of the Act provides that

> The Secretary shall make available to … the … local housing agency … an amount equal to 50 percent of the amount recaptured from the project…

No mention is made of HUD recapturing such funds not expended within six months of receipt. Thus, OIG's recommendation appears to incite HUD to exceed its statutory authority.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 8

Comment 9

Comment 10

Similarly, the thrust of the regulations is directly contrary to OIG's assertion:

> …[McKinney Act] savings shall be subject to the above use requirements for 10 years from the date of receipt of the savings.

24 C.F.R. § 811.110(g). Thus, it appears that a PHA is entitled to take 10 years or more to expend McKinney Act funds.

NHA acknowledges that it did not timely submit the required report and certification to HUD, nor timely expend those funds. However, when it was notified of this oversight on July 12, 2004, it submitted a proposal for expenditure of McKinney Act funds, which HUD found acceptable in their correspondence of September 27, 2004.

That resolved the default, because the refunding agreements provide that:

> Upon the occurrence of any default under the Agreement…, HUD shall notify the [Housing Finance] Corporation and direct the actions to be taken to cure the default within a stated time.

Section 10 of the form RA. NHA cured the default to HUD's satisfaction within the stated time so that this issue has been resolved.

In this context, it should be noted that the statement in the draft report that NHA did not "inform HUD on what these funds would be used for…until May 2005 after we [OIG] began our inquiry during the audit period" is inaccurate. The Office of Housing had informed NHA of its failure to submit the required reports by letter dated July 12, 2004, and NHA informed HUD as to what the funds would be used for on September 3, 2004. HUD approved this proposed use on September 27, 2004. Copies of this documentation have already been provided to OIG. Thus, this sentence, which incorrectly implies that OIG deserves credit for HUD being informed, should be deleted.

Thus, Recommendation 1D is not justified. It should be deleted from the final report.

Questionable Disbursements

OIG next asserts that the HFC inappropriately disbursed $147,524 in McKinney Act funds. The first questioned cost of $26,035.37 was for legal fees incurred on a lawsuit against a construction company. Housing for very low income families had been destroyed because of defective construction, and the purpose of this lawsuit was to obtain funds for rebuilding. Making housing available directly benefits very low income families or individuals.

The second questioned payment of $80,000 is cited as being "to prevent early prepayment of mortgage." This payment was made to the mortgagor in exchange for its agreement not to exercise its right to prepay the mortgage. This agreement enabled HFC to prepay a high interest rate bond loan and thereby refinance the project at a lower interest rate[1]. This payment resulted in HFC and HUD each netting $526,708.48 from the refinancing. See the documentation at Tab B. These two payments are clearly appropriate because they are associated with the refinancing the debt of a Section 8 project.

[1] The mortgagor agreed to use this $80,000 for repairs and capital improvements to the project.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 11

Comment 12

The third category of costs, totaling $41,488.53, was challenged as unsupported because there was insufficient documentation. Of this cost, $31,701.78 was for a study to locate satisfactory sites for Section 8 housing. The consultant prepared extensive reports, copies of which are enclosed so that the concern about documentation can be alleviated. See Tab C. Locating sites where additional very low income housing can be built directly benefits very low income families and individuals.

The remaining $9,786.75 was for a feasibility study of the acquisition from HUD and rehabilitation of the Brick Towers project. If HFC or NHA were to make this a successful housing project for low income and very low income families and individuals, a feasibility study was obviously needed. Since OIG is concerned that this expenditure is not adequately documented, such information is supplied in Tab D.

Thus, Recommendation 1E is inappropriate and should be deleted. Since the foregoing establishes that there have been no breaches of federal regulations, Recommendation 1F should be deleted since there has been no need shown for it.

Finding 2

This finding asserts that NHA did not maintain adequate documentation to support payments to the City of Newark under two Memoranda of Understanding whereby the City agreed to provide services in addition to those that were furnished under the Cooperation Agreement between NHA and the City.

The actual period covered by the agreement between NHA and the City of Newark was 1998 to 2003. The initial resolutions authorizing the agreement had discrepancies in this regard. Detailed discussions with the former City Chief Financial Officer, Chief of Police, the Corporation Counsel and the former Deputy Executive Director of NHA, made it clear that the original intent of the agreement was to cover the period from 1998 to 2003, and the discrepancy was subsequently corrected by a Board resolution dated July 18, 2005.

These payments were the subject of OIG document requests dated April 21, 2005 and August 16, 2005. In response to that request, NHA submitted substantial documentation provided by the Newark Police Department on September 16, 2005.

Of the total $6.9 million, $778,508 related to health and human services and emergency services costs. We have requested additional documentation from the Department of Health and Human Services in connection with those services and will supply that information to OIG as soon as we receive it. See Tab E.

The balance of the $6.9 million was for additional police protection. Additional police protection was required in public housing projects because of high crime rates and drug dealing, problems that were not occurring to the same extent in the rest of the City. The need for additional police services in public housing sites around the country is well-known and well-established, and Newark's public housing is no exception. NHA, for example, was awarded federal drug elimination grant under HUD's Public Housing Drug Elimination Program the years in which such funds were made

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 12

available, thus demonstrating the need for additional police services above the baseline -- from 1991 through 2001 (which includes the period during which the supplemental services were provided to NHA by the City). These competitively awarded funds were used to hire special police to work part time patrolling public housing sites. When the drug elimination funds were expended, NHA had to discharge these officers.

Although police services were provided to housing authority residents for baseline services under the Cooperation Agreement between NHA and the City, the level of crime in housing projects required a higher level of police service, and not to address just drug crimes, but all categories of crimes including homicides, assaults, car thefts, etc. Extreme police measures were needed to combat the overwhelming criminal activities concentrated at public housing sites. For example, police were required to implement a "lockdown" of the Baxter Terrace public housing complex for seven months during the period in question, an operation that required the extensive use of police personnel for 24 hours a day, seven days a week during the lockdown period, resulting in costs substantially above the baseline. Thus, police services for public housing were far in excess of that provided to the rest of the City.

There is no doubt that the Newark Police Department performed these additional services and kept records, as evidenced by the affidavit provided by the Police Department and attached at Tab F. The Police Department provided three boxes of documents for the period in question which details police activity at NHA sites. Those documents include motor patrol logs, foot patrol logs and supervisor logs which indicate the name or badge number of the officer on duty, the length of his or her shift (referred to as a "tour"), locations of incidents, disposition of incidents, and the amount of time the officer spent on the call. See Tab G. The file also includes summaries of key activities based on the tour assignment sheets. For example, the police documentation includes correspondence dated July 7, 2005 from Deputy Chief Guy Hamstra to Police Chief Irving Bradley which reports that the Patrol Division deployed a total of four police officers a day for 42 hours a day (approximately 1260 hours) within Hyatt Court Complex in November 2002. See Tab H. The voluminous records that have been provided are maintained in the normal course of business for law enforcement, although the format in which such data is kept may not be "convenient" for OIG. Nonetheless, these records showed police services provided to the tune of over $12 million, though the payment made to the City was only for $6.9 million.

OIG's complaint is that the Police Department did not keep the records OIG would have had it keep:

> The information obtained is considered to be inadequate because it did not identify the number of hours worked, the names of the employees working, a description of activities, and the location where services were performed.
>
> * * *
>
> For example, salary and wage cost [sic] should be supported by time distribution records approved by a responsible official with periodic certifications that employees actually worked on a program or activity.

Draft Report, p. 14.

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AUDITEE COMMENTS AND OIG'S EVALUATION

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Comment 12

However, the police documentation does contain this information, although perhaps not in the format preferred by OIG. OIG then concludes that this documentation did not meet OMB Circular A-87 requirements. Despite the implication in the Draft Report that the quoted "requirements" are requirements of Circular A-87, that is not the case. Circular A-87 simply requires that expenditures be adequately documented. See Paragraph C.1.j. of the Circular. (The previous version of Circular A-87 dated May 4, 1995 contained the identical provision.)

Thus, OIG is attempting to retroactively impose its idea of adequate documentation with respect to the services provided under the Memoranda of Understanding. It has cited no source for its conclusion that the documentation is inadequate except for the above-quoted "requirements." Therefore, there is no objective basis for a finding of inadequacy and the entire finding should be withdrawn.

OIG asserts that the absence of baseline data showing the level of police service under the Cooperation Agreement made it difficult to determine if police services provided to the NHA sites were in addition to the baseline. In fact, NHA collected baseline data from the Police Department and provided HUD with the baseline police services in the form of certifications which were required to be included in NHA's application for the Public Housing Drug Elimination Program. In addition, NHA filed with HUD bi-annual Progress Reports on crime levels and police services covering January to June, and July to December for each year in question. At no time did HUD ever complain about the quality or quantity of information included in those certifications and reports.

HUD has acknowledged that "because policing is a local matter in the United States, there is not a single federal definition of what constitutes baseline police services." Public Housing Safety and Security Activities Frequently Asked Questions. pp. 7-8. See Tab I. In view of this and of the obvious increased police activity required by public housing in Newark, OIG should drop its insistence that the Newark Police Department define baseline in accordance with the definition of baseline that OIG envisions.

Despite this lack of basis for OIG's complaint, NHA requested the Police Department to review its files again in order to see if any additional documentation could be located. The Police Department responded by letter from Police Director Anthony F. Ambrose III, dated January 3, 2006. See Tab J.

We urge you to review Mr. Ambrose's letter with care. In it he notes that, contrary to OIG's assertion, the Department supplied documentation that serves as a time record and depicts the date, tour (hours worked), location deployed, and the rank, name and identification number of the officer. As Mr. Ambrose notes, this official Newark Police Department document, the "Tour assignment report," is responsive to the OIG document request. In addition, Mr. Ambrose forwarded documentation about police service at public housing sites and statistics about violent crime from 2000 to 2004. Finally, he indicates that certain quality of life complaints could not be captured by the reporting system during the relevant time period. We submit that Mr. Ambrose's letter and attachments, together with materials previously made available to OIG, provide adequate documentation of extra police services to support the payment of funds to the City.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 12

The detailed recommendations begin with Recommendation 2A which would require NHA to provide documentation concerning these services. As has been shown above, the Newark Police Department and NHA have provided such documentation but OIG, for whatever reason, does not believe it adequate. OIG's unsupported belief provides no basis for this finding, and it should be withdrawn.

Comment 13

Recommendation 2B would require that NHA obtain specific HUD approval before entering into any agreements with the City of Newark. No statutory or regulatory authority is cited for imposing this approval requirement on NHA, and this point is not discussed in the body of the Draft Report. In these circumstances, it should be deleted.

Comment 14

Recommendation 2C goes to the question of proper documentation. For any future service agreements, NHA would welcome OIG's views as to the documentation that should be obtained and the basis for these views. The other aspects of this proposed finding have not been established and indeed, are outside the scope of the overall finding, which is concerned with documentation. Again, this finding should be deleted.

Comment 13

The suggestion, in Recommendation 2D, that NHA's Executive Director and Board of Commissioners be sanctioned is unwarranted and unnecessary. In the first place, these events occurred under the **former** Executive Director. As for the Board of Commissioners, they are responsible for NHA policies, but not for the day-to-day operations of the NHA. Moreover, for the OIG to suggest that the housing authority should "oversee" law enforcement operations is neither logical nor practical. Further, it would be the height of arbitrariness to sanction anyone because OIG retroactively disagrees as to what constitutes adequate documentation. This finding should be deleted.

Finding 3

Comment 15

OIG notes that NHA settled general liability claims without first obtaining written approval for each settlement from HUD. As the Draft Report noted, this occurred because NHA believed that HUD approval had already been obtained through HUD's approval of NHA's budget which had a line item for insurance settlements. When paragraph 5-3(c) of HUD Handbook 1530.01 REV-5 was pointed out to NHA, it immediately began changing its procedures. However, with respect to the requirement of obtaining HUD concurrence on insurance matter, we understand that this procedure has not been adopted by HUD throughout the country.

NHA has moved to establish procedures to insure that HUD concurrence is obtained before settling general liability claims. NHA is discussing these procedures with the Chief Counsel in HUD's Newark Office. NHA has submitted three proposed settlements to HUD and has obtained HUD's concurrence on one.

Comment 16

In its last finding, OIG notes that NHA entered into a contract, which was ultimately for three years and $229,650, for an annual workmen's compensation claims audit and liability claims operations. It then notes that only one year's audit was performed, but does not note several facts. First, the

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 16

Comment 17

claims audit was part of the contract and amounted to $7,000 per year. Thus, only $14,000 of the $229,650 is at issue. The balance was for training, inspections, regulatory updates, and other loss control activities. Second, the performance of the second and third year audits was postponed while significant issues identified by the first year audit were resolved. Third, the contractor performed other services, related to asbestos problems at NHA headquarters and at one project, in lieu of conducting second and third year audits. Documentation of the asbestos work is set forth at Tab K. Thus, there is no basis for Recommendation 3D, and it should be withdrawn.

Finally, OIG identifies two items which it believes are "significant weaknesses" in NHA's internal controls. Draft Report at 22. As noted above, these two findings speak to the past; there is no evidence in the draft report that these "weaknesses," even if they ever existed, still exist. For this reason alone, these two findings should be deleted. Further, as has also been shown above, the bases for these two findings are untenable, providing a further reason for their deletion. The one exception is the failure to obtain HUD approval for litigation settlements. This resulted from NHA's misunderstanding of HUD's guidance and was corrected as soon as it was recognized, which is hardly an indicator of a significant weakness in internal controls.

For the above stated reasons, the findings in the draft report should be clearly modified or deleted.

If you have any questions concerning these comments or wish to discuss this matter further, please contact me directly at 973-273-6600 or Shaye S. Araromi, Asst. Executive Director, at 973-273-6410.

Sincerely,

Harold Lucas
Executive Director

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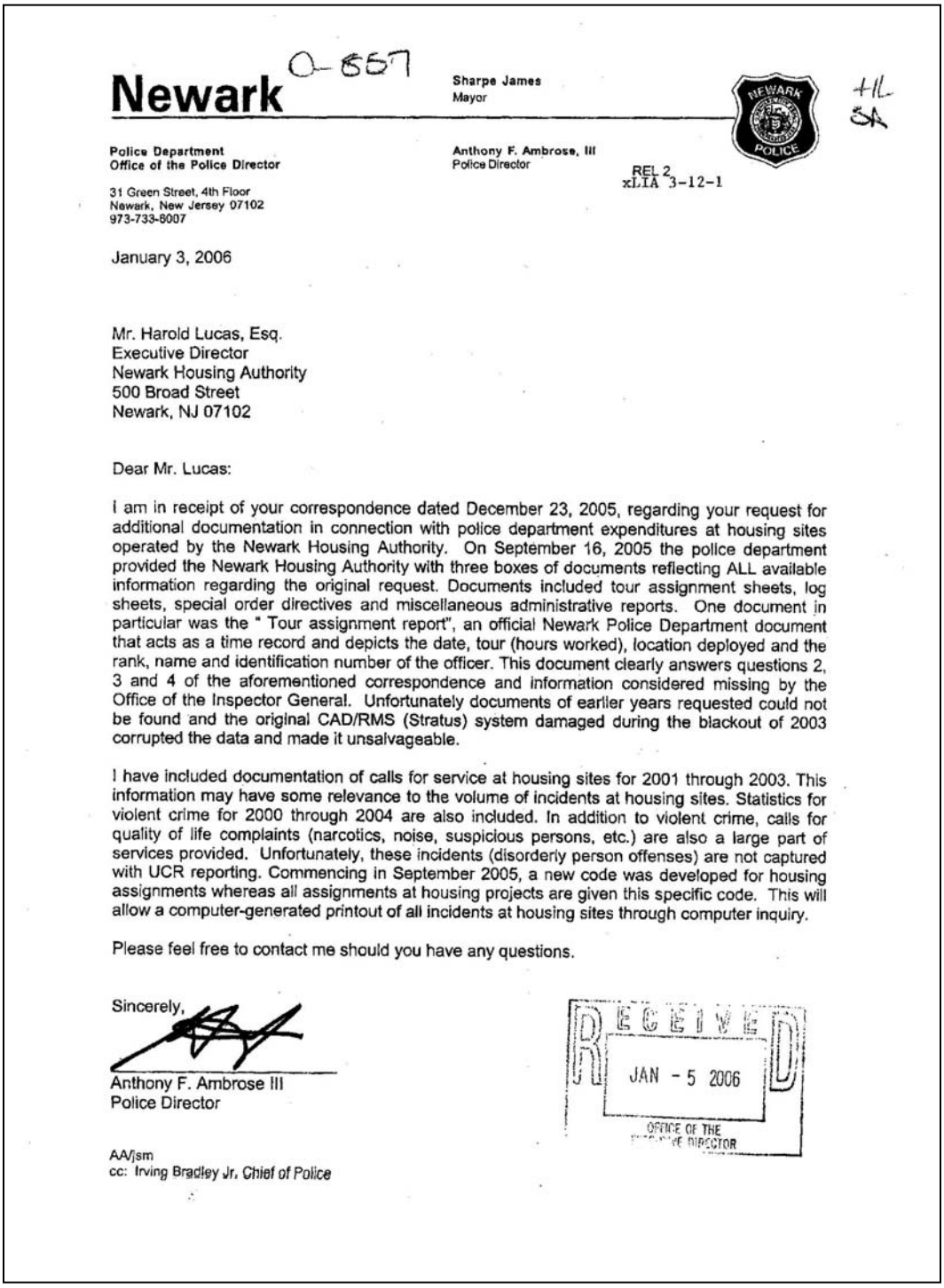
Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**



Newark O-657

Sharpe James
Mayor

Police Department
Office of the Police Director

Anthony F. Ambrose, III
Police Director

REL 2
xLIA 3-12-1

31 Green Street, 4th Floor
Newark, New Jersey 07102
973-733-6007

January 3, 2006

Mr. Harold Lucas, Esq.
Executive Director
Newark Housing Authority
500 Broad Street
Newark, NJ 07102

Dear Mr. Lucas:

I am in receipt of your correspondence dated December 23, 2005, regarding your request for additional documentation in connection with police department expenditures at housing sites operated by the Newark Housing Authority. On September 16, 2005 the police department provided the Newark Housing Authority with three boxes of documents reflecting ALL available information regarding the original request. Documents included tour assignment sheets, log sheets, special order directives and miscellaneous administrative reports. One document in particular was the " Tour assignment report", an official Newark Police Department document that acts as a time record and depicts the date, tour (hours worked), location deployed and the rank, name and identification number of the officer. This document clearly answers questions 2, 3 and 4 of the aforementioned correspondence and information considered missing by the Office of the Inspector General. Unfortunately documents of earlier years requested could not be found and the original CAD/RMS (Stratus) system damaged during the blackout of 2003 corrupted the data and made it unsalvageable.

I have included documentation of calls for service at housing sites for 2001 through 2003. This information may have some relevance to the volume of incidents at housing sites. Statistics for violent crime for 2000 through 2004 are also included. In addition to violent crime, calls for quality of life complaints (narcotics, noise, suspicious persons, etc.) are also a large part of services provided. Unfortunately, these incidents (disorderly person offenses) are not captured with UCR reporting. Commencing in September 2005, a new code was developed for housing assignments whereas all assignments at housing projects are given this specific code. This will allow a computer-generated printout of all incidents at housing sites through computer inquiry.

Please feel free to contact me should you have any questions.

Sincerely,

Anthony F. Ambrose III
Police Director

RECEIVED
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EXECUTIVE DIRECTOR

AA/jsm
cc: Irving Bradley Jr. Chief of Police

OIG Evaluation of Auditee Comments

Comment 1

The report scope has been corrected to reflect that our audit covered the period April 1, 2001 through March 31, 2005, and was extended to cover periods before and after these dates as necessary. Therefore, although our testing has led us to earlier years, the Authority's current management is still responsible for the issues disclosed in this report.

Comment 2

Although a prior OIG finding was resolved in an earlier year, it does not follow that the conditions that caused the finding do not exist today. Various issues described in this report do exist today, resulting in the current audit findings. In finding 1 funds still have not been deposited in debt service reserves and McKinney Act savings were still not being reported or expended in accordance with the requirements of the refunding agreements. In finding 2 the Authority has still not been able to obtain adequate supporting documentation for payments to the City of Newark for services that may have been provided as recently as 2003. In finding 3 HUD approval was not sought or obtained for general liability claims that occurred from 2003 through 2005.

Comment 3

It is understood that the former executive director and board members may have initiated policy that led to some of the control weaknesses cited in this report; however, when the current executive director and board members assumed responsibility over the Authority it became their job to correct the control weaknesses. Nevertheless, we revised our finding to reflect that the former executive director was involved in the deficiencies noted.

Finding 1

Debt Service Reserves

Comment 4

In 1992 OIG chose to audit the flow of funds related to certain bonds issued by the City of Newark's Housing Finance Corporation (Report No. 92-NY-204-1009), and as a result, the Authority agreed to reimburse its Housing Finance Corporation the ineligible cost it received and to follow federal regulations pertaining to the receipt and use of excess compensation. However, as in 1992, the Authority did not fund the debt service reserves of the individual projects for which it had received excess compensation for, therefore, we are readdressing this issue. Further, the report requested that $1.5 million in excess management service income be placed into the individual projects' debt service reserves. We requested that $320,959 ($59,450 and $261,409) be either returned to HUD or for HUD to determine whether it should be returned.

Comment 5

The Authority indicated that the citations of 24 CFR [Code of Federal Regulation] 811.105 and 811.108 were not applicable to bond issues under the old regulations. The old regulations did not require that surplus funds in the debt service reserve be remitted to HUD. The Authority also indicated that 44 Federal Register 12360, (March 6, 1979) stated the new regulations are only effective for those projects for which the Section 8 notification of selection of the preliminary proposal was issued on or after April 5, 1979, the effective date of the new regulations. The Authority stated that it had not been able to locate any notifications of selection and wanted to know our basis for applying the new regulations. The citations in 24 CFR [*Code of Federal Regulations*] Part 811 apply because all of the bonds other than Aspen Temple were issued after the effective date of the new regulations.

Further, during our prior audit (92-NY-204-1009), HUD's counsel verbally opined that the regulations were applicable. However, since we could not locate a formal opinion addressing this issue, we have added a recommendation for HUD to obtain a formal legal opinion regarding the applicability of the cited regulations and advise the Authority on the proper disposition of the funds in excess of expenses related to Aspen Temple and the other projects.

Comment 6

The Authority indicated that the citations of 24 CFR [Code of Federal Regulations] 811.105(a) (2) (iii) (b) and 811.108 were not applicable for the bond issue for Aspen Temple which closed on November 21, 1978 before the April 5, 1979 effective date of the new regulations. However, the indenture of trust for Aspen Temple, section 103 provides that it is agreed among the Housing Finance Corporation, the trustee, and the Authority that all terms and provisions of the regulations, Federal Housing Administration regulations, and the National Housing Act are hereby incorporated by reference in the indenture and that they shall be controlling to the extent that they are in conflict with or in addition to the terms and provisions of the indenture and in the event of any inconsistency with the provisions of the indenture. Thus, it appears that the new regulations are applicable.

The Housing Finance Corporation is entitled to reimbursement for its expenses including costs related to the bond issuance. Therefore, our review is only requesting that the total compensation that is in excess of the Housing Finance Corporation's allowable costs be deposited in the debt service reserves of the individual projects. For Aspen Temple, the excess management service income was earned between June 30, 1980, and February 9, 1993 (after the effective date of the new regulations). Further, section 706 of the indenture of trust provides that the Aspen Temple Apartments Company may pay each of its fiduciaries reasonable compensation for services rendered under the indenture including reimbursement for all reasonable expenses incurred in the performance of

duties under the indenture. The Housing Finance Corporation recorded $491,369 in management services income applicable to Aspen Temple from June 30, 1980, through February 9, 1993. However, because no expenses were noted after June 30, 1980, on the Housing Finance Corporation's records for management services provided to this project, this compensation does not appear to be reasonable according to the terms of the indenture of trust. Accordingly, we requested a legal determination regarding the disposition of these funds.

Comment 7

The Housing Finance Corporation's financial records (cash receipts journals) showed that the $50,778 was recorded as management services income pertaining to Fairview Homes not to the development Norfolk Square. Further, OIG's prior audit report (Audit Report 92-NY-204-1009) questioned the fact that the Housing Finance Corporation did not place the excess funds into the project's debt service reserves. Instead, funds ($125,800) were placed into the Authority's general revolving fund. Upon our audit, the Authority returned these funds to the Housing Finance Corporation, although, a review of the records showed that the Housing Finance Corporation did not place these funds into the debt service reserves as required. However, based on the Authority's claim that the regulations are not applicable, we revised our finding to include a recommendation for HUD to obtain a legal determination as to the proper disposition of the funds being retained by the Housing Finance Corporation. Thus, recommendation 1A, 1B, and 1C of the draft report are still applicable and are now 1B, 1C, and 1D.

McKinney Act Savings

Comment 8

The Housing Finance Corporation was required to report semiannually that it had expended the McKinney Act funds/savings within six months. Since it did not report on the use of these funds as required for a 10-year period, HUD was not aware that the funds were not being expended in a timely manner. Therefore, HUD was unable to apply a remedy to the Housing Finance Corporation's default of possibly suspending the payment of future McKinney Act savings/payments until the default was resolved. Consequently, all of the McKinney Act savings/funds installments had been paid to the Housing Finance Corporation before HUD became aware of the default. Thus OIG recommended that the remaining McKinney Act savings that had not been spent be repaid to HUD due to the default on the requirements for reporting and spending the McKinney Act savings/funds. Further, the requirements do not state that the Authority has 10 years to expend the funds; however, they do state that the savings/funds are subject to specific **use** requirements for 10 years. The funds must be expended within six months of receiving each installment payment according to the refunding agreement.

In addition, the Authority's September 3, 2004, submission of its proposal on how the McKinney Act funds would be expended did not resolve the default of not reporting. In HUD's September 27, 2004, response, HUD stated that the Authority's letter satisfied the 90 day deadline for an initial progress report and that HUD looked forward to receiving timely reports in the future to the extent the Authority continued to receive McKinney Act savings installments. This letter did not state that HUD had approved the proposed use of funds. Nevertheless, since Authority officials state that repayment or recapture is not an option for not expending the funds in a timely manner in accordance with the regulations and the refunding agreement, we have revised our recommendation to require the Office of Public Housing to obtain a legal determination as to the proper disposition of the unspent McKinney Act savings/funds being retained by the Housing Finance Corporation. We further recommend that in the event the Housing Finance Corporation is allowed to retain the McKinney Act savings, controls should be established to ensure compliance with the spending and reporting requirements of the refunding agreements and regulations. We also removed the statement that the Authority did not respond until OIG began its inquiry during the audit. Further, recommendation 1D of the draft report is now 1E, and it now reflects that the funds in question should be disposed in accordance with the legal determiniation.

Questionable Disbursements

Comment 9

In this section the costs that are being questioned represent items paid with non-McKinney Act funds, which should only be used for the payment of principal and interest on the obligation or for expenses related to the financing of the project. Since some of the funds used for these expenses may have been from McKinney Act savings, the draft report states that these funds could also be used for providing housing for low-income families. However, the $26,035 paid for the lawsuit was paid with non-McKinney Act funds, and since these costs were not directly related to financing activities, they appear to be ineligible costs. However, based on the documents submitted at the exit conference, we classify these costs as unsupported pending an eligibility determination by HUD.

Comment 10

We have accepted the $80,000 in costs paid to the borrower as being an allowable financing-related cost based on the Authority's explanation and review of the supporting documents. These questioned costs have been eliminated from the finding.

Comment 11

Regarding the $41,489 for consulting services, we could not determine whether it was paid with McKinney Act or Non-McKinney Act funds. These costs would not be allowable if paid with non-McKinney funds since the costs were not directly related to financing activities. Further, if

the funds were classified as McKinney Act disbursements, a determination would have to be made by HUD that they are allowable development costs. Therefore, we classify these costs as unsupported pending an eligibility determination by HUD. Regarding the recommendations, they are valid because the Housing Finance Corporation has not conducted its operations in accordance with the applicable regulations. However, we have revised our recommendations; recommendation 1E is now 1G, which reflects that the amount of questioned costs is now $67,524.

Finding 2

Comment 12

The Authority's comments allude that OIG looked at the additional payments to the City of Newark because the initial resolution authorizing the services contained discrepancies in the time of performance of these services, which was addressed, after the fact, by a board resolution made during the audit (July 2005); however, this was not the only reason we examined these costs. Authority officials provided three boxes of documents related to the police services; however, as mentioned in the audit finding, the information did not provide the basis for determining the costs, nor did the Authority substantiate that the services provided were in addition to the normal services required of the city under the cooperation agreementThe supporting documents provided did not contain payroll-related information about salary or wages, time distribution records signed and approved by a responsible official. Moreover, there were no periodic certifications signed or certified by employees or supervisors having first hand knowledge of the work performed. More importantly, the documentation provided by the City indicated that the costs charges were based on a rate of $50 per hour, yet the actual salary costs for the periods in question were never provided.

The Authority also asserts that additional police services were needed as evidenced by HUD providing them with a Drug Elimination Grant during the period. However, Drug Elimination Grants are not necessarily for additional police services. In this case, the Drug Elimination Grants were provided from 1998 to 2001 for the employment of security and investigators, voluntary tenant patrols, physical improvements, drug prevention, special initiatives, gun buyback programs, and other program costs. The Drug Elimination Grants did not mention additional police services.

Further the report does not state that police services were not provided or that the Authority should monitor the activities of the police. The report indicates that the services may have been routine, and that the cost of these services is not documented. Although the Authority as stated in their reponse provided three boxes of documents and two binders at the exit

conference, stating that the city incurred over $12 million in costs, there was insufficient evidence to substantiate the cost of these services, that the services were in addition to what was required under the cooperation agreement, and that the services were worth more than the $800,000 already provided to the city in payments in lieu of taxes. As such, the auditors asked for cost data, such as payroll records etc., that could be used to justify the additional payments made to the city. As mentioned in the finding, the schedules provided documented routine items such as traffic stops, auto accidents, domenstic disputes and reported roberies, etc., however, the documentation was inadequate to make a determination that the costs were reasonable. Therefore, contrary to the requirement of its annual contribution contract, cooperation agreement, and federal regulations, the Authority did not maintain adequate documentation to support the additional payments made to the City of Newark.

Comment 13

After consultation with the Newark HUD Office of Public Housing, draft recommendation 2B that required the Authority to obtain HUD approval before entering into any agreements with the City of Newark has been deleted. In addition, we have deleted draft recommendation 2D that required sanctions against the board and the executive director. Further, OIG never stated that the Authority should oversee law enforcement activities; however, the Authority should ensure that documents submitted to request reimbursement for services are adequately reviewed before payment.

Comment 14

The Authority did not have procedures in place to ensure that service agreements were properly monitored; that the services were provided and that the costs were reasonable, necessary and properly documented. Note that recommendation 2C in the draft report is still applicable and is now 2B.

Finding 3

Comment 15

The Authority's actions are responsive to the audit finding.

Comment 16

The Authority's comments admit that the claims audits were not performed for two of the years. However, Authority officials state that in lieu of these audits the contractor performed other services related to asbestos problems at the Authority's headquarters office and at one project. Authority officials further stated that since the audits only cost $7,000 per year only $14,000 should be at issue. However, although we accept most of the Authority's comments that other services may have been provided; the additional

documentation provided indicated that the claims audits that were not performed might be valued at $21,300 ($10,380 and $10,920). Nevertheless, to clarify this issue HUD needs to make a determination on whether the equivalent services provided were adequate in lieu of the audits that were not performed, and on whether any funds should be repaid.

Comment 17

The significant weaknesses identified in the Internal Control section of the report, which relate to the Authority not having adequate systems to ensure compliance with laws and regulations and to ensure resources are properly safeguarded are valid conclusions that still exist today based on the results of the audit (see examples in the evaluation of comment 2). Further, we have evaluated the Authority's comments and supporting documentation and made appropriate revisions to the findings and recommendations.