Issue Date	September 22, 2006
Audit Report Number	2006-NY-1012

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

Edgar Moore

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

SUBJECT: The Housing Authority of the City of Passaic, Passaic, New Jersey, Has Allegations of Mismanagement That Need to Be Addressed

HIGHLIGHTS

What We Audited and Why

In response to a hotline complaint that the Housing Authority of the City of Passaic (Authority) was being mismanaged, we audited the Authority's Section 8 and Public Housing Capital Fund programs. We also audited controls over disbursements and costs allocated to different programs. The objective of the audit was to determine whether the allegations of hotline complaint were valid. We also determined if Section 8 units complied with housing quality standards.

What We Found

Some complaint allegations were valid, and others could not be substantiated. The Authority did not adequately manage its Section 8 program from 2002 through 2005. Contrary to federal regulations, the Authority made ineligible transfers of program funds by transferring Section 8 administrative fee reserves to the low-rent housing program without U.S. Department of Housing and Urban Development (HUD) approval and capital funds to the Section 8 program. Section 8 administrative fee reserves were transferred to prevent HUD from reducing the fee reserves, and capital funds were transferred to cover shortfalls in the Section 8 program. As a result, the Section 8 administrative fee reserves were understated by $1 million, and $590,042 was not available for recapture by HUD, while the capital fund was understated by $401,046.

While the Authority's financial management system generally safeguarded funds, weaknesses in its controls need to be addressed. Contrary to federal regulations, the Authority did not maintain adequate documentation to support (1) rental payments charged to the Section 8 program, (2) employee benefit charges allocated to the Section 8 program, and (3) payments to the City of Passaic for police services. As a result, the Authority has no assurance that $883,813 charged to the Section 8 program and $521,000 in payments to the City of Passaic are reasonable and necessary. Further, Section 8 administrative fee reserves may need to be recaptured.

Furthermore, The Authority's Section 8 units did not always meet housing quality standards. Of 65 units statistically selected for inspection, 44 failed due to material noncompliance with housing quality standards. Based on the result of our statistical sample, at least 823 units may have been in material noncompliance. As a result, tenants lived in units that were not decent, safe, and sanitary, and the Authority made housing assistance payments for units that did not meet standards.

The complete results of our evaluation of the individual allegations are contained in appendix C of this report.

What We Recommend

We recommend that the director, New Jersey Office of Public Housing, instruct the Authority to (1) reimburse the Section 8 administrative fee reserve for the $1 million transferred to the low-rent housing program and recapture or reduce Section 8 administrative fees by $590,042, (2) reimburse the capital fund $401,046 from the Section 8 program, (3) provide additional supporting documentation for rent expenses, employee benefits costs, and payments for police services and repay any unsupported costs determined to be ineligible, and (4) develop and implement procedures to ensure that units meet housing quality standards.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the results of our review during the audit and at an exit conference held on September 5, 2006. Authority officials provided their written comments on September 12, 2006. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Passaic (Authority) was established in 1950 after the passage of the Federal Housing Act of 1937 to build and manage public housing developments for residents of the City of Passaic. 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 city council, and one member is appointed by the New Jersey Department of Community Affairs as delegated by the governor. The former executive director of the Authority is Mr. Eric Kolbe, who retired June 30, 2006.

The Authority owns approximately 700 low-income housing units and assists an additional 1,792 families through the Section 8 Housing Choice Voucher program. The Authority reported total operating revenue of more than $13.3 million for the period ending December 31, 2005.

We received a hotline complaint pertaining to the Authority on November 20, 2005. The complainant alleged that the executive director (1) mismanaged the Housing Choice Voucher program, (2) forged the chairperson's signature on the five-year plan, (3) submitted an audit report to the U.S. Department of Housing and Urban Development (HUD) without board audit and approval, (4) used funds from the capital fund to pay housing choice voucher landlords, (5) made fund transfers from the Housing Choice Voucher program that may not have been proper, (6) provided HUD with a capital fund amendment form without board approval, (7) targeted African-American employees for job termination, and (8) managed the Authority in an autocratic style. Therefore, the complainant believed that there was a need for more oversight of the daily operations of the Authority by the board of commissioners. Appendix C contains a summary of the results of our evaluation of these allegations.

The objective of the audit was to determine whether the allegations of hotline complaint were valid. We also determined if Section 8 units complied with housing quality standards.

RESULTS OF AUDIT

Finding 1: The Authority Made Ineligible Transfers of Program Funds

Contrary to federal regulations, the Authority made ineligible transfers of program funds. It transferred Section 8 administrative fee reserves to the low-rent housing program without HUD approval and capital funds to the Section 8 program. Section 8 administrative fee reserves were transferred to prevent HUD from reducing the fee reserves, and capital funds were transferred to cover shortfalls in the Section 8 program. As a result, the Section 8 administrative fee reserves were understated by $1 million, and $590,042 was not available for recapture by HUD, while the capital fund was understated by $401,046.

Ineligible Section 8 Administrative Fee Transfers

In March 2003, Authority officials transferred $1 million from the Section 8 administrative fee reserve to the low-rent housing program without obtaining HUD's or its board of commissioners' approval. A letter from the Authority's executive director, dated March 13, 2003, and addressed to the board of commissioners, contained the following statement: "This week the housing authority's fee accountant transferred $1 million to the low rent housing program."

Although, the funds were transferred in March 2003, Authority officials included the transaction in the fiscal year 2002 general ledger as an adjustment on December 31, 2002, because the fiscal year 2002 general ledger was not closed until the end of March 2003. Authority officials stated that they transferred the $1 million to avoid the reduction in the fiscal year 2003 ongoing Section 8 administrative fee reserves imposed by HUD in an effort to increase program savings and efficiency.

PIH [Public and Indian Housing] Notice 2002-7 provides that "a PHA [public housing authority] that has not achieved at least a 95 percent lease-up rate (i.e., has not leased at least 95 percent of its contracted units that have been under annual contributions contract for 12 months or has not spent at least 95 percent of its budget authority) is not authorized to use any funds in its administrative fee reserve for any purpose, unless explicitly authorized in writing to use its reserves by the HUD field office. Upon approval of the year end settlement statement, the Financial Management Center will advise the field office if a PHA has not achieved a 95 percent lease-up rate. Until the PHA reaches the 95 percent lease-up threshold, the PHA may only use the administrative fee reserve for expenses related to on-going program administration."

Since the Section 8 Management Assessment Program indicated that the Authority's lease-up rates for fiscal years 2002 and 2003 were 75 and 89 percent, respectively, to comply with PIH [Public and Indian Housing] Notice 2002-7, Authority officials had to obtain HUD's approval before using its administrative fee reserves for any purpose that was not related to the Housing Choice Voucher program

Further, PIH [Public and Indian Housing] Notice 2005-30 provides that "notwithstanding any other provision of law or regulation, the amount of fiscal year 2003 fee payments otherwise authorized pursuant to the first proviso in this paragraph for a public housing agency shall be reduced accordingly by any such amount remaining in such agency's administrative fee reserve account as of January 31, 2003, which exceeds 105 percent of the amount of fee paid to such agency from funds made available in fiscal year 2002." "... provided further, that hereafter, the Secretary shall recapture any funds provided in this paragraph from a public housing agency, which are in excess of the amounts expended by such agency for the Section 8 tenant-based rental assistance program and not otherwise needed to maintain an administrative fee reserve balance of not to exceed 5 percent."

Therefore, in compliance with the above notice, we calculate that $590,042 should have been available for recapture by HUD on January 31, 2003, as follows:

Excess funds in the Section 8 administrative fee reserve as of January 31, 2003	
Section 8 administrative fee reserves as of December 31, 2002	$ 886,087
Add	
Unallowable funds transferred to low-rent housing	$1,000,000
Total Section 8 administrative fee reserves as of December 31, 2002	$1,886,087
Subtract	
105% of Authority's ongoing administrative fee earned in fiscal year 2002 ($1,234,329 x 105%)	$(1,296,045)
Excess funds in the Section 8 reserves above 105% of fiscal year 2002 administrative fee	$590,042
Amount of ongoing administrative fees earned that should have been recaptured	**$590,042**

As a result of transferring the $1 million from Section 8 administrative fee reserves in March 2003, the Section 8 administrative fee reserves recorded on the general ledger were understated by $1 million, and the Authority's ongoing

Section 8 administrative fee for fiscal year 2003 was not reduced by the excess administrative fee reserve amount that was above 105 percent of the ongoing administrative fees earned for fiscal year 2002, or $590,042.

Ineligible Transfer of Funds from the Capital Fund to the Section 8 Program

Authority officials stated that they transferred more than $1.1 million from the capital fund to the Section 8 program to cover a shortfall in Section 8 housing assistance payments in fiscal year 2005. Authority officials stated that the $1.1 million was a reimbursement to the Section 8 program to cover Section 8 funds that were used for housing-related capital improvements in fiscal years 2002, 2003, and 2004. However, $401,046 of this amount did not qualify as a reimbursement to the Section 8 program because the Section 8 program had not paid these costs. Consequently, it was an ineligible use of the capital funds.

According to 24 CFR [*Code of Federal Regulations*] 968.112, public housing modernization funds used for public housing operating assistance is an ineligible use of capital funds. When physical or management improvements, including administrative cost, will benefit programs other than public housing, such as Section 8 or local revitalization programs, eligible costs are limited to the amount directly attributable to the public housing program.

Based on the above, since part of the capital fund transfers were not originally transferred from the Section 8 program, we calculated that $401,046 in capital fund transfers, which is the amount that exceeded the allowable Section 8 reimbursable amount, is ineligible as follows:

Ineligible capital funds transferred to the Section 8 program in fiscal year 2005

Total allowable Section 8 funds used to pay for capital improvements in fiscal year 2002.	$409,958
Total allowable Section 8 funds used to pay for capital improvements in fiscal years 2003&2004.	$293,769
	========
Total allowable Section 8 funds to pay for capital improvements in fiscal years 2002, 2003, and 2004	$703, 727
	========
Total amount of allowable reimbursement to Section 8 fund in fiscal year 2005	$703,727
Less:	
Total amount of funds transferred from capital fund to Section 8 program in fiscal year 2005.	($1,104,773)
	==========
Total ineligible capital funds transferred to Section 8 program in fiscal year 2005	**($401,046)**
	==========

Because of the ineligible funds transferred in fiscal year 2005, the capital fund is understated by $401,046, and the Authority was deprived of the use of these funds for capital improvements.

Conclusion

In March 2003, the Authority transferred $1 million from the Section 8 administrative fee reserves to the low-rent housing program without obtaining HUD's or its board of commissioners' approval. As a result, the Authority's fiscal year 2003 ongoing administrative fee reserve was not reduced by $590,042, and HUD was deprived of program savings.

Further, in fiscal year 2005, the Authority transferred more than $1.1 million from the capital fund to the Section 8 program to cover a funding shortfall in Section 8 housing assistance payments. However, $401,046 of that amount was an ineligible use of capital funds. Consequently, the capital fund is under funded by $401,046, and this amount is not available for capital improvements.

Recommendations

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

1A. Reimburse the Section 8 administrative fee reserve for the $1million that was transferred to the low-rent housing program.

1B. Recapture or reduce the Section 8 administrative fee reserve account by $590,042 to comply with the requirements of PIH [Public and Indian Housing] Notice 2005-30.

1C. Establish and implement internal control procedures that will ensure compliance with HUD's Section 8 reporting requirements.

1D. Reimburse the capital fund from the Section 8 program the $401,046 in excess/ineligible capital fund transfers.

1E. Establish and implement internal control procedures to ensure that capital funds are used for eligible purposes according to 24 CFR [*Code of Federal Regulations*] 968.112.

Finding 2: The Authority Had Control Weaknesses in Its Financial Management System

Contrary to federal regulations, the Authority did not maintain adequate documentation to support (1) rental payments charged to the Section 8 program, (2) employee benefit charges allocated to the Section 8 program, and (3) payments to the City of Passaic for police services. These deficiencies occurred because the Authority did not develop procedures to ensure that all payments were adequately supported. As a result, it has no assurance that $883,813 charged to the Section 8 program and $521,000 in payments to the City of Passaic are reasonable and necessary. Further, Section 8 administrative fee reserves may need to be recaptured.

Unsupported Rent Expenses Charged to the Section 8 Program

In fiscal years 2003 and 2004, the Section 8 program was charged a total of $612,000 ($306,000 per year) for rental expenses. The rent was related to office space for the Authority's administrative offices located at a low-rent housing project that was used by the Section 8 and low-rent housing programs; however, these charges were not adequately supported.

The consolidated annual contributions contract requires the Authority to maintain records in such a manner as to allow HUD to determine that all funds have been expended in accordance with each specific program regulation and requirement. The contract also requires the Authority to maintain complete and accurate books of account for the projects of the Authority to permit the preparation of statements and reports and to allow for speedy and effective audits in accordance with HUD requirements.

Authority officials stated that they hired a fee accountant who prepared cost allocation plans in fiscal years 2003 and 2004; however, they did not have any cost allocation plans to support the distribution of the rent expenses charged to the Section 8 and the low-rent housing programs. As a result, they cannot determine whether the rent charges to the Section 8 program were reasonable or necessary. Consequently, the $612,000 in rental expenses charged to the Section 8 program is questioned pending a HUD review for eligibility.

Unsupported Employee Benefit Costs Charged to the Section 8 Program

The Authority charged $360,183 and $336,223 in employee benefit costs, respectively, for fiscal years 2003 and 2004 to the Section 8 program. However, it did not allocate the employee benefit costs in a manner that was adequately supported by salaries charged. The Authority's management officials stated that they only had a cost allocation plan for salaries and they allocated the salaries according to the plan. However, the Authority did not maintain any documents to support the actual time distribution for employees who worked on the Section 8 and low-rent housing programs. The Authority should developed procedures to record time logged by employees to various activities involving multiple programs in order for the allocation of employee benefits to be more accurate.

Using the same ratio as the allocation of salary costs, we determined that the employee benefit costs that should have been charged the Sections 8 program for fiscal years 2003 and 2004 were $216,005 and $208,555, respectively. As a result, excessive employee benefit costs amounting to $271,813 ($144,178 in fiscal year 2003 and $127,635 in fiscal year 2004) were charged to the Section 8 program. Consequently, since the allocation of the $271,813 in employee benefit costs charged to the Section 8 program is not adequately supported, this amount is questioned pending a HUD eligibility determination.

Section 8 Administrative Fee Funds Subject to Recapture

Since the above questionable rental costs and employee benefit costs were charged to the Section 8 administrative fee reserve account in fiscal years 2003 and 2004, the Section 8 administrative fee reserve balance at each year's end may have been understated if these costs are unallowable. Therefore, once HUD has determined the allowable costs for employee benefits and office rental expense, the Section 8 administrative fee reserve balances for each year should be recalculated. In addition, a determination should be made of whether the recalculated administrative fee reserve balances for each year should be subject to reduction or recapture in accordance with requirements of PIH [Public and Indian Housing] Notice 2005-30.

Unsupported Payments to the City of Passaic

In fiscal years 2003, 2004, and 2005, the Authority entered into several contracts with the City of Passaic and paid it a total amount of $750,000 for police services beyond those services that should have been furnished at no cost under the terms of a cooperation agreement between the City of Passaic and the Authority. The cooperation agreement called for the Authority to make payments in lieu of taxes in exchange for additional city police services to be provided to the Authority. However, $521,000 of the $750,000 was not supported with adequate documentation to justify the costs. Consequently, $521,000 of the payments for police services did not comply with the HUD annual contributions contract requirements.

The Authority did not have adequate controls to ensure compliance with the annual contributions contract requirement to maintain records in such a manner as to allow HUD to determine that all funds have been expended in accordance with each specific program regulation and requirement. Further, the Authority did not ensure that the City of Passaic complied with the terms and conditions of the contracts. For instance, all of the contracts stated that two or three officers would be guaranteed for Friday, Saturday, Sunday, and Monday, but the police daily assignment reports provided as support for these costs showed that officers were not working on Sundays or Mondays. Also, the contracts stated that "in the event any officers shall become disabled or sick for any period in excess of three weeks during the term of this contract, said officer shall be replaced by the City, or the Authority shall receive a credit of $48 per hour for the period during which said officer is sick or disabled." However, the police daily assignment reports showed that an officer was sick or disabled for two months in fiscal year 2005, the Authority did not receive any credit for the unfurnished services, and the City of Passaic did not replace the disabled officer.

Most of the available daily assignment reports provided did not include the required information such as the number of hours worked at each public housing development and the ending time of each police officer's shift or assignment. As a result, since adequate supporting documents to justify these costs were not maintained, the $521,000 is questioned pending an eligibility determination by HUD.

Recommendations

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

2A. Provide HUD with documents supporting the $612,000 rent expense charged to the Section 8 program in fiscal years 2003 and 2004 and determine what amount of the rent is eligible. Moreover, the director should instruct the Authority to reimburse the Section 8 administrative fee reserve for any ineligible cost identified.

2B. Provided HUD with documentation to support the $271,813 of excessive employee benefit costs in fiscal years 2003 and 2004 charged to the Section 8 Housing Choice Voucher Program and reimburse the Section 8 Housing Choice Voucher Program from the low-rent housing program for the amount that is determined to be ineligible.

2C Develop and implement a formal cost allocation methodology to support employee benefit contributions charged to various HUD programs.

2D. Determine if any retroactive adjustment should be made to the Section 8 administrative fee reserve balance and recapture or reduce the Section 8 administrative fees to comply with Public Indian Housing Notice 2005-30, based on the reimbursement of ineligible rent expenses and employee benefits costs from the low rent housing program.

2E. Provide HUD with adequate and complete documents to support the payment of $521,000 to the City of Passaic for additional police services and have the City of Passaic reimburse the Authority for any payments determined to be ineligible.

2F. Establish and implement adequate internal control procedures to ensure that municipal contracts applicable to HUD funds are performed in compliance with HUD requirements, federal regulations, and the consolidated annual contributions contract prior to funds being paid.

Finding 3: Tenants Lived in Units That Were Not Decent, Safe, and Sanitary

Our inspection of 65 Section 8 units showed that 55 units (85 percent) did not meet HUD's minimum housing quality standards. Of the 55 units, 44 units were in material noncompliance. Projecting the results of the statistical sample to the population would indicate that at least 1,091 units of the Authority's 1,410 units did not meet minimum housing quality standards and 823 units were in material noncompliance. This condition occurred because the Authority's management did not place sufficient emphasis on housing quality standard requirements and did not implement an adequate internal control plan to ensure compliance with HUD requirements at all times. As a result, tenants lived in units that were not decent, safe, and sanitary, and the Authority made housing assistance payments for units that did not meet standards.

HUD Will Pay More Than $ 6.5 Million for Units in Material Noncompliance

The Authority's management did not implement an effective internal control plan, which ensured that it complied with HUD requirements at all times. Therefore, units were not decent, safe, and sanitary, and the Authority made housing assistance payments for units that did not meet standards. We estimate that over the next year, the Authority will pay housing assistance payments of more than $6.5 million for units that are in material noncompliance with housing quality standards if it does not implement adequate controls.

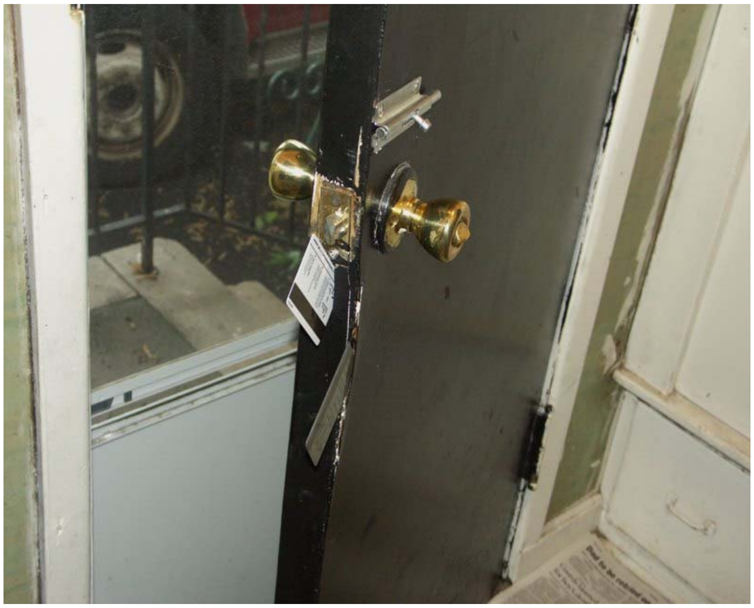
We inspected a statistical sample of 65 units with a HUD Office of Inspector General (OIG) appraiser and found that 55 units (85 percent) did not meet minimum housing quality standards. Of the 55 units, 44 units with 275 total deficiencies were in material noncompliance with housing quality standards. Of the 275 deficiencies, Authority inspectors did not identify 25 deficiencies or did not report them as failing conditions during their most recent inspections. These deficiencies included window and door problems, blocked exits, gas stove health and safety issues, and electrical hazards. Appendix E provides additional details of the deficiencies for the 44 units that were in material noncompliance with standards.

The following table lists the most frequently occurring deficiencies for the 55 units that did not meet minimum housing quality standards.

Type of deficiency	Number of deficiencies	Number of units	Percentage of units
Doors	53	30	55
Window	25	18	33
Gas stove health and safety	22	21	38
Blocked exits	24	14	25
Electrical hazards	23	12	22
Continuous running water/ water leaks	15	12	22

Door and Window Deficiencies Were Predominant

The most predominant deficiencies were doors and windows that did not operate properly or could not be secured.



Damaged entry door with significant splits and missing strike pad.

Damaged main entrance door with damaged door frame and strike pad.

We found a number of fire hazards, such as blocked exits and inoperable smoke detectors.

Furniture and personal effects block the window in a bedroom, preventing exit or fire department entry in an emergency.

We found 23 instances of electrical hazards, such as exposed wires and missing outlet covers.

Exposed fuse covered with dirt.

The Authority Did Not Have Adequate Internal Controls

The Authority's management did not have an effective internal control plan that ensured units met minimum housing quality standards and inspections complied with requirements. Regulations at 24 CFR [*Code of Federal Regulations*] 982.54 provide that the Authority must adopt a written administrative plan that establishes local policies for administration of the program in accordance with HUD requirements. The plan should include procedural guidelines and performance standards for conducting required housing quality standard inspections. Section 982.401 provides the performance and acceptability criteria that assisted units must meet to comply with HUD's housing quality standards. Section 982.405 provides that the Authority must inspect leased units before the initial term of the lease and at least annually to determine whether the unit meets housing quality standards and further provides that the Authority must conduct supervisory quality control housing quality standard inspections.

The internal control plan should include written policies and procedures that provide detailed guidance and a quality control plan that ensures policies and procedures are followed. The internal control plan should also require an analysis to determine whether management employed sufficient staff to perform inspections. It should provide guidance on how to properly conduct inspections and identify corrective measures for inspectors who perform poorly. These policies and procedures are not included in the Authority's administrative plan.

The Authority employs one Section 8 inspector who is responsible for inspecting more than 1,400 Section 8 units. The Authority also employs a public housing inspector who assists in inspecting Section 8 units one day per week. The inspectors are responsible for annual inspections, reinspections, special inspections, and all initial inspections. The Authority's full-time Section 8 inspector is also responsible for scheduling each inspection and mailing notices to tenants and landlords. The director of management and operations is responsible for performing a supervisory inspection, which he performs once a year for the Section 8 Management Assessment Program due to his other responsibilities in overseeing the Section 8 and low-rent housing programs. Further, according to the Authority's inspector, because there are not enough inspectors to meet the workload requirements, the director of management and operations sometimes helps in conducting annual or special inspections.

According to the Authority's inspectors, they inspect 13 units per day on average, and the time allotted for each inspection is less than a half hour including travel time. The Section 8 program inspector inspects new units for initial move-ins on Tuesdays and Thursdays to increase the time allotted for new inspections to approximately 45 minutes.

Based on the above facts, Authority officials need to assess whether they have enough inspectors and consider performing quality control audits at least quarterly to improve the quality of their inspections for housing quality standards. The Authority has begun requesting landlords and tenants to correct the deficiencies on the 55 units, and its inspectors have begun conducting reinspections.

Conclusion

The inadequate inspections occurred because the Authority (1) did not develop an effective internal control plan to ensure inspections complied with HUD regulations, (2) conducted supervisory inspections for the Section 8 Management Assessment Program but did not use them as a tool to enhance inspector performance and identify whether inspections were performed properly, and (3) did not perform an analysis to determine whether it employed adequate inspection staff to perform all required inspections. Therefore, the Authority cannot be assured that it has an adequate number of inspectors or that inspectors have enough time to perform a detailed inspection of all units. As a result, tenants lived in units that were not decent, safe, and sanitary, and the Authority made housing assistance payments for units that did not meet housing quality standards. By making necessary improvements, the Authority will assure that at least $6.5 million in Section 8 funds will be spent on units that are decent, safe, and sanitary.

Recommendations

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

3A. Inspect the 55 units that did not meet minimum housing quality standards to verify that the owners took appropriate actions to make the units decent, safe, and sanitary. If appropriate corrective actions were not taken, the Authority should abate the housing assistance payment or terminate the housing assistance payment contracts. The Authority should also terminate tenants that cause deficiencies in the units.

3B. Develop and implement an internal control plan, which ensures that units meet housing quality standards and inspections meet HUD requirements to prevent $6.5 million from being spent on units that are in material noncompliance with standards.

SCOPE AND METHODOLOGY

Our audit was conducted at the Authority, located at 333 Passaic Street, Passaic, New Jersey. To accomplish our objectives, we performed the following:

- Audited applicable laws, regulations, and other HUD program requirements.
- Audited the Authority's Section 8 policies, procedures, and administrative plan.
- Audited the Authority's annual contributions contracts, records, and financial reports for Section 8, public housing, and the Public Housing Capital Fund programs.
- Examined HUD and the Authority's program files for the low-rent housing and Section 8 programs.
- Interviewed HUD officials and officials of the Authority.
- Obtained a download of the Authority's Section 8 housing stock for the Housing Choice Voucher program as of April 1, 2006.
- Selected a statistical sample of units for inspection from the Authority's Section 8 housing stock.
- Audited previous Authority inspection reports.
- Inspected 65 units with a HUD OIG appraiser from the Technical Oversight and Planning Division.

We audited various documents including financial statements, ledgers, bank statements, invoices, purchase orders, contracts, check vouchers, and prior OIG and HUD reports on the Authority. We audited documentation regarding service agreements with the City of Passaic including activity reports and other supporting documents furnished by the Authority and the City of Passaic. We also audited the Authority's financial and administative records.

The download of the Authority's Section 8 housing stock for the Housing Choice Voucher program resulted in 1,410 active units. We used a statistical software program to select a random sample of 65 units. The 65 units were selected to determine whether they met HUD's housing quality standards. Our sampling criteria used a 90 percent confidence level, 50 percent estimated error rate, and precision of plus or minus 10 percent.

Our sampling results determined that 44 of the 65 units (67.7 percent) materially failed to meet HUD's housing quality standards. Units are considered to be in material noncompliance with housing quality standards because of the overall poor condition of the unit; one of the fail conditions was a 24-hour emergency deficiency; the fail condition was a preexisting condition that either was not identified or not reported at the time of the Authority's last inspection; and/or the unit had inadequate repairs.

Projecting the results of the 44 units that were in material noncompliance with housing quality standards to the population yields the following:

The most conservative statistical projection or lower limit is that 823 units were in material noncompliance with housing quality standards (58.37 percent X 1,410 units).

The Authority's April 1, 2006, housing assistance payments register showed that the average monthly housing assistance payment was $663. Using lower limit of the estimate of the number of units and the average monthly housing assistance payment, we estimate that the Authority will annually spend at least $6,547,788 (823 units X $663 average payment X 12 months) for units that are in material noncompliance with housing quality standards. This estimate is presented solely to demonstrate the annual amount of Section 8 funds that could be put to better use on decent, safe, and sanitary housing if the Authority implements our recommendations. While these benefits would recur indefinitely, we were conservative in our approach and only included the initial year in our estimate. We also considered (1) that the Authority did not identify many of the past conditions during its most recent inspections, (2) the circumstances, and (3) that it would take the Authority at least a year to complete all inspections under an improved inspection process.

We conducted our fieldwork from February through June 2006 at the Authority's offices in Passaic, New Jersey. Our audit covered the period January 1, 2003 through December 31, 2005. However, we extended the period as necessary to achieve our objectives.

We performed our audit in accordance with generally accepted government auditing standards and included tests of management controls that we considered necessary.

INTERNAL CONTROLS

Internal control is 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,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and segregation of duties.

Internal controls relate to management's plan of organization, methods, and procedures adopted to meet its missions, goals, and objectives. Internal controls include the process 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 audit, we believe the following items are significant weaknesses:

- The Authority's controls were not adequate to ensure that program objectives were achieved (see findings 1 and 3).

- The Authority's controls did not ensure that the use of resources complied with laws and regulations when it made ineligible transfers of funds and allowed units not to meet housing quality standards (see findings 1 and 3).

- The Authority's controls do not adequately safeguard assets due to weaknesses in its financial management system that allowed charges to be inadequately supported and ineligible transfers to be made (see findings 1 and 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$1,000,000		
1B	$590,042		
1D	$ 401,046		
2A		$612,000	
2B		$271,813	
2E		$521,000	
3B			$ 6,547,788
Total	$ 1,991,088	$ 1,404,813	$ 6,547,788

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. In this instance, if the Authority implements our recommendations, it will cease to incur Section 8 costs for units that are not decent, safe, and sanitary and will expend those funds for units that meet HUD's housing quality standards. Once the Authority successfully implements its controls, this will be a recurring benefit. Our estimate reflects only the initial year of these recurring benefits.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

HOUSING AUTHORITY of the CITY of PASSAIC

333 PASSAIC STREET
PASSAIC, NEW JERSEY 07055

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September 12, 2006

Edgar Moore
Regional Inspector General for Audit
U.S. Dept. of Housing & Urban Development
26 Federal Plaza, Room 3420
New York, New York 10278 0068

Re: **Passaic Housing Authority**

Dear Mr. Moore:

I have reviewed the draft audit report that was completed by the Office of Inspector General (OIG). As you are aware, we would like to comment on the issues cited in the audit report. I would also like to thank your staff for the professionalism that they exhibited during the audit process. I personally view the audit as an opportunity to improve the operations of the Housing Authority. We will most certainly address each of the items in our quest to ensure that the Passaic Housing Authority is administering its programs in an economical and efficient manner.

We would like to herewith respond to the three findings contained in the audit report:

Finding 1: The Authority Made Ineligible Transfers of Program Funds

Comment 1

a) Ineligible Fee Transfer from Section 8-The report correctly cites PIH Notice 2007-7 and PIH Notice 2002-30 that both preclude the Authority from making the transfers based upon its lease-up rate and which capped the amount of the reserve that the Authority was eligible to retain as of 1/31/2003. We do, however, disagree with the calculation of the excess Section 8 administrative reserve that is contained in the audit. The audit calculation (pg. 7) indicates that the Housing Authority owes $590,042 in excess reserves that should be recaptured. Our calculation is as follows:

Section 8 Administrative Fee reserves as of 12/31/02	$886,086
Unallowable Funds transferred to low-rent program	$1,000,000
Total Section 8 administrative fee reserves as of 12/31/2002	$1,886,087
Total allowable Section 8 funds used for Cap. Improvements in 2002	($409,958)
Revised Section 8 Administrative Fee Reserve as of 12/31/02	$1,476,129
105% of PHA's on-going administrative fee earned in FY 2002 ($1,234,329 x 105%)	($1,296,045)
Excess funds in Section 8 reserves above 105% of FY 2002 Admin. Fee	**$180,084**

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

Edgar Moore
September 12, 2006

During our meeting, your staff indicated that the $409,958 in eligible expenses was considered in the calculation of the12/31/02 administrative fee reserve. Our accountant has confirmed that this amount was not subtracted from the maximum reserve calculation. We have also discovered other expenses that may be eligible for reducing the 12/31/02 reserve to an even lower level. This documentation is currently being compiled and will be submitted at a later date. We, therefore, feel that the maximum amount eligible for recapture is $180,084.

Comment 2

b) Ineligible Transfer of Funds from the Capital Fund to the Section 8 Program-The Authority transferred Capital Funds in the amount of $1,100,000 to the Section 8 program as follows:

$1,000,000	Reimbursement of funds transferred from the Section 8 program
$100,000	Reimbursement of expenses charged to the Section 8 program
$1,100,000	Total transfer
($1,000,000)	Transfer from Section 8 Program to Low-Rent
$100,000	Difference between the transfers

Your analysis indicates that the Capital Fund is under funded by $401,046 due to ineligible expenses that were associated with operating costs (per 24CFR 968.112). We disagree with the basis of your analysis that indicates that the Section 8 Program should reimburse the Capital Fund in the amount of $401,046. Our analysis indicates that the maximum liability to the Capital Fund Program would be $100,000.00. Our analysis is based upon a simple accounting transaction where $1,000,000 was moved to the Capital Fund Program from Section 8 and $1,100,000 was reimbursed. The difference is $100,000. As such we disagree with the conclusion that the Capital Fund is under funded by $401,046.

Finding #2: The Authority had Control Weaknesses in its Financial Management System:

Comment 3

a) Unsupported Rent Expenses Charged to the Section 8 Program-The report indicates that Section 8 Program was charged $612,000 for use of rental space to support the program. We are in the process of collecting market data to document what the average rental cost (per square foot) would be for similar type office space. This information will be submitted at a later date.

Comment 4

b) Unsupported Employee Benefit Costs Charged to the Section 8 Program-We are developing a cost allocation methodology which is based upon the staff that is actually assigned to the program.

Comment 5

c) Section 8 Administrative Fee Funds Subject to Recapture- We do not believe that there were excessive administrative fee reserve balances at 12/31/03 & 04.

Comment 6

d) Unsupported Payment to the City of Passaic-We are requesting that the City of Passaic (Police Department) provide documentation supporting the payments that were made for the Police Contracts. The documentation supporting the contract will be forwarded at a later date. All credits will be repaid or applied towards future contracts.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 7

Find #3: Tenants Lived in Units that were not Decent, Safe and Sanitary-The audit report indicates that there are significant failures in the inspection procedures employed by the Passaic Housing Authority. The Housing Authority's Administrative Plan already addresses procedures for inspecting units. We will be reviewing the plan in order to determine if it needs to be revised to incorporate the recommendations contained in the audit report. Our staff will be inspecting the 55 units that failed to meet HQS and appropriate actions will be undertaken to ensure that the repairs are made to the units. We will abate or terminate assistance to those units that remain noncompliant with HQS. Tenants that are responsible for causing damages will be removed from the program through the informal hearing process contained in the Administrative Plan.

We are also implemented a quality control program to ensure that all units are compliant with HQS. This program will:

1) Expand the number of units that are reinspected for Quality Control Purposes:
2) Retrain the inspectors to ensure that they understand their responsibilities and inspection standards.

We have also observed that some of the units failed HQS because they had drop-ceilings installed in the kitchens and bathroom. It is our understanding that it is an acceptable practice to install these ceilings in kitchens and bathroom as per the BOCA code. We also understand that the ceiling components must be in good condition free of rust, chipping, mold and other items that could lead to health related problems.

Please feel free to contact me if you have any question regarding our comments to the audit report. We look forward to working with the Department in an effort to resolve all of the issues cited in the report. The report will also be utilized as a management tool to improve our administrative functions.

With best regards, I remain

Very truly yours,

W. F. Snyder by JWS

WILLLIAM F. SNYDER
Executive Director

Xc: Edward DePaula, HUD Newark
Joseph Vizer, OIG

OIG Evaluation of Auditee Comments

Comment 1 The auditee disagreed with our computation of the amount of excess administrative fee reserves that were subject to recapture on January 31, 2003. The auditee indicated that the administrative fee reserve balance as of December 31, 2002, should have been reduced by $409,958 because these funds were used for capital improvements in fiscal year 2002; therefore, this should have reduced the amount of funds subject to recapture from $590,042 to $180,084.

However, PIH Notice 2002-7 prohibited the Authority from transferring funds from the Section 8 administrative fee reserves during the period March 31, 2002 through March 31, 2003 without HUD's explicit approval because the PHA's lease-up rate was below 95% for fiscal years 2002 and 2003. As a result, the entire $1,000,000 which had been transferred to the low rent housing program in 2002 was not an approved transfer, therefore, it had to be added back to the December 31, 2003, administrative fee reserve balance to determine the amount of Section 8 administrative fees subject to recapture at January 31, 2003. As such, $590,042 was subject to recapture as computed in the report.

Comment 2 The auditee disagreed that the capital fund was under funded by $401,046 due to ineligible expenses associated with operating costs. The auditee indicated that based on a simple accounting transaction where $1,000,000 had been moved from the capital fund to the Section 8 program and $1,100,000 had been reimbursed to the Section 8 program from the capital fund, the maximum liability to the capital fund should be $100,000. However, as shown in the report, although $1,104,773 was transferred to the Section 8 program in fiscal year 2005, only $703,727 of the amount transferred was an eligible reimbursement for the capital improvements that had been paid for by the Section 8 program. The remaining $401,046, which had been transferred from the capital fund to the Section 8 program was not an allowable reimbursable cost because these funds were used for the payment of housing assistance, which is an ineligible use of capital funds per 24 CFR [Code of Federal Regulations] 968.12.

Comment 3 The auditee's actions are responsive to our recommendations, however, in obtaining market data to document the reasonable rents that should be charged to Section 8 program, the auditee needs to consider the time period of the estimate used for the costs or rent amounts.

Comment 4 The auditee's actions are responsive to our recommendations, however, they need to provide HUD with documentation to support the $271,813 of excessive employees benefit costs charged to the Section 8 program in fiscal years 2003 and 2004 and reimburse the Section 8 program from the low rent housing program for any amount determined to be ineligible.

Comment 5 Auditee officials stated that the Authority does not believe that there were excessive administrative fee reserve balances at 12/31/2003 and 2004. However, if any of the reimbursed rent expenses and cost benefits are determined to be ineligible, a retroactive adjustment to the Section 8 administrative fee reserve balance should be made and the Section 8 administrative fees should be recaptured or reduced to comply with Public Housing Notice 2005-30.

Comment 6 The auditee's actions are responsive to our recommendations.

Comment 7 Auditee officials generally agreed with our recommendations and have begun taking corrective action, yet, they believe that some units were failed because drop ceilings were installed in the kitchens and bathrooms, even though this was an acceptable practice per the BOCA code. However, no units were failed just based on having a drop ceiling. Although the conditions of some drop ceilings were cited as an HQS violation there were other material deficiencies that caused these units to not meet housing quality standards.

Appendix C

SUMMARY AUDIT OF COMPLAINT ALLEGATIONS

Allegation 1

The executive director mismanaged the Housing Choice Voucher program.

Evaluation: There is evidence that the Housing Choice Voucher program was mismanaged. The Authority was underfunded for its Housing Choice Voucher program for 2005 and 2006 because HUD could not calculate the 2005 renewal funding needs due to the nonsubmission of 2004 Voice Management System data to HUD. As a result, there was a $1.8 million shortfall in the amount needed to operate the program. HUD determined the funding level for 1,489 units, while the total number of units under lease was 1,670. The Authority has reported the information regarding the funding level and the units under lease; however, HUD has not increased the level of funding.

The Authority transferred $1 million from the Section 8 administrative fee reserve to the low-rent housing program in fiscal year 2003 to avoid recapture of excess administrative fee reserves by HUD. However, the required approvals from HUD and the board of commissioners were not obtained for this transfer. As a result, $590,042 in Section 8 administrative fee reserves is subject to recapture (see finding 1).

The Authority used another $1 million in Section 8 administrative fee reserves to make capital improvements for the low-rent housing program, which were allowable uses of the reserve at the time the disbursements were made (see finding 1).

The Authority received a Section 8 Management Assessment Program score of 93, which would indicate that its performance was satisfactory. However, our inspection of units revealed that additional attention is required to ensure units meet housing quality standards (see finding 3).

Allegation 2

The executive director forged the chairperson's signature on the public housing authority certification that had been attached to the five-year plan and submitted to HUD in Washington, DC.

Evaluation: This allegation could not be substantiated because there was no evidence that the executive director forged a signature on the public housing authority certification. We noted that the Authority submitted the five-year plan electronically on October 18, 2005, because it was the deadline for submission. However, the plan was never approved by HUD because the Authority never certified the public housing authority plan.

Allegation 3

The executive director and the independent public accountant submitted the audit report to the clearinghouse in Indiana, HUD's Newark field office, and the Real Estate Assessment Center without board knowledge, approval, and audit.

Evaluation: This allegation is true. The independent public accountant submitted the 2004 audit report to HUD before it was audited or approved by the board of commissioners. However, management was approaching the deadline for the submission of the 2004 audit report. Housing authorities face sanctions for not submitting audit reports within nine months after the housing authority's fiscal year end.

Allegation 4

The executive director used capital fund money in 2002, 2003, 2004, and 2005 to pay Section 8 landlords.

Evaluation: This allegation is true. In fiscal year 2005, the Authority transferred $1,104,773 to cover a Section 8 fund shortage in housing assistance payments. The executive director and finance officer stated that the funds transferred were a reimbursement to the Section 8 program because Section 8 funds were used in fiscal years 2002, 2003, and 2004 to pay for capital improvements. Based on our audit, we determined that $703,727 was a reimbursement for capital improvements that had been paid with Section 8 funds but that $401,046 was not. Therefore, $401,046, which does not represent a reimbursement of Section 8 funds, is ineligible (see finding 1).

Allegation 5

The executive director made fund transfers from the Housing Choice Voucher program that may not have been proper.

Evaluation: This allegation is true. The Authority transferred Section 8 administrative fee reserves to the low-rent housing program without HUD approval. As a result, the Section 8 administrative fee reserves were understated by $1 million, and $590,042 was not available for recapture by HUD, while the capital fund was understated by $401,046 (see finding 1).

Allegation 6

The executive director provided a capital fund amendment form to HUD without board approval and knowledge.

Evaluation: This allegation could not be substantiated. Our audit disclosed that the board of commissioners passed a resolution on September 20, 2005, approving a budget amendment and revisions to the Public Housing Capital Fund program budget for 2002, 2003, and 2004. After receiving board approval, the Authority submitted the budget amendments and revisions to the capital fund budget to HUD on September 21, 2005, for HUD's approval.

Allegation 7

The executive director targeted African-American employees for job termination.

Evaluation: This allegation could not be substantiated. The Authority maintained complete and adequate employee files and compiled valid documentation of the cause for terminations. We did not note any instances in which the Authority terminated an employee based on race, religion, sex, or creed.

Allegation 8

The executive director managed the Authority in an autocratic style, and there is a need for more oversight of the daily operations of the Authority by the board of commissioners.

Evaluation: This allegation could not be substantiated. There was not enough evidence to determine that the executive director was managing in an autocratic style. However, regarding providing more oversight of daily operations, the executive director on December 16, 2005, wrote a letter to the management of the HUD Newark office requesting a limited management audit with respect to governance issues as they relate to the Authority. We determined through personal observation and discussions with the executive director and commissioners that there were disagreements over the responsibilities of the board of commissioners and the executive director. However, the executive director retired on June 30, 2006.

Appendix D

SCHEDULE OF UNITS IN MATERIAL NONCOMPLIANCE WITH HOUSING QUALITY STANDARDS

Sample number	Total deficiencies	24-hour emergency deficiencies	Preexisting conditions	Inadequate repairs
1	8	2		
3	2	1		
4	3	1		
7	4	1		
8	16	3	2	
10	6	3	1	
12	3	2		
14	3	2		
15	4	2	1	
16	6	2		
17	8	2	2	
19	10	3		
21	14	2	5	1
22	3	1		
24	10	3	3	
25	9	2		
26	8	2		
27	12	3	2	
30	5	2	1	
31	5	2		
32	5	1		
34	11	6	1	
36	6	2	1	
37	7	1		
38	3	1		
39	4	1	2	
40	3	1		
42	10	1	2	
44	5	2	1	
45	9	1	1	
54	4	1		
55	5	1		
56	3	2		
58	8	4		

Sample number	**Total deficiencies**	**24-hour emergency deficiencies**	**Preexisting conditions**	**Inadequate repairs**
60	**5**	**2**		
63	**10**	**5**		
65	**5**	**1**		
66	**7**	**2**		
67	**9**	**3**		
69	**2**	**1**		
70	**2**	**1**		
71	**2**	**1**		
73	**2**	**1**		
74	**9**	**2**		