Issue Date June 1, 2012	
Audit Report Number 2012-NY-1008	

TO: Sonia L. Burgos, Director, Office of Public Housing, Newark Field Office, 2FPH

Edgar Moore

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

SUBJECT: Transactions Between the Housing Authority of the City of Perth Amboy, NJ, and its Nonprofit Subsidiary Did Not Always Comply With HUD Regulations

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Perth Amboy's transactions with its nonprofit subsidiary, the Perth Amboy Redevelopment Team for Neighborhood Enterprise and Revitalization (PARTNER), in response to a hotline complaint. The audit objectives were to assess the merits of the complaint and determine whether Authority officials complied with provisions of the Authority's regulatory agreement and other U.S. Department of Housing and Urban Development (HUD) financial and operational regulations when executing transactions with PARTNER. In addition, we performed a limited review of the Authority's Family Self-Sufficiency (FSS) program because of the funding provided to it by PARTNER.

What We Found

The issues raised in the complaint allegations were factually correct, but no violation of HUD regulations was found (the complaint allegations are evaluated in appendix C). In addition, Authority officials complied with HUD regulations when they established and funded PARTNER with Section 8 administrative fee

reserve funds in 2003; however, PARTNER had realized limited accomplishments.

The Authority did not always comply with HUD regulations governing the execution and reporting of transactions with PARTNER. Specifically, the award of a social services contract to PARTNER did not comply with HUD procurement requirements, administrative expenses were not always adequately documented, and PARTNER activity was not properly reported. These deficiencies occurred because Authority officials misinterpreted HUD regulations pertaining to funds provided to PARTNER and believed that funds provided to PARTNER could be used at their discretion. Limited review of the Authority's FSS program disclosed that the program was operated in accordance with HUD regulations.

What We Recommend

We recommend that the Director, Office of Public and Indian Housing, Newark field office, instruct Authority officials to (1) submit a specific plan to HUD for approval of the use of the $286,782 in unspent funds held by PARTNER or reimburse the Authority's Section 8 administrative fee reserve account, (2) justify the award of the social services contract to PARTNER, (3) strengthen documentation for the allocation of Authority officials' time spent on PARTNER's activities, and (4) ensure that the Authority's component units are properly included in reports to adequately inform HUD of Authority activities.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. 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 May 11, 2012. On May 15, 2012, Authority officials provided their written comments and generally agreed with the draft report findings. The complete text of the Authority's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

The Housing Authority of the City of Perth Amboy, located in Perth Amboy, NJ, was incorporated as a not-for-profit public corporation in 1938 to develop, acquire, and administer housing programs for low- and moderate-income families residing in Perth Amboy. The Authority is governed by a seven-member board of commissioners. The board establishes policy affecting the Authority and appoints an executive director to manage the Authority's daily operations.

The Authority owns and operates five low-rent developments comprised of 614 units, and another mix-financed development with 31 low-rent units and 6 project-based Section 8 units. It administers 814 Section 8 vouchers; operates Family Self-Sufficiency (FSS), Resident Opportunity and Self-Sufficiency, and home-ownership counseling programs; and receives funding from the U.S. Department of Housing and Urban Development's (HUD) Public Housing Capital Fund program, as well as from local and State governments. Total funding in fiscal years 2010 and 2011 was approximately $12.4 million and $11.8 million, respectively.

The Authority established the Perth Amboy Redevelopment Team for Neighborhood Enterprise and Revitalization (PARTNER) as an Internal Revenue Code Section 501(c)(3) nonprofit subsidiary in 2003 to provide service and support to promote economic opportunity and self-sufficiency, as well as housing counseling and education, to low- and moderate-income individuals and families. The Authority transferred $600,000 from its Section 8 administrative fee reserve funds to PARTNER as startup funds. PARTNER is governed by a five-member board of directors. From its inception through December 2007, two of PARTNER's five board members were Authority commissioners, and another was an Authority employee. Therefore, the Authority directed a majority of PARTNER's board through 2007. Since January 2008, the number of authorized board members and the ratio of Authority-associated members has varied.

The audit objectives were to assess the merits of a hotline complaint and determine whether Authority officials complied with provisions of the Authority's regulatory agreement and other HUD financial and operational regulations in establishing and executing transactions with PARTNER. In addition, we performed a limited review of the Authority's FSS program because of the funding provided to it by PARTNER.

RESULTS OF AUDIT

Finding: The Authority's Transactions With Its Nonprofit Subsidiary Did Not Always Comply With HUD Regulations

Authority officials complied with HUD regulations when they established and funded PARTNER with Section 8 administrative fee reserve funds in 2003; however, PARTNER had realized limited accomplishments. In addition, officials did not always comply with HUD regulations governing the execution and reporting of transactions with PARTNER. Specifically, the award of a social services contract to PARTNER did not comply with HUD procurement requirements, administrative expenses were not always adequately documented, and PARTNER activity was not properly reported. These deficiencies occurred because Authority officials misinterpreted HUD regulations pertaining to funds provided to PARTNER and believed that funds provided to PARTNER could be used at their discretion. As a result, (1) $286,782 of the initial startup funds provided to PARTNER had not been spent as of December 31, 2011, (2) $156,250 awarded to PARTNER for a social services contract was not adequately documented, (3) staff and consultant expenses allocated between PARTNER and the Authority were not adequately documented, and (4) HUD was not adequately informed of the transfer and use of the Section 8 administrative fee reserve funds held by PARTNER. Limited review of the Authority's FSS program disclosed that the program was operated in accordance with HUD regulations.

The Formation and Funding of PARTNER Complied With Regulations

Authority officials complied with HUD regulations when they established and funded PARTNER with Section 8 administrative fee reserve funds in March, 2003. Regulations at 24 CFR (Code of Federal Regulations) 982.155 provide that a public housing authority may use Section 8 administrative fee reserve funds for other housing purposes permitted by State and local law.

Authority officials established PARTNER as an Internal Revenue Code Section 501(c)(3) nonprofit organization to provide economic and social opportunities, as well as housing, for low- and moderate-income individuals and families. The Authority's board of commissioners approved the transfer of $300,000 from the Authority's Section 8 administrative fee reserves to PARTNER on March 13, 2003 (retroactive to January 1, 2003). In approving the transfer, the board minutes reported that the funds were to be earmarked for housing and other related purposes. The minutes also noted the board's concern that the reserve funds would be subject to recapture by HUD.[1] Board officials expected to have a balance of $667,691 in the Authority's administrative fee reserve account as of March 31, 2004. The board approved another $300,000 transfer on August 12, 2003.

Limited Accomplishments Were Realized by PARTNER

PARTNER had realized limited accomplishments in the furtherance of its mission since its funding in 2003 with the Authority's Section 8 administrative fee reserve funds. The majority of the transferred administrative fee reserves had been expended for PARTNER salary and administrative expenses, and as of December 31, 2011, $286,782 remained unspent. HUD public and Indian housing Notices PIH 2004-7 and 2005-1 provide that Section 8 administrative fee reserve funds must be expended to be considered used for other housing purposes and the transfer of amounts from the administrative fee reserve to another non-Section 8 program account does not constitute use of the reserves for other housing purposes.

From its inception through December 31, 2011, PARTNER had realized receipts of approximately $752,351, of which $650,000, or 86 percent, was provided by the Authority; $30,500 was granted by private entities; and the remaining $71,851 was generated from consulting services provided under contract to three nonlocal housing authorities. While PARTNER was formed to provide economic, social, and housing opportunities to low- and moderate-income individuals and families, activity in the furtherance of its mission had been limited. From its formation through December 31, 2011, PARTNER had incurred administrative expenses of $252,218, representing 34 percent of total receipts, of which $217,848, or 86 percent, was for employee and contractor expense. During the same period, PARTNER expended approximately $110,000,[2] representing 15 percent of total revenue, for the following activities, which could be considered to be for housing-related purposes related to its mission:

- Scholarships: $21,000 was disbursed to 21 of the Authority's low-rent and Section 8 tenants from 2004 to 2008, and $9,000 was disbursed to 9 tenants in 2011 from social services contract funds awarded by the Authority.

- Authority's home-ownership counseling program: $40,000 was provided in 2010 and 2011 from PARTNER's Section 8 administrative fee reserve funds for the Authority's home-ownership counseling services, which provided participants with essential knowledge to navigate through the home-buying process and long-term successful home ownership. While PARTNER's board

[1] Fiscal year 2003 appropriation legislation required HUD to recapture public housing authorities' administrative fees that exceeded 105 percent of the fees earned in 2002.
[2] This amount includes $40,000 given back to the Authority from a $50,000 installment on a contract awarded by the Authority.

of directors passed resolutions to provide $15,000 in 2007 and 2010 to fund a home-ownership manager position at the Authority, the funds were not provided. Similarly, while resolutions were approved in 2009 and 2010 to provide $20,000 annually for administrative costs for the Authority's home-ownership counseling program, no funds were provided until 2010.

- Authority's FSS and home-ownership programs: $40,000 of the $50,000 awarded to PARTNER by the Authority to provide social services was transferred back to the Authority in 2011 to pay administrative expenses of the Authority's FSS and home-ownership programs. Consequently, PARTNER did not provide any services under this contract; it merely provided funds already awarded.

Authority officials acknowledged the limited redevelopment activity of PARTNER but noted that, while they planned for PARTNER to participate in one of the Authority's redevelopment projects with the City of Perth Amboy, the project was suspended in 2005 when the City lacked the funds to purchase the Authority's property. Authority officials further stated that they hoped PARTNER would participate in future housing redevelopment activities with the Authority.

The Authority Improperly Awarded a Social Services Contract

Authority officials awarded PARTNER a $250,000 social services contract in November 2010 through a noncompetitive, sole source procurement without an adequate cost reasonableness analysis and qualification assessment as required by HUD regulations. Regulations at 24 CFR 85.36 require that all procurement transactions be conducted in a manner providing full and open competition. Regulations at 24 CFR 943.148 require a public housing authority to maintain documentation to substantiate the cost reasonableness of its selection of any entities procured and the unique qualification of the entity if a noncompetitive, sole source procurement method is used to acquire social services.

The Authority's board approved funding the $250,000 contract with program income generated from the Authority's Parkview Mixed Finance Redevelopment Project. Since HUD had provided 62.5 percent of the funding for this project from Replacement Housing Factor grants, 62.5 percent of the $250,000, or $156,250, should be subject to HUD procurement regulations.

The contract provided that the $250,000 would be distributed to PARTNER in five annual increments of $50,000 to subsidize the following programs:

-- $10,000 for a scholarship program,
-- $20,000 for the Authority's home-ownership program, and

-- $20,000 for the Authority's FSS program.

Authority officials explained that transfer of the funds to PARTNER would provide flexibility in their use for other housing purposes. They believed that a cost reasonableness study was not necessary because the funds were going to be used to fund scholarships and support the Authority's FSS and home-ownership programs. They further noted that a qualification assessment was unnecessary because PARTNER was an affiliate and they were aware of its operations. However, the qualification assessment was the Authority officials' opinion and was not appropriately supported as part of the procurement process in accordance with applicable regulations. As a result, HUD lacked assurance that services would be procured at the most efficient and effective price. We attribute this deficiency to Authority officials' misinterpretation of HUD procurement regulations.

Further, the Authority certified in exhibit H of the Parkview annual contributions contract amendment with HUD that any program income generated from the project would be used only for specified eligible and approved activities, such as affordable housing purposes. However, the social services contract did not adequately provide for an evaluation of performance because it did not specify outcome measures or a timeframe for completion. In addition, while, the contract required that PARTNER submit an annual report to the Authority on the use of the funds, the required report was not submitted. Consequently, Authority officials were unable to demonstrate how the redevelopment project's program income was used for affordable housing purposes.

Further, on December 31, 2011, PARTNER transferred $40,000 of the first $50,000 increment received under the contract to the Authority to fund the Authority's home-ownership counseling and FSS programs. Authority officials explained that this transfer occurred because PARTNER was not a HUD-certified counseling agency, and the Authority was, but lacked funding for the program. Therefore, PARTNER did not carry out any home-ownership counseling or family self-sufficiency social services.

Administrative Costs Were Not Always Adequately Documented

Documentation for the allocation of employee costs between the Authority and PARTNER was not adequate to ensure that costs were properly allocated. This weakness existed because the Authority and PARTNER lacked adequate financial controls to ensure the proper allocation of costs among various activities that involved HUD funds.

Office of Management and Budget Circular A-87 provides that a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to the cost objective in accordance with the relative benefits received. The annual contributions contract between the Authority and HUD requires that the Authority maintain complete and accurate books of account for the Authority's projects in a manner to permit the preparation of statements and reports in accordance with HUD requirements and to permit a timely and effective audit.

The Authority's executive director, secretary, and accountant[3] are employees of PARTNER, and PARTNER also hired other employees of the Authority to work on its activities. PARTNER was to reimburse the Authority for any time its employees spent on PARTNER activity during their routine Authority work day. However, Authority and PARTNER officials did not maintain adequate time distribution records to ensure that costs incurred by employees who worked on both Authority and PARTNER activities were properly allocated. While records did record times worked, the records were not specific as to start and end times of tasks performed and lacked the specific tasks in which the staff was engaged. For example, one Authority staff person claimed 8 hours of work for PARTNER in 1 day—6 hours during the employee's regular working hours as an employee of the Authority and 2 hours during the employee's personal time. PARTNER reimbursed the Authority for the 6 hours and paid the employee for the 2 hours in addition to the employee's annual salary as a PARTNER employee. However, PARTNER's time records showed that the employee worked an additional 4 hours for PARTNER. Without detailed information on start and end times, we were unable to determine whether the allocation of employee cost between the Authority and PARTNER was proper. In the case of another Authority employee who also worked as an employee of PARTNER, the time records did not specify the projects on which the employee worked, and the hours recorded on the invoice did not always reconcile with the supporting timesheets.

In addition, PARTNER lacked documentation showing that its employee and consultant compensation was reasonable. In response to an independent auditor recommendation in 2011, PARTNER adopted a spending policy that established principles for determining allowable costs. This policy provided that compensation for personal service is considered reasonable if it is comparable to similar work in the industry and performed by employees qualified to perform the work required. PARTNER lacked documentation showing that an analysis was performed to determine the reasonableness of compensation paid.

PARTNER Activity Was Not Always Adequately Reported

Authority officials did not always adequately report PARTNER activity because the Authority's financial statements did not disclose the financial activity of

[3] The accountant provided services to PARTNER as a consultant from March 2003 through June 30, 2010, after which the accountant's services were provided as an employee.

PARTNER while it was a component unit. As a result, HUD was not adequately informed of the transfer and subsequent status of the Section 8 administrative fee reserve funds held by PARTNER. This condition occurred because Authority officials believed that PARTNER was not a component unit and, therefore, consolidated financial statements were not required.

Regulations at 24 CFR 85.20 require housing authorities to maintain financial records that are accurate and current and adequately identify the source and application of funds provided for assisted activities. In addition, HUD's Real Estate Assessment Center guidance[4] requires public housing authorities to follow Government Accounting Standards Board (GASB) Statement 14,[5] which provides for consolidated financial statements of component units. GASB 39 provides that an entity that meets all of the following criteria should be presented as a component unit in consolidated financial statements:

- The economic resources received or held by the component unit are entirely or almost entirely for the direct benefit of the authority, its component units, or its constituents;

- The authority or its component units is entitled to or has the ability to access a majority of the economic resources held by the component unit, and

- The economic resources received or held by the component unit that the authority is entitled to or has the ability to otherwise access are significant to the authority.

Although the degree of control the Authority could exercise over PARTNER varied as the composition of PARTNER's board changed, PARTNER appeared to have met the GASB definition of a component unit through July 2008 when Authority commissioners or employees represented 50 percent or more of PARTNER's board members.

The FSS Program Was Adequately Administered

The Authority administered its FSS program in accordance with HUD regulations at 24 CFR 984.201. The purpose of the FSS program is to promote the development of local strategies to coordinate the use of housing assistance with public and private resources to enable eligible families to achieve economic independence and self-sufficiency. The Authority operated its program in compliance with its FSS action plan, which was approved by HUD. Under the program, participants execute a contract to enable them to reach specified goals,

[4] Real Estate Assessment Center Generally Accepted Accounting Principles (GAAP) Flier Volume1, Issue 3.
[5] GASB 14 was amended by GASB 39, which provided further guidance on determining when an entity should be reported as a component unit.

and the Authority maintains an escrow account for them, which is provided to them upon successful completion of the contract. During our audit period from March 2003 through December 2011, 130 participants were enrolled in the program, 23 successfully completed the program, 31 did not successfully complete their contract, and 76 remained active.

Limited testing of FSS expenditures and participant case files disclosed that funds were used for eligible and reasonable costs, participants were properly enrolled, contracts were established in accordance with regulations, escrow accounts were accurately calculated and reported, and escrow funds were disbursed for approved purposes

Conclusion

While Authority officials complied with HUD regulations in the transfer of $600,000 in Authority Section 8 administrative fee reserve funds to form PARTNER, PARTNER had engaged in limited activity in the furtherance of its mission, and transactions between the Authority and PARTNER did not always comply with HUD regulations. Specifically, the award of a social services contract to PARTNER did not comply with HUD procurement requirements, administrative expenses were not always adequately documented, and PARTNER activity was not properly reported.

Recommendations

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

1A. Submit a specific plan to HUD for approval of PARTNER's planned use of the $286,782 in unspent Section 8 administrative fee reserve funds or reimburse the funds to the Authority's Section 8 administrative fee reserve account to be awarded to PARTNER as funds are needed for expenditures related to eligible activities.

1B. Provide supporting documentation to justify the award of the $250,000 (of which $156,250 is subject to HUD regulation) social services contract to PARTNER and provide specific services and outcomes to be realized with the use of the funds or reimburse the funds to the Authority's Section 8 administrative fee reserve account.

1C. Strengthen controls over procurement to provide HUD assurance that goods and services are obtained under the most advantageous terms.

1D. Strengthen controls over cost allocation and time distribution records to assure HUD that Authority officials' time spent on PARTNER's activities is properly recorded.

1E. Strengthen controls over employee and consultant compensation to comply with PARTNER's spending policy guidelines requiring that costs be reasonable in comparison to amounts paid by similar organizations.

1F. Improve controls over financial reporting to ensure that component units are included in annual financial reports submitted to HUD to adequately inform HUD of the activities of the Authority and its component units.

SCOPE AND METHODOLOGY

We performed the audit fieldwork from September 2011 through February 2012 at the Authority's office located at 881 Amboy Avenue, Perth Amboy, NJ. The audit generally covered the period from the inception of PARTNER in March 2003 through December 31, 2011, and was extended as needed to accomplish the audit objectives.

To accomplish the audit objectives, we performed the following steps:

- Reviewed relevant HUD regulations, program requirements, and applicable laws.
- Obtained an understanding of the Authority's management controls and procedures.
- Interviewed appropriate HUD and Authority officials.
- Reviewed reports from HUD systems, such as the Line of Credit Control System, the Public Housing Authority Financial Accounting Subsystem, and the Public and Indian Housing Information Center system. Assessment of the reliability of the data in these systems was limited to the data sampled, which was reconciled to the Authority's records.
- Reviewed Authority and PARTNER files and records, including incorporation files, redevelopment plans, financial data schedules, financial statements, general ledgers, bank statements, and staff timesheets.
- Reviewed HUD monitoring reports and independent accountant audit reports of the Authority and PARTNER.
- Reviewed contracts signed between HUD and the Authority and the Authority and PARTNER and related procurement procedures.
- Reviewed all significant transactions between the Authority and PARTNER during the period 2003 through 2011.
- Tested all PARTNER disbursements in 2009. We selected 2009 because it was the year with the most disbursements, $84,039, which represented 24 percent of total PARTNER expenditures of $354,800 from 2003 to 2010.
- Tested all 30 invoices amounting to $30,000 for the scholarship program and reviewed the selection procedures of the recipients.
- Reviewed all drawdowns from the 2008 FSS grant to determine whether funds were drawn down for eligible purposes and tested five FSS participant files to ensure that participants and the Authority complied with program requirements.

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

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations, as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to the effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

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

- The Authority did not have adequate controls over compliance with laws and regulations, as it did not always comply with HUD regulations when executing transactions with its nonprofit organization, PARTNER (see finding).

- The Authority did not implement effective controls to safeguard assets when social services were not properly procured and activities related to Section 8 administrative fee reserve funds were not reported (see finding).

APPENDIXES

Appendix A

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

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A		$286,782
1B	$156,250	
Total	$156,250	$286,782

1/ 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.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if the Authority implements our recommendation to provide a specific plan for the expenditure of the $286,782 in unspent administrative fee reserve funds transferred to PARTNER or otherwise return these funds to the Authority, HUD will be assured that the funds will be properly spent.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Housing Authority of the City of Perth Amboy
881 AMBOY AVENUE, P.O. BOX 390, PERTH AMBOY, NJ 08862
TELEPHONE: (732) 826-3110
FAX: (732) 826-3111

May 15th, 2012

Mr. Edgar Moore, Regional Inspector General for Audit, NY-NJ
U.S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Re: *Audit Report-Housing Authority of the City of Perth Amboy*

Dear Mr. Moore,

Attached for your review and inclusion in the above noted audit report please find the Authority's response to the finding issued in the draft.

I would like to thank you and your staff for their courtesy and professionalism shown to me and my staff during the audit field work.

Should you have any questions regarding our response please do not hesitate to contact me.

Sincerely,

Douglas G. Dzema
Executive Director

DD:rmk
Attachment.

Ref to OIG Evaluation | **Auditee Comments**

RESPONSE TO DRAFT AUDIT REPORT
HOUSING AUTHORITY OF THE CITY OF PERTH AMBOY "HACPA"
MAY 15th, 2012

Finding: The Authority's transactions with its nonprofit subsidiary did not always comply with HUD Regulations

Item #1: The formation and funding of PARTNER complied with HUD Regulations.

HACPA Response: We concur with the IG's statement that the HACPA complied with HUD regulations when we established the nonprofit PARTNER.

Item #2: Limited accomplishments were realized by PARTNER.

Comment 1

HACPA Response: In reference to this item the IG has only addressed a few activities of PARTNER in supporting their opinion that limited accomplishments were realized. There were numerous actions taken by PARTNER in an effort to support its mission. Some of those actions unfortunately were not realized due to circumstances beyond its control. Please note PARTNER was initially formed to be involved in the redevelopment of Delaney Homes. The redevelopment plan at Delaney was put on hold as the Schools Construction Corporation ran out of funds and as a result the Board of Education did not have enough funding to purchase Delaney. Also at that time the market started its downward spiral making it difficult to move forward with any plans for this property. Although these plans have been on hold, it is the intention of the HACPA to redevelop this property. More than likely, PARTNER as a 501 (c) 3, entity will be an active partner as the Authority looks at any and all options to solidify funding for this endeavor. Current funding made it possible to demolish some of the buildings on the Delaney site. Now with the market progressing upwards, we will be planning and working toward this redevelopment in the next few years with PARTNER as an initricle participant. At this point we are unsure what funding will be available or how PARTNER will participate in this process but it is almost certain we will have a need for a nonprofit with 501 (c) 3 status under foreseeable build out scenarios.

Also please note that although the Delaney project has not been developed to date the HACPA has built an 84 unit senior citizen complex (known as the "Parkview") with the help of the PARTNER organization. Thirty-one of these units are subsidized through the PHA's operating subsidy formula as a result of using the replacement units demolished at Delaney Homes as a source for the funding. The original intent for the Parkview was to use PARTNER as the development manager at the site but due to various application restrictions for tax credits, a manager with development experience was needed to solidify the funding and PARTNER was replaced as manager just prior to filing the tax credit application for the project.

The IG states that PARTNER did not carry out the homeownership counseling and FSS social services. Please note however it was and remains our intention to have PARTNER get further involved in both these programs. Historically, it was PARTNER who was the lead entity preparing to apply to HUD to become a certified counseling agency. After speaking with HUD officials who stated the HACPA had a better chance to become certified based on its past record the work and task was turned over to the Housing Authority.

Ref to OIG Evaluation **Auditee Comments**

Regarding the FSS social services, we intended for PARTNER to provide the services to the Parkview and plans and models were developed but the failure to sell Delaney resulted in a lack of funds available to contract and provide staffing to carry-out this function.

Again PARTNER cannot emphasize enough that these plans may not have materialized to date but the organization continues to plan and seek opportunities for the future.

We note that although PARTNER is not directly involved in administering the homeownership and FSS programs for the HACPA, it is providing an important source of revenue for these programs. It is extremely important to note that funding received from PNC Foundation ($10,000) and Investors savings ($20,000) were only available to 501 (c) 3 organizations. We anticipate continuing to expand these alternative sources of funding. PARTNER continues to expand and grow in its non-profit mission. The PNC monies would not have been received if PARTNER wasn't in existence. Moreover, PARTNER could not have granted and transferred the funds to the HACPA and the HACPA would have gained no benefit. These additional funds are vital to the FSS Program and in helping balance the programs budget. As you know the Section 8 program has experienced a dramatic decrease in administrative fees over the past several years. (this year's proration may be as low as 75%) In addition, funding for staff positions that administer this program were cut from three to two several years ago and further cuts are looming with every budget.

Comment 1

In order to seek out other funding sources, PARTNER is in the process of exploring the potential of becoming a Community Housing Development Organization (CHDO) making it eligible for funding from various entities. As you may be aware the HACPA cannot get this designation making PARTNER the only organization that we are affiliated that has a viable option to provide this service to our residents and surrounding community.

Next we would point out that the scholarship program that PARTNER administers has helped several of our FSS participants with education costs making one their goals attainable under this program. Please note due to HUD restrictions on use of reserves such a program could not be administered by the HACPA.

Finally, in regards to other plans for the nonprofit there are on-going plans and negotiations with Habitat for Humanity that will allow us to have a joint venture to build homes in Perth Amboy and make them available to first time homebuyers educated through the HACPA FSS program. This endeavor cannot be carried out by the HACPA for several reasons including HUD restricts use of Section 8 admin fees for administration of the program and Habitat for Humanity's own requirements for venturing on this project.

In the near future we believe PARTNER will continue to be a useful entity providing services to residents, the HACPA and the surrounding community.

Ref to OIG Evaluation	Auditee Comments

Item 3: The Authority improperly awarded a social services contract

Comment 2

HACPA Response: In advance of awarding any contract the Housing Authority sought and received legal opinions on the method of procurement. Based on a legal opinion by a well versed law firm that deals with HUD rules and regulations, we were advised the HACPA could use sole source as the method of procurement. Under the advice of counsel and the legal opinion we understood sole source could be used so long as the program could document cost reasonableness and uniqueness. It is our feeling the use of the funds for the past year and the proposed use for the remaining four years provides both these elements. While we did not officially document cost reasonableness we did consider and find the costs were reasonable based on the fact that this program would be carried out by the Housing Authority staff at cost.

With regard to the scholarship program PARTNER has provided over 30 scholarships to residents of public housing and Section 8. This scholarship is unique as it is the only scholarship that is available solely to our program participants. The cost is certainly reasonable as the $1,000 is well below the total cost of one's education. The scholarships allow residents and their families the opportunity to pursue a college education giving them the chance to gain self-sufficiency and relieve them from their reliance on federal subsidies. It is our feeling this scholarship program provides the Housing Authority FSS participants and other residents with help in meeting their ultimate goal of self-sufficiency.

Comment 3

With reference to the homeownership and self-sufficiency programs PARTNER, has provided the remaining funds from the grant to the PHA's Section 8 Program to help in their administration of the FSS and homeownership programs. This was done in order for the Authority to help offset the deficit they have in this program. The deficit is as a result of HUD cuts in administration fees and the FSS/Homeownership grant funding. The programs provided by the Authority are quite unique as there is no other program available that provides low income families the opportunity to gain homeownership and self-sufficiency. The IG performed a limited review of our program and was satisfied the program is running efficiently and provides a much needed service to our residents. To summarize below are some of the achievements we are most proud of:

Family Self Sufficiency Current Participants-94
Family Self Sufficiency Program Completions since Yr. 2000-94

Homeownership Current Participants-258
Homeownership Purchases since implementation-59

Based on these results both the Authority and PARTNER believe the program has provided many successes and continue to support the funding of this program as it is essential to its continued success.

Comment 4

On the issue of cost reasonableness, we note there has been no additional cost to the PHA as a result of this transfer. The funds were transferred from program income received from the development of the Parkview. These funds were restricted to be used for low income housing purposes and as you can see the transfer meets that definition. Whether the transfer was made directly from the PHA to the Section 8 program or via PARTNER the cost would have been the same. The main reason the Housing Authority transferred these funds to PARTNER was to provide more flexibility for the use of the funds. If the funds were transferred to the Section 8 program then by regulation they could only be used for the administration of the Section 8 program and could not be used for any other purpose. By transferring

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the funds to PARTNER it had the flexibility to use the funds for "other housing purposes". This means endeavors such as the one PARTNER is currently undertaking to build homes in Perth Amboy in a joint venture with Habitat for Humanity can be pursued. Our plan is to provide a participant in our FSS program the opportunity to own a home. Such a program could not be completed through the Section 8 program as HUD regulations restrict use of reserves for anything other than the administration of Section 8. This is certainly a unique program as PARTNER is the first organization in Perth Amboy to team up with Habitat for this type of project. It will certainly be cost effective as most of the funding comes from fundraising efforts conducted by both PARTNER and Habitat.

In summary the use of the monies received from the Parkview proceeds are providing help to those low income individuals who need it and this goal meets the mission of PARTNER and the Housing Authority.

Item # 4: Administrative costs were not always adequately documented

Comment 5

HACPA Response: We concur with the IG that there is no violation of HUD regulations and agree it is not a conflict of interest for HACPA employees to work and be compensated from an affiliate of the Housing Authority. Please note the HACPA did provide to the IG time distribution records to document time spent by PARTNER employees on PARTNER duties. Although these employees were also Housing Authority employees it was stated from the start of the audit there were very few instances when the employees performed their PARTNER duties on Housing Authority time. In those very few instances the employees tracked that time and the Housing Authority was reimbursed for that cost. In those few instances there was an agreement executed between the Housing Authority and PARTNER for use of the staff and reimbursement of the time spent. Since HUD provides no specific guidance on the preparation of time sheets, we believed the ones maintained were appropriate. The IG noted that these records could be maintained with more information and PARTNER has already implemented the suggested recommendation.

Comment 6

In addition the finding states that the employee and consultant compensation lacked documentation that the costs were reasonable. Please note PARTNER had an independent auditor perform an agreed upon procedures as to whether the compensation paid to employees was normal and customary. It was stated in the results of that audit that based on the qualifications of the employees the compensation packages received were normal and customary.

Item #5: PARTNER was not always adequately reported

Comment 7

HACPA Response: We believe that a historical prospective must be taken and time should not be collapsed when reviewing the same. In 2003 HUD's guidance on reporting entities as component units was not clear. Obviously this has been better defined over the years. When evaluating this issue with that guidance now in place we do not see an issue in the future should similar circumstances arise. Please note the Authority clearly reflected the transfer to PARTNER in its financial statements and neither the HACPA auditor nor the HUD reviewer advised us that PARTNER should be reflected as a component unit.

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Item #6: The FSS Program was adequately administered

HACPA Response: We concur with this item. Further we would like to note for the record we are very proud of the accomplishments of this program along with the Homeownership program that has allowed many of our Public Housing and Section 8 residents to gain the ultimate goal of self-sufficiency and realized the American dream of owning their own home.

Item #7: Recommendations

Comment 8

HACPA Response: We concur with all the proposed recommendations and look forward to working with the Newark Field Office to clear all the findings noted in the report.

Item #8-Evaluation of Complaint Allegations

Comment 9

HACPA Response- We are pleased the allegations that precipitated this audit were found to have no merit and the HACPA complied with HUD rules and regulations regarding these items. In addition it was found that PARTNER complied with its internal policies and procedures further supporting the actions taken and disparaging the allegations.

OIG Evaluation of Auditee Comments

Comment 1 Authority officials state that the report addressed only a few of PARTNER's activities in concluding that PARTNER realized limited accomplishments, and that PARTNER took numerous actions, some of which unfortunately were not realized due to circumstances beyond its control. This report does acknowledge that some of PARTNER's planned activities were not accomplished due to factors outside its control; nevertheless, while PARTNER was formed to provide economic, social, and housing opportunities to low- and moderate-income individuals and families, activities in the furtherance of its mission had been limited. As noted in the report, from its formation in March 2003 through December 31, 2011, PARTNER had incurred administrative expenses of $252,218, representing 34 percent of total receipts, of which $217,848, or 86 percent, was for employee and contractor expenses. Therefore, we recommend that Authority officials submit a plan for HUD's approval specifying the planned PARTNER activity to be financed from the unspent Section 8 administrative fee reserves.

Comment 2 As stated by Authority officials, regulations would permit award of a sole source procurement provided that cost reasonableness and uniqueness could be documented. However, Authority officials acknowledge that they did not officially document cost reasonableness when contracting with PARTNER to provide social services on the belief that PARTNER's programs were unique and the cost was reasonable based on the fact that the program would be carried out by Authority staff at cost. Accordingly, we do not believe that the Authority has adequately documented the cost reasonableness and uniqueness as required by HUD regulations.

Comment 3 Our limited review of the Authority's Family Self-Sufficiency Program concluded that it was administered in accordance with HUD regulations; however, PARTNER's involvement with this Program was limited to returning to the Authority the funds Authority officials awarded it through the social service contract so that the Authority could use the funds to run the Program and pay the associated administrative expenses.

Comment 4 Regarding cost reasonableness, Authority officials state that there was no additional cost to the Authority as a result of the transfer of funds. However, since PARTNER had become an affiliate, rather than an instrumentality of the Authority in 2008, it was independent of the Authority, which no longer had legal control over PARTNER's assets, operations, and management. As a result, the Authority did not have control over the funds once transferred to PARTNER. Therefore, at this point the use of proper procurement procedures were required to ensure that services would be obtained at the best price.

Comment 5 Authority officials noted that HUD does not provide specific guidance on the preparation of timesheets to record Authority staff time spent on PARTNER activities, and they believed that the time sheets they maintained were appropriate. Nevertheless, Authority officials stated that they have already implemented the suggested recommendation to maintain more information on time sheets; however, they did not provide specifics. As such, the recommendation will be resolved during audit resolution process.

Comment 6 Authority officials stated that an independent auditor concluded that compensation paid to PARTNER employees and consultants was reasonable based on their qualifications. However, at the time of our audit, PARTNER lacked documentation to support that an employee compensation reasonableness analysis was performed by comparing the personal services to similar work in the industry. As a result, we recommend the Authority officials strengthen controls over future employee and consultant compensation to comply with PARTNER's spending policy guidelines, which were established in response to the independent auditor's recommendation.

Comment 7 Authority officials state that in 2003 HUD guidance on reporting component units was not clear. However, in 1999 HUD's Real Estate Assessment Center issued its "Generally Accepted Accounting Principle Flier", which provides detailed guidance for financial reporting of public housing authorities. Additionally, Authority officials state that the transfer of funds was clearly reflected in its financial statements. We acknowledge that the Authority reported the first $300,000 transfer to PARTNER in its 2003 Financial Data Schedule (FDS) as an equity transferred to a non-profit corporation. However, the name of the entity to which the transfer was made was not mentioned, and its affiliation was not disclosed; further, the second $300,000 transfer was reported as a general expense payment to PARTNER; therefore, we disagree that the transfer of funds was clearly reported. In addition, the relationship between PARTNER and the Authority and subsequent activities of PARTNER were never disclosed. Nevertheless, Authority officials acknowledge that now the guidance is clearer and they do not see an issue in the future should similar circumstances arise.

Comment 8 Authority officials agree with all the proposed report recommendations.

Comment 9 The review of the complaint allegations disclosed that the complaint issues were factually correct, but did not indicate any non-compliance with HUD regulations. Nevertheless, the audit disclosed other issues of non-compliance and internal control weaknesses in the execution and reporting of transactions between the Authority and PARTNER, and Authority officials have agreed to take actions that are responsive to the report recommendations.

Appendix C

EVALUATION OF COMPLAINT ALLEGATIONS

Allegation #1: **The Authority's executive director, attorney, accountant, and executive secretary financially benefited by forming PARTNER and drawing a salary from PARTNER; thus, it created the appearance of conflict of interest.**

The issue is factually correct in that the subject parties did receive financial benefit by their service to PARTNER and, therefore, an appearance of a conflict of interest could be found; however, there is no violation of HUD regulations. The U.S. Housing Act of 1937 provides that "notwithstanding any other provision of law, a public housing agency may (A) form and operate wholly owned or controlled subsidiaries…and other affiliates, any of which may be directed, managed, or controlled by the same persons who constitute the board of directors or similar governing body of the public housing agency, or who serve as employees or staff of the public housing agency; or (B) enter into joint ventures, partnerships, or other business arrangements with, or contract with, any person, organization, entity, or governmental unit…(ii) for the purpose of providing or arranging for the provision of supportive social services." HUD encourages public housing authorities to establish entities to accomplish economic development and generate additional sources of revenue. Further, HUD Notice PIH 2007-15 provides that there is no conflict of interest as prohibited in an authority's annual contributions contract with HUD when an agent of the authority receives a normal and customary compensation package for employment by an affiliate or instrumentality such as PARTNER. However, as noted in this report section entitled "Administrative Costs Were Not Always Adequately Documented." PARTNER officials had inadequately documented that the compensation paid was reasonable or customary.

Allegation #2: **Board members financially benefited by charging dinner expenses disguised as meeting expenses.**

The issue has some merit, but there is no violation of HUD regulations. A review of PARTNER's financial records disclosed that $3,550 was expended for meals at 10 board meetings during the period 2003 through 2011. This expense represents less than 1 percent of total expenses of $443,000 incurred during the period, and HUD regulations allow for such expenses in limited circumstances. In addition, the timing, location, and nature of PARTNER board meetings would generally not be subject to HUD regulation but, rather, State law, and PARTNER's spending policy guidelines provide that meals and other specified expenses incurred in connection with meetings and conferences are allowable. Accordingly, no exception is taken.

Allegation #3: **A board member's relative received a scholarship awarded by PARTNER.**

The issue is factually correct, but there is no violation of HUD regulations. While a review of PARTNER's records disclosed that a scholarship was awarded to a board member's relative, the award was made in accordance with PARTNER's scholarship program guidelines, and the selection was found to be adequately justified. Accordingly, no exception is taken.