Department of Community Affairs
Housing Assistance and Inspection Programs

July 1, 2001 to March 24, 2003

Richard L. Fair
State Auditor
The Honorable James E. McGreevey  
Governor of New Jersey

The Honorable John O. Bennett 
President of the Senate

The Honorable Richard J. Codey 
President of the Senate

The Honorable Albio Sires  
Speaker of the General Assembly

Mr. Albert Porroni 
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of Community Affairs’ Housing Assistance and Inspection Programs for the period July 1, 2001 to March 24, 2003. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor

July 24, 2003
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Objectives</td>
<td>2</td>
</tr>
<tr>
<td>Methodology</td>
<td>2</td>
</tr>
<tr>
<td>Conclusions</td>
<td>3</td>
</tr>
<tr>
<td>Findings and Recommendations</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>4</td>
</tr>
<tr>
<td>Balanced Housing Loans</td>
<td>11</td>
</tr>
<tr>
<td>Timely Deposits</td>
<td>13</td>
</tr>
</tbody>
</table>
Department of Community Affairs  
Housing Assistance and Inspection Programs

Scope

We have completed an audit of the Department of Community Affairs’ Housing Assistance and Inspection Programs for the period July 1, 2001 to March 24, 2003. These programs include the Division of Fire Safety, Division of Housing and Community Resources, and Division of Codes and Standards. Our audit included financial activities accounted for in the state’s General Fund and the following special revenue funds: New Home Warranty Security Fund, Urban and Rural Centers Unsafe Buildings Demolition Revolving Loan Fund, Boarding House Rental Assistance Fund, Petroleum Overcharge Reimbursement Fund, and Volunteer Emergency Service Organizations Loan Fund.

The Division of Fire Safety maintains the Uniform Fire Code through inspection, training and monitoring. The Division of Housing and Community Resources is responsible for implementing programs that provide rental housing assistance, and that support neighborhood preservation and community development initiatives. This division encourages and facilitates the construction of affordable housing for low- and moderate-income families. The Division of Codes and Standards is the primary building codes and standards agency in the state, responsible for the adoption, implementation and enforcement of construction codes. The Bureau of Housing Inspection registers and inspects hotels, motels and multiple dwellings. The Bureau of Uniform Construction Code requires that all buildings are constructed in accordance with uniform standards. The Bureau of Boarding Home Inspection provides for the health, safety and welfare of those who reside in rooming and boarding houses in the state. Expenditures of the divisions/bureaus under review were approximately $600 million during our 21 month audit period.
Revenues were $525 million during this audit period. The major component of revenue was the federally funded Section 8 Tenant Based Housing Assistance grant program.

**Objectives**

The objectives of our audit were to determine whether financial transactions were related to the department’s housing programs, were reasonable, and were recorded properly in the accounting system. We also tested for resolution of significant conditions noted in our prior report.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

**Methodology**

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the department. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed department personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Transactions were judgmentally selected for testing.

To ascertain the status of findings included in our prior report, we identified corrective actions, if any,
taken by the department and walked through the system to determine if the corrective action was effective.

Conclusions

We found that the financial transactions included in our testing were related to the department’s housing programs, were reasonable, and were recorded properly in the accounting system. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations meriting management’s attention regarding accounts receivable collections and the timely deposit of revenue. We also found that the department has resolved the significant issues noted in our prior report except for matters related to the Balanced Housing loans. This issue has been restated in our current report.
Improvements are needed in maintaining the accounts receivable records and subsequent collection efforts.

Accounts Receivable

The department disbursed over $140 million of federal Section 8 Tenant Based Assistance program funds and $4.5 million of state Homelessness Prevention Program (HPP) funds during fiscal year 2002. As a result of incomplete accounts receivable record keeping there are $1.9 million of receivables currently deemed uncollectible.

Treasury Circular Letter 03-06-OMB requires the agency to maintain an internal control system which is adequate to effectively collect the amounts due to the agency, track the age of accounts, and to flag delinquent accounts. The details of our audit of the accounts receivable for several programs are presented below.

Rental Assistance Program

The Department of Community Affairs (DCA) administers the Section 8 Tenant Based Assistance Program through a grant from the United States Department of Housing and Urban Development. The purpose of the program is to make housing available to low-income families in the private rental market. Households that meet eligibility requirements normally pay no more than 30 percent of their adjusted monthly income towards their rent and utility costs. The program pays the balance of the rent directly to the landlord of the property. During fiscal year 2002, DCA received and expended in excess of $140 million in accomplishing this objective.

Monies are due from landlords who were overpaid due to tenants vacating apartments prior to the end of the lease, and from tenants under-reporting income and/or damaging rental units. Our review indicates certain receivables can not currently be collected due to insufficient record keeping practices. We identified 1,175 overpayments representing in excess
of $800,000 in landlord receivable accounts and another 302 tenant receivables approximating $160,000 that are currently uncollectible due to missing or incomplete debtor information. The missing information on many of these receivables may reside on archived data tapes that can be retrieved with the help of the state’s Office of Information Technology (OIT). We made this observation to DCA management and they have contacted OIT to determine the details and extent of the recovery process. The department has implemented a new software application that may correct the above noted deficiencies.

There is a program within the Section 8 grant known as Family Self Sufficiency (FSS). An FSS participant may, under certain circumstances, receive a monthly escrow account credit over a five-year period. Upon completion of a contract of participation the successful candidate receives in cash the value of the accumulated credits. Our review identified nine individuals who owed the program money due to previous damage claims that were not offset against the escrow payment. We also noted two FSS graduates who received in excess of $10,000 more than they were entitled to because the monthly credits continued even though their contracts had been completed.

*Homelessness Prevention Program Loans*

The Prevention of Homelessness Act of 1984 appropriated to the Department of Community Affairs $1.65 million for rental and mortgage assistance grants to municipalities, and loans and grants to qualified applicants who face imminent eviction or foreclosure. Repaid loans are to be deposited into the account to be used to assist future applicants. The program has continued to be funded through an annual appropriation of $4.5 million. In fiscal year 2002 there were $2.8 million in grants to
individuals, $1.3 million in grants to municipalities and non-profits, and $400,000 in loans to individuals.

In 1986, the department initiated an undocumented change in policy reclassifying loans to grants for first time recipients of rental assistance payments. Mortgage assistance payments and those receiving rental assistance payments two or more times are considered as loans that must be repaid. In May 2002, $430,000 in loans issued between 1984 and 1986 were converted to grants. The actual amount converted to grants can not be determined by management due to incomplete information.

Loans for rental assistance totaled $2.3 million as of January 10, 2003. Mortgage assistance loans expected to be repaid as of this date also approximate $2.3 million.

Our audit disclosed the department’s record keeping practices have resulted in the inability to submit for collection $1 million of loans due to insufficient or missing information. As in the case of the Rental Assistance loans, information recovery is attainable using OIT and by conducting a thorough review of existing files. Our audit has identified specific loans and has made that list available to the department. Accordingly, the department has been in contact with OIT regarding these loans and is in the preliminary stages of retrieving the missing information.

_Housing Inspection_

Housing inspection fees and the related violation penalties are recorded on separate systems. Inspection fees are recorded by the code administration unit and penalties are recorded by the compliance unit. Since the code administration unit does not have access to the system used by the compliance unit, incoming checks may need to be manually added to an electronically generated transmittal so that it agrees to the deposit. This
procedure may result in a lower accuracy of the transmittal. In addition, the agency was unable to provide a schedule of accounts receivable due to the design of these systems.

**Recommendation**

We recommend that the department:

Reduce the amount of uncollectible loans and eliminate the overpayment of escrow accounts by enhancing existing controls. Proper safeguards should be implemented to assist in verification and retention of critical collection data. Improved collaboration between the program and fiscal components will reduce or eliminate errors resulting in overpayments.

Review the existing hard copy files and retrieve electronic files for the missing information to improve collection efforts. The department should allocate the necessary resources to enable OIT to search archived databases containing the missing information. Procedures should be established to ensure future loans are properly documented and information is retained. Document the retroactive policy change that converted loans to grants issued to first-time recipients of rental assistance, and determine the appropriateness of continuing this practice.

Continue efforts to replace or upgrade the inspection fee and violation penalty systems so they can identify their current accounts receivable for collection and eliminate the procedure of manually adding checks to electronic transmittals.

**Auditee’s Response**

*Rental Assistance Program - Landlord Receivables*

The audit reflects 1,175 checks were issued to landlords as overpayments. The Section 8 program issues over 260,000 checks annually. Landlord overpayments may occur when a unit is abandoned and the participant fails to notify the landlord or the Section 8 program, a cancellation of a payment to a
client for program violations occurs too late in the month for a reversal, or cancellation requests from the field office do not reach the data input section in time to stop the payment. These overpayments were made prior to the installation of the new Happy software application that now makes it easier to offset landlord overpayments.

The audit disclosed overpayments to landlords of $800,000 as of March 2003. This receivable is not collectible as much of the debt is at least two years old, some dating back to 1985. An investigation conducted following the audit shows that this amount is aged two years or older, some dating back to 1985. This sum is not deemed to be a true receivable until each overpayment is investigated to determine if the landlord is entitled to the payment due to a tenant violation of the lease or some other disputed matter. Frequently landlords claim they returned the overpayment or make payment directly to the State General Fund. Each overpayment is now investigated to determine if the landlord is entitled to this payment. If the landlord disputes the debt, an effort is made to validate the claim using old mainframe data and/or check trace through OMB, and is very labor intensive. At the conclusion of this process, if the overpayment cannot be collected, the file is sent to the Division of Revenue for collection. A review of collections made by this unit for Fiscal Year 2002 reflected a successful collection rate of 6.02 percent for landlord overpayments. The realistic value of this receivable is approximately $48,000. OIT may have information on old mainframe data files that would assist in finding missing file information. There is an associated cost to extract this information and convert it to a readable data cd format. Based on Circular Letter 03-06-OMB, Write-Off of Uncollectible Accounts Receivable, approximately 80 percent to 85 percent of the Landlord receivable, $640,000 to $680,000, is eligible to be written off as uncollectible. This is a more viable option than investing additional funds.
and resources on collection of receivable with a very low expectation of repayment.

Rental Assistance Program - Tenant Receivables

The audit identifies 302 tenant receivables of approximately $160,000. It is unlikely that information on archived data tapes at OIT will help in collecting this receivable. Information in many of these files is missing current address information due to tenants moving and not leaving forwarding addresses, a typical occurrence in the Section 8 program. Some of these receivables originated in 1985. These collection files were originally sent to the Division of Revenue for collection and returned to the Section 8 program because of missing information, notwithstanding Treasury’s expertise and substantial resources. The collection rate for tenant receivables for Fiscal Year 2002 was 1.46 percent. The realistic value of this receivable is approximately $2,500. Based on criteria provided by Circular Letter 03-06-OMB, approximately 86 percent of the Tenant Receivables, $138,000, is eligible to be written off as uncollectible.

Rental Assistance Program - Family Self Sufficiency (FSS)

The Fiscal Staff responsible for the fiscal oversight of the Section 8 program has implemented control procedures to ensure overpayments of tenant escrow accounts do not occur. The Section 8 program will develop procedures to write off uncollectible accounts receivable in compliance with Circular Letter 03-060OMB, Write-Off of Uncollectible Accounts Receivable.

Homelessness Prevention Program (HPP) Loans

The Prevention of Homelessness Act provides the Section 8 program with the authority to make either loans or grants based on the reasonable prospect of
repayment. This policy has been in effect since 1986 and has been included in N.J.S.A. 52:27C-24, 52:27D-280 chapter 12 subchapter 2 section 5:41-2.3(b) Levels of Assistance.

HPP deals with a segment of the population that is a high loan risk. These clients are at risk of losing their homes and need emergency financial assistance to prevent them from becoming homeless. The Section 8 program will obtain a legal opinion on whether the current policy employed by HPP is in compliance with the intent of the Prevention of Homelessness Act.

The $430,000 in loans issued between 1984 and 1986 were converted to grants in keeping with the current policy of issuing grants to individuals. In the future, any conversions of this nature will be reviewed by the Division’s Fiscal Office and approved by the Division Director.

Investigating OIT data files to locate missing information that may assist in the collection of loan receivables of $1 million is not cost effective. It is a labor intensive process since most of these loans were transacted between 1985 and 1995. The collection rate for HPP receivables in 2002 was 4.29 percent. The realistic value of this receivable is approximately $43,000. Of the $1 million in HPP loan receivables, $584,725 is secured by various homeowner properties. Sending these receivables to the Division of Revenue is not cost effective since the unit charges a 10 percent fee on all funds successfully collected. It would cost the division $58,000 to collect the secured receivable. Because the debt is secured by property, DCA will collect the loan repayment when there is a change in ownership or if the property is refinanced the $415,000 balance is unsecured and expectation of repayment is low. Based on criteria provided by Circular Letter 03-060OMB, approximately 80-85 percent of the receivable, $332,000 to $352,000, is eligible to be written off as uncollectible. The Section 8 program
will develop procedures to write off uncollectible accounts receivable in compliance with Circular Letter 03-06-OMB, Write-Off of uncollectible Accounts Receivable.

**Housing Inspection**

The division plans on replacing the antiquated computer system with a modern system that will be capable of recording revenues to different units within the Bureau. A recent meeting was held with Office of Information Technology staff to develop a strategy to proceed with a new system. A RFP has been developed and issued to obtain a consultant to perform this task.

---

**Balanced Housing Loans**

The department funds two types of loans to developers for the construction of affordable housing. They are either fixed payments loans with repayment based on a predetermined schedule or “excess cash flow” loans with repayment contingent on the availability of cash proceeds at year end. There are 17 fixed payment loans with balances totaling $15.5 million and 16 closed projects with “excess cash flow” loans totaling $20 million as of March 2003. The “excess cash flow” loans require the submission of audited annual financial statements.

Our prior audit indicated that the department was not following up timely on delinquent payments for fixed payment loans or audit report submissions for cash flow loans. Our review of the files found this condition still exists. The Loan Management Unit policy requires that the first delinquency notice for fixed payment loans be sent ten days after the payment is due and that cash flow loan borrowers be contacted if an audit report is not submitted within 120 days of the end of the borrower’s fiscal year. In
addition, Treasury Circular Letter 03-06-OMB requires the agency to maintain an internal control system which is adequate to effectively collect the amounts due the agency, track the age of the accounts, and to flag delinquent accounts. Five of nine fixed payment loans reviewed were delinquent and follow-up letters were not timely. There were no current audit reports submitted for seven of the ten cash flow loan files reviewed and letters to request the reports were not sent for several years.

We found one case in which a developer received in 1990 a $4 million cash-flow loan (phase I), and later was given a $1 million fixed payment loan (phase II) in 1993 for a project. Since audit reports have not been submitted since 1999 (for 1994-1997) for phase I it cannot be determined if payments are due on this loan. Repayments for phase II should have started in March 2000. As of March 2003 the developer has not made any of the four required annual payments.

**Recommendation**

We recommend the department enforce the submission of audited financial reports requirement from developers. Loans need to be monitored and controls implemented so delinquency notices are sent timely.

**Auditee’s Response**

The Balanced Housing Unit (BHU) funds the construction of affordable housing with grants and loans, in accordance with state statutes. The current Balanced Housing portfolio has two types of loan structures: a fixed payment loan at variable interest rates; or a 1 percent loan. Both loan types are repaid to the extent that the project generates cash flow. Specifically, cash flow is calculated and equally split between the developer and the department. The fixed payment loan structure is no longer being utilized.

All loans are now structured at a 1 percent interest rate and 50 percent of cash flow, paid annually. The Mortgage Note requires that the annual audit include a calculation of cash flow as well as the payment due
to the department. Unpaid interest accrues and is due and payable along with any outstanding principal upon maturity “at the option of the department”. This language provides flexibility and allows the department to forgive a loan if the project cannot support repayment. At the maturity date the BHU makes the determination to demand payment, forgive, amend or extend the loan based on a variety of facts and conditions but all considerations are evaluated against the impact on the affordability of the housing units, i.e. the objective of the BHU is to ensure the affordability of the units funded with Balanced Housing funds.

The BHU unit has procedures that support the loan payment process but the unit has been challenged by inadequate staffing. Specific changes have been made to the procedures that will aid in obtaining audited financial statements in a timely manner and also implement controls that will simplify the monitoring process.

Timely Deposits

Receipts should be deposited timely.

We found that 28 of 35 cash receipt documents tested were not deposited timely. These deposits totaled $1.2 million and ranged from $50 to $155,000. Twelve deposits contained funds held more than two weeks, including one for $18,000 that was held for eight weeks. Treasury Circular Letter 94-24 requires the timely deposit of funds. Timely deposited checks will maximize interest earnings and are less likely to be lost or misappropriated.

Recommendation

The department needs to ensure the timely deposit of funds in accordance with the treasury circular.

Auditee’s Response

In recognition of OMB Circular 94-24-OMB, Deposits by State Agencies, the Department of Fiscal Office issued procedure #1.60.13, Receipt, Deposit and Recording of Revenue, which reiterates OMB’s
policy to deposit revenue the same day that it is received. Those responsible for the receipt and deposit of revenue are to comply with this departmental procedure.