The State of New Jersey, Trenton, NJ

Community Development Block Grant Disaster Recovery-Funded Superstorm Sandy Housing Incentive Program Contract

Office of Audit, Region 3
Philadelphia, PA

Audit Report Number: 2016-PH-1009
September 30, 2016

To: Stan A. Gimont, Acting Deputy Assistant Secretary for Grant Programs, DGB

//signed//

From: David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia Region, 3AGA

Subject: The State of New Jersey Did Not Disburse Disaster Funds to Its Contractor in Accordance With HUD, Federal, and Other Applicable Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the State of New Jersey's Community Development Block Grant Disaster Recovery-Funded Superstorm Sandy Housing Incentive Program contract.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 215-430-6734.

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The State of New Jersey Did Not Disburse Disaster Funds to Its Contractor in Accordance With HUD, Federal, and Other Applicable Requirements

Highlights

What We Audited and Why

We audited the State of New Jersey's Community Development Block Grant Disaster Recovery-funded Superstorm Sandy Housing Incentive Program contract. We conducted the audit because the contract involved a significant amount of funds ($67.7 million), was critical to the implementation of three of the State's disaster programs, and was terminated less than 1 year into the 3-year contract term. Our objective was to determine whether the State disbursed disaster funds to its contractor in accordance with U.S. Department of Housing and Urban Development (HUD), Federal, and other applicable requirements for costs that were eligible, supported, reasonable, and necessary.

What We Found

The State did not disburse disaster funds to its contractor in accordance with HUD, Federal, and other applicable requirements. Specifically, it did not ensure that (1) disbursements met a national objective, (2) expenses were incurred after the contract was executed, (3) other direct costs were fully supported and the prices paid were fair and reasonable, (4) labor costs were fully supported, (5) travel costs were fully supported, and (6) disbursements were for costs that were reasonable and necessary. Further, the State did not show that it properly managed equipment purchased with disaster funds. These conditions occurred because the State did not have adequate controls in place to administer its contract and monitor contract performance and was not fully aware of Federal procurement and cost principle requirements. As a result, HUD did not have assurance that the $43.1 million disbursed under the contract was for costs that were eligible, supported, reasonable, and necessary.

What We Recommend

We recommend that HUD require the State to provide documentation to show that the $43.1 million disbursed under the contract was for costs that met a national objective and were supported, reasonable, and necessary or direct the State to repay HUD from non-Federal funds. Further, HUD should require the State to repay HUD from non-Federal funds for the $128,990 in charges incurred before the contract effective date. HUD should also require the State to implement controls to ensure that it adequately administers current and future contracts related to disaster funds, adequately monitors contract performance, and takes appropriate action when contractors fail to meet performance goals stated in the contract.

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Background and Objective

On October 29, 2012, Hurricane Sandy made landfall near Atlantic City, NJ. The storm caused unprecedented damage to New Jersey's housing, business, infrastructure, health, social service, and environmental sectors. On October 30, 2012, President Obama declared all 21 New Jersey counties major disaster areas. The U.S. Department of Housing and Urban Development (HUD) identified the following nine counties as New Jersey's most impacted areas: Atlantic, Bergen, Cape May, Essex, Hudson, Middlesex, Monmouth, Ocean, and Union.

Through the Disaster Relief Appropriations Act of 2013,[1] Congress made available $16 billion in Community Development Block Grant funds for necessary expenses related to disaster relief, long-term recovery, restoration of infrastructure and housing, and economic revitalization. In accordance with the Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1974, these disaster relief funds were to be used in the most impacted and distressed areas affected by Hurricane Sandy and other declared major disaster events that occurred during calendar years 2011, 2012, and 2013.

On March 5, 2013, HUD issued a Federal Register notice,[2] which advised the public of the initial allocation of $5.4 billion in Block Grant funds appropriated by the Disaster Relief Appropriations Act for the purpose of assisting recovery in the most impacted and distressed areas declared a major disaster due to Hurricane Sandy.[3] The notice[4] allowed preaward costs to be reimbursable as long as the costs were incurred after the date of the storm. To date, HUD has awarded the State of New Jersey approximately $4.2 billion, including $1.8 billion from this initial allocation of funds. On April 29, 2013, HUD approved the State's initial action plan. The action plan identified the purpose of the State's allocation, including criteria for eligibility, and how its uses addressed long-term recovery needs. On May 13, 2013, HUD approved a grant agreement that obligated more than $1 billion in funding from the $1.8 billion allocation. On July 29, 2014, HUD approved the State's second grant agreement, which obligated an additional $500 million. On June 1, 2015, HUD approved the State's third grant agreement, which obligated an additional $1.4 billion. The Disaster Relief Act required the State to spend obligated funds within 2 years of the date of obligation.

The governor of New Jersey designated the State's Department of Community Affairs as the responsible entity for administrating its Block Grant Disaster Recovery grant. The State decided to retain a contractor that would administer its Superstorm Sandy Housing Incentive Program, which affected three disaster assistance programs that were allocated $850 million in the State's initial action plan. The contractor would be responsible for establishing intake centers in the

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1 Public Law 113-2, dated January 29, 2013

2 78 FR 14330 (March 5, 2013)

3 Areas impacted by Hurricane Sandy included New York City, New York State, New Jersey, Connecticut, Rhode Island, and Maryland.

4 78 FR 14342 (March 5, 2013)

State's nine most impacted counties; developing a management information system; and performing intake, application processing, eligibility determinations, loan closings, and more for the (1) Reconstruction, Rehabilitation, Elevation, and Mitigation Program; (2) Homeowner Resettlement Program; and (3) Small Rental Program.

The State issued a request for quotation on April 17, 2013. It received bids from two contractors as shown in the table below.[5]

Expense category	Hammerman and Gainer, Inc.	Contractor B
Labor	$42,517,117	$175,627,124
Other direct costs	23,662,652	15,046,336
Travel	1,560,220	3,751,332
Total bid	**$67,739,989**	**$194,424,792**

On May 8, 2013, the State awarded the 3-year contract to Hammerman and Gainer, Inc. (HGI), totaling $67.7 million. After negotiations between the State and HGI, the contract was terminated by mutual agreement on December 6, 2013. Work on the contract ended on January 20, 2014, and a settlement was reached on May 7, 2015. The State made its final settlement payment on June 12, 2015. In total, the State paid HGI more than $43.5 million for less than 9 months[6] of work performed under the 3-year contract, including $43.1 in Block Grant disaster funds.[7] As the State indicated in a June 2015 letter to HUD, the amount paid to HGI was less than the $57.5 million invoiced by HGI and less than the $45.3 million that the State determined was accurate and supported, without consideration of performance adjustments. The table below shows the total amounts proposed and invoiced by HGI, the total amount the State determined to be accurate and supported before performance adjustments, and the total amount the State disbursed to HGI.

Expense type	Total amount proposed for the 3-year contract period	Total amount invoiced by HGI	Total amount the State determined to be accurate and supported	Total disaster funds disbursed
Labor	$42,517,117	$47,052,452	$35,066,168	$32,817,752
Other direct costs	23,662,652	9,686,457	9,566,671	9,566,671
Travel	1,560,220	734,142	696,509	696,509
Total	**$67,739,989**	**$57,473,051**	**$45,329,348**	**$43,080,932**

[5] The information shown is from the contractors' best and final offers.

[6] HGI performed work under the contract between May 2013 and January 2014.

[7] Although the State disbursed more than $43.5 million to HGI, $454,517 was for Federal Emergency Management Agency funds under the Hazard Mitigation Grant Program.

Regulations at 24 CFR (Code of Federal Regulations) 85.36(b)(11) indicated that grantees and subgrantees alone are responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements. These issues include, but are not limited to source evaluation, protests, disputes, and claims. The regulations further stated that Federal agencies will not substitute their judgment for that of the grantee or subgrantee unless the matter is primarily a Federal concern. However, the State was still required to comply with HUD, Federal, and other applicable requirements.

Our objective was to determine whether the State disbursed disaster funds to its contractor in accordance with HUD, Federal, and other applicable requirements for costs that were eligible, supported, reasonable, and necessary.

Results of Audit

Finding: The State Did Not Disburse Disaster Funds to Its Contractor in Accordance With HUD, Federal, and Other Applicable Requirements

The State did not disburse disaster funds to its contractor in accordance with HUD, Federal, and other applicable requirements. Specifically, the State did not ensure that (1) disbursements met a national objective, (2) expenses were incurred after the contract was executed, (3) other direct costs were fully supported and the prices paid were fair and reasonable, (4) labor costs were fully supported, (5) travel costs were fully supported, and (6) disbursements were for costs that were reasonable and necessary. Further, the State did not show that it properly managed equipment purchased with disaster funds. These conditions occurred because the State did not have adequate controls in place to administer its contract and monitor contract performance and was not fully aware of Federal procurement and cost principle requirements. As a result, HUD did not have assurance that the $43.1 million disbursed under the contract was for costs that were eligible, supported, reasonable, and necessary.

The State Did Not Ensure That Disbursements Met a National Objective

The State did not maintain sufficient documentation to show that the costs it allocated among its activities met national objectives. Program regulations at 24 CFR 570.483 provide the criteria for determining compliance with the national objective requirements.[8] The State provided general information showing how the $43.1 million it disbursed was allocated among activities (the programs supported by the contract) and between two national objectives. It indicated that the allocation between activities was sometimes based on how contractor case managers' time was spent when providing services for the State's programs. In other cases, the State said that the allocation among activities was made using a flat distribution percentage because time could not be easily split among the programs. However, the State did not always provide documentation to show how it allocated costs among the activities. Further, it did not provide documentation to show how it allocated disbursements between the two national objectives selected and that the $43.1 million it disbursed achieved those national objectives. The State needed to demonstrate that the funds were used for eligible program delivery costs that met the selected national objectives. See the table below for a breakdown of the $43.1 million in allocations by national objective.

[8] Every activity, except for program administration and planning, must meet one of the following three national objectives: (1) benefit low- and moderate-income persons, (2) aid in preventing or eliminating slums or blight, or (3) address certain urgent needs in a community because conditions pose an immediate threat to the health and welfare of the community.

Activity	Amount allocated to the selected national objective		Total allocated to each activity
	Benefit to low- and moderate-income persons	Urgent need	
Reconstruction, Rehabilitation, Elevation, and Mitigation Program	$16,644,361	$8,561,558	$25,205,919
Homeowner Resettlement Program	7,102,118	6,694,060	13,796,178
Small Rental Program	4,078,835	0	4,078,835
Totals	**$27,825,314**	**$15,255,618**	**$43,080,932**

This occurred because the State did not establish controls to ensure that it collected and maintained documentation to support its cost allocation among activities and national objectives, and to demonstrate that it had achieved the selected national objectives. As a result, HUD did not have assurance that the $43.1 million the State disbursed under the contract was supported by documentation to show that it met a national objective.

The State Did Not Ensure That Expenses Paid Were Incurred After the Contract Was Executed

The State did not ensure that disbursements for labor, travel, and other direct costs were for expenses incurred after the contract was executed. Specifically, for the invoice reviewed, the State paid for $109,260 in labor charges, $9,190 in travel charges, and $10,540 in other direct costs that were incurred between May 2 and May 8, 2013. On May 2, 2013, the State notified both contractors that bid that it intended to award the contract to HGI. However, the contract was not official at that time. It was awarded on May 8, 2013, and executed on May 9, 2013. Further, the first task order listed the performance period as starting on May 9, 2013. The State paid these expenses because it believed that expenses incurred before the contract was signed and before the performance period established by the first task order were eligible to be paid. As a result, it paid $128,990 for ineligible costs incurred before May 9, 2013.

The State Did Not Ensure That Other Direct Costs Were Fully Supported and Were for a Fair and Reasonable Price

The State did not show that disbursements for other direct costs were fully supported and the prices paid were fair and reasonable. The contract required the contractor to obtain authorization from the State's contract manager before making purchases and submit documentation authorizing purchases with invoices. It also required the contractor to follow the regulations at 24 CFR 85.36 for other direct costs, which included procurement standards detailing the methods of procurement to be followed, the requirement for transactions to be conducted in a manner providing full and open competition, and the requirement for a cost estimate and cost analysis. Further, requirements at 2 CFR Part 225, appendix A, paragraph C(1)(j) required that costs be adequately documented. The State could not show that $2.4 million disbursed for other direct costs for the invoice reviewed met these requirements. For example, the State did not provide

- Purchase authorizations from the State's contract manager,

- Documentation showing the procurement method used for each purchase and compliance with the specific procurement standards in 24 CFR 85.36,
- Receipts totaling $258 for plants, and
- An executed lease and support for a security deposit and lease payment.

See the table below for details.

Description	Amount disbursed	Amount missing receipts or an executed lease agreement	Authorization not documented	Compliance with procurement requirements not documented
Computer equipment	$783,419		X	X
Furniture and fixtures	743,429		X	X
Software	575,000		X	X
Security deposits and rent for leased space	225,342	$35,000	X	X
Temporary office space	35,927		X	X
Legal fees	16,345		X	X
Office supplies	9,048	258	X	X
Totals	**$2,388,510**	**$35,258**		

The leases contained several issues. For example,

- One of the leases was not fully executed. It was not dated and was missing signatures from the landlord and the contractor.
- The square footage on one of the leases significantly exceeded the square footage listed on the related task order. The lease was for 20,874 square feet, while the task order showed 15,000 feet. This was important because the rent was based on the square footage.
- The annual price per square foot for two of the leases exceeded the price per square foot listed in the contractor's proposal. In one case, the annual price per square foot was $1.50 higher than the amount proposed. In the other case, the annual price per square foot was $2 higher than the amount proposed.

The conditions described above occurred because the State did not ensure that the documentation submitted with the invoice demonstrated compliance with applicable requirements. As a result, HUD had no assurance that $2.4 million in disbursements for other direct costs was supported and was for prices that were fair and reasonable.

The State Did Not Ensure That Labor Costs Were Fully Supported

The State did not show that labor costs it considered to be accurate and supported were fully supported. When submitting invoices for payment, the contract required the contractor to provide copies of weekly timesheets for employees assigned to do the work referenced in the invoice. Further, Federal cost principle requirements at 2 CFR Part 225, appendix B, paragraph (8)(h)(4), required the State, in instances in which employees worked on multiple activities or cost objectives, to have personnel activity reports or equivalent documentation to support the distribution of its salaries or wages. This documentation was required to reflect an after-the-fact distribution of the actual activity of each employee, account for the total activity for which each employee was compensated, be prepared at least monthly and coincide with one or more pay periods, and be signed by the employee. For the invoice reviewed, the State did not always provide documentation to meet these requirements. For example,

- For 20 employees, the State did not provide any time records to support $70,097.
- For 177 employees, the timesheets provided to support $398,969 were not signed by the employees. Further, the timesheets for 45 of these employees were not weekly as required by the contract.
- For 16 employees, the timesheets provided did not fully support the hours considered accurate and supported by the State. While the State's invoice reconciliation included more than 2,200 hours for the 16 employees, the timesheets provided did not support $49,620 paid for more than 500 hours.
- While some of the timesheets provided allocated employee time between tasks, none of them divided time among the three programs (activities) to which the State allocated contract disbursements.

The State should have had weekly timesheets or equivalent personnel activity reports in its possession when it paid invoices as required by the terms of the contract. Also, 24 CFR 570.490(a)(1) required the State to establish and maintain such records as may be necessary to facilitate review and audit by HUD of its administration of Block Grant funds under 24 CFR 570.493.

The conditions described above occurred because the State did not fully understand the Federal cost principle requirements and did not adequately review the timesheets submitted with the invoice to ensure that they complied with all the applicable requirements. As a result, HUD had no assurance regarding how much time the contractor's employees spent working on the programs, and the $516,560[9] that the State disbursed to the contractor for labor costs was unsupported.

[9] Some timesheets contained more than one deficiency.

The State Did Not Ensure That Travel Costs Were Fully Supported

The State did not show that travel costs it considered to be accurate and supported were fully supported. The contract required it to follow the General Services Administration's (GSA) Federal travel regulations. However, for the invoice reviewed, the State disbursed

- $9,430 for expenses that were not related to travel. This amount included $8,990 for printing at FedEx-Kinko's and $440 in cleaning and office supplies.
- $547 for fuel expenses when a rental car was not documented.
- $480 for upgraded business class train tickets, which were not allowed under the GSA Federal travel regulations.
- $335 for hotel and per diem charges for an employee who had traveled home for the weekends.
- $330 for mileage reimbursements that did not have MapQuest printouts as required by the State's invoice processing manual.
- $146 for an expense exceeding $75 that did not have a receipt as required by GSA Federal travel regulations.

This occurred because the State did not adequately review the supporting documentation submitted with the invoice to ensure that the travel costs complied with all applicable requirements. As a result, $11,268 that the State disbursed to the contractor for travel costs was unsupported.

The State Did Not Show That It Properly Managed Equipment Purchased With Disaster Funds

The State did not show that it managed equipment purchased with disaster funds in accordance with requirements. Regulations at 24 CFR 85.32(b) required the State to use, manage, and dispose of equipment acquired under a grant in accordance with State laws and procedures. The State provided its policy for property management and disposition of property purchased with disaster funds. While its policy only addressed property management requirements for subrecipients, the State indicated that it generally followed these requirements. However, the inventories provided by the State did not always contain information required by its policy and did not always reconcile to previous equipment records. For example, the April 2016 information technology asset inventory did not always contain sufficient descriptions for and information about the use of items, and contained fewer items than a January 2014 inventory that showed information at the time the contract was terminated. The State also indicated that it was in the process of updating its inventory records for some of the information technology and furniture items due to the recent consolidation of its housing recovery centers.

This occurred because the State did not have adequate controls in place to ensure that it followed its policy for managing equipment. Without a complete and up-to-date inventory, HUD did not have assurance that assets purchased with disaster funds were managed in accordance with applicable requirements.

The State Did Not Ensure That Payments Made Under the Contract Were for Costs That Were Reasonable and Necessary

The State did not show that payments made under the contract were for costs that were reasonable and necessary. Regulations at 2 CFR Part 225, appendix A, paragraph C, discussed factors affecting the allowability of costs, including the need for costs to be reasonable and necessary. The documentation provided by the State did not show that it had considered whether costs were reasonable and necessary when compared to the contractor's proposal, the State's task orders, and the contractor's performance.

The State did not prepare an independent cost estimate and cost analysis before receiving bids or proposals and awarding the contract. The regulations at 24 CFR 85.36(f) required the State to make independent estimates before receiving bids or proposals. They also required the State to perform a cost analysis. An independent cost estimate serves as a yardstick for evaluating the reasonableness of the contractor's proposed costs or prices. An independent cost analysis consists of evaluating the separate elements (labor, materials, etc.) that make up a contractor's total cost proposal to determine whether they are allowable, directly related to the requirement, and reasonable. Although the State did not adopt the Federal procurement standards, it certified that its policies and procedures were equivalent to the Federal standards. Therefore, it needed to show that it had developed a yardstick for evaluating the reasonableness of the contractors' proposed costs or prices and evaluated the separate elements that made up the contractors' total costs. The need for an independent cost estimate and analysis was illustrated by the large variance in the bids received from two contractors. The bid from the second contractor totaled more than $194 million, while the bid for HGI totaled $67.7 million. Although the State expressed concern about the large variance between the bids, it determined that HGI's bid was the most advantageous to the State, price and other factors considered. The State should have performed a detailed cost estimate and analysis to ensure that the contract amount was fair and reasonable.

The State also did not perform an analysis of the reasonableness and necessity of charges before disbursing funds. The State performed a detailed reconciliation to determine the amount of invoiced charges it considered to be accurate and supported; however, it did not perform an analysis of the reasonableness and necessity of the charges. See the table below for details on the total amounts proposed and invoiced by HGI, along with the total amount the State determined to be accurate and supported before performance adjustments.

Expense type	Total amount proposed for the 3-year contract period	Total amount invoiced by HGI	Total amount the State determined to be accurate and supported
Labor	$42,517,117	$47,052,452	$35,066,168
Other direct costs	23,662,652	9,686,457	9,566,671
Travel	1,560,220	734,142	696,509
Total	**$67,739,989**	**$57,473,051**	**$45,329,348**

While the State's integrity monitor stated that the reasonableness of the labor hours charged by the contractor would be the subject of a monitoring report, the State said that the review was not completed because the contract was terminated and the State reached a settlement with the contractor. The need for an analysis of the reasonableness and necessity of the charges, including the labor costs, was illustrated by the difference between the contractor's proposal and the amount it invoiced. While the contract ended after less than 9 months of work, the contractor invoiced for approximately $4.5 million more than it had proposed for labor expenses for the full 3-year contract period. The amount invoiced and paid also exceeded the maximum amount authorized in the first two task orders by $18.3 million.

The need for an analysis of the reasonableness and necessity of the amounts paid was further illustrated by the performance issues identified by the State and the effect the contractor's performance had on the State's programs. The State incorporated performance requirements and penalties into the contract as required by the Federal Register notice.[10] It later identified several issues with the contractor's performance and the documentation submitted with invoices. For example, the contractor failed to deliver a fully operational management information system as required, which affected eligibility determinations. These issues resulted in delays of assistance to recipients and may have resulted in unnecessary labor costs for idle contractors. After the contract was terminated by mutual agreement and the State had completed its detailed reconciliation, it notified HGI that $45.3 million of the $57.5 million invoiced was accurate and supported, but that performance adjustments would need to be made due to the quality of work and costs associated with replacing HGI's system and reviewing the eligibility determinations. The State subsequently reached a settlement with HGI that brought the total disaster funds paid to $43.1 million.

The conditions described above occurred because the State did not have adequate controls in place to administer its contract and monitor contract performance. Further, it was not fully aware of applicable Federal procurement and cost principle requirements. As a result, HUD did not have assurance that the $43.1 million disbursed under the contract was for costs that were reasonable and necessary.

Conclusion

The State did not disburse disaster funds to its contractor in accordance with HUD, Federal, and other applicable requirements because it did not have adequate controls in place to administer its contract and monitor contract performance and was not fully aware of Federal procurement and cost principle requirements. As a result, HUD and the State had no assurance that the $43.1 million disbursed under the contract was for costs that were eligible, supported, reasonable, and necessary. Further, performance issues with the contractor affected the State's implementation of three disaster programs, which resulted in delays of assistance to recipients and may have resulted in unnecessary labor costs for idle contractors.

[10] 78 FR 14344 (March 5, 2013)

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs direct the State to

1A. Provide documentation to show that the $40,046,144[11] disbursed under the contract was for costs that met a national objective or direct the State to repay HUD from non-Federal funds any amount that it cannot support (excluding any amount repaid as a result of recommendations 1B, 1C, 1D, 1E, and 1F).

1B. Repay HUD from non-Federal funds for the $128,990 in charges incurred before the contract effective date.

1C. Provide documentation to show that $2,377,970[12] disbursed for other direct costs was supported and was for prices that were fair and reasonable or repay HUD from non-Federal funds any amount that it cannot support (excluding any amount repaid as a result of recommendation 1B).

1D. Provide documentation to support $516,560 disbursed for wages and salaries charged to its programs by its contractor's employees or repay HUD from non-Federal funds any amount that it cannot support.

1E. Provide documentation to support $11,268 disbursed for travel or repay HUD from non-Federal funds any amount that it cannot support.

1F. Provide documentation showing that the amount it paid under the contract was reasonable and necessary or repay HUD from non-Federal funds any amount that it cannot support.

1G. Provide documentation to show that it has complete and up-to-date inventory and equipment records for all items purchased under the contract in accordance with its property management and disposition policy.

1H. Implement policies and procedures to ensure that it adequately administers current and future contracts related to disaster funds and disburses funds for costs that are eligible, supported, reasonable, and necessary.

1I. Implement policies and procedures to ensure that it monitors contract performance related to disaster funds and takes appropriate action when contractors fail to meet performance goals contained in the contract terms.

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[11] To avoid double-counting, we reduced the amount shown as unsupported for recommendation 1A by the amounts discussed in recommendations 1B, 1C, 1D, and 1E. The $40,046,144 is the full $43,080,932 paid less the amounts cited in recommendations 1B ($128,990), 1C ($2,377,970), 1D ($516,560), and 1E ($11,268).

[12] To avoid double-counting, we reduced the amount shown as unsupported for recommendation 1C by the amount of other direct costs also covered by recommendation 1B. The $2,377,970 is the full $2,388,510 discussed in the finding less the amount also counted in recommendation 1B ($10,540).

Scope and Methodology

We conducted the audit from September 2015 through April 2016 at the State's offices located at 101 South Broad Street, Trenton, NJ, and our office located in Philadelphia, PA. The audit covered the period March 2013 through June 2015.

To accomplish our objective, we reviewed

- Relevant background information;
- Applicable regulations, HUD notices, and the State's policies and procedures;
- The Disaster Relief Appropriations Act, Public Law 113-2;
- The State's Block Grant Disaster Recovery action plan and amendments;
- Funding agreements between HUD and the State;
- Correspondence between HUD and the State;
- The State's request for quotation;
- Bids, proposals, and other supporting documentation submitted by contractors;
- The State's bid evaluation documentation;
- The State's contract, termination agreement, and settlement agreement with HGI, Inc.;
- The State's reconciliation spreadsheets, showing the invoiced amounts it determined to be accurate and supported, as well as amounts it took exception with;
- Contractor invoices and supporting documentation;
- Reports from the contractor's automated timekeeping systems;
- Integrity monitoring reports prepared by the State's contractor; and
- HUD management review reports.

We conducted interviews with responsible employees of the State and HUD staff located in Fort Worth, TX.

To achieve our audit objective, we relied in part on the State's computer-processed data. We used the data to select an invoice for review. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purpose.

The State disbursed $43.1 million in disaster funds to its contractor related to 33 invoices, including negotiated payments made while the contract was winding down and a final settlement payment. While its payments were not always directly tied to invoices, the State performed an overall invoice reconciliation to document which labor, travel, and other direct costs it determined to be accurate and supported for each of the 33 invoices. Of the two invoices that represented at least 5 percent of the costs in each of the three categories, we selected the invoice with the largest total accurate and supported amount in the State's reconciliation spreadsheet. Although this approach did not allow us to make a projection to the entire population of invoices or to the full $43.1 million paid, it was sufficient to meet our objective and allowed us to review

costs from all three categories. According to the invoice reconciliation data, the State determined that $4.5 million related to this invoice was accurate and supported.

Expense category	Total amount the State determined to be accurate and supported	Total amount the State determined to be accurate and supported for the selected invoice	Percent
Labor	$35,066,168	$1,986,090	5.7
Other direct costs	9,566,671	2,388,510	25.0
Travel	696,509	95,955	13.8
Total	**$45,329,348**	**$4,470,555**	**9.9**

We reviewed the invoice and related documentation to determine whether the amount considered accurate and supported by the State was for costs that were eligible, supported, reasonable, and necessary.

We conducted the 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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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 objective:

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

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 effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The State did not establish and implement procedures to ensure that it complied with Federal, HUD, and other applicable requirements.

Followup on Prior Audits

The State of New Jersey, Trenton, NJ, Community Development Block Grant Disaster Recovery-Funded Tourism Marketing Program, Audit Report 2014-PH-1008, Issued August 29, 2014

The following recommendations were still open at the time of this report: 1C. Determine whether the documentation the State provided is adequate to support $3,487,461 disbursed for wages and salaries charged to the program by the contractors' employees and if not, direct the State to repay HUD from non-Federal funds for any amount that it cannot support; and 1D. Direct the State to update its procurement processes and standards to ensure that they are fully aligned with applicable Federal procurement and cost principle requirements. For recommendation 1C, HUD agreed to review the adequacy of the documentation provided by the State for wages and salaries charged to the program by the contractors' employees and consider the range of remedies for noncompliance found in 24 CFR 570.496 by September 30, 2015. For recommendation 1D, HUD agreed to advise the State to revise its policies and procedures to reflect the procurement requirements for subrecipients and include a reference to 24 CFR 570.489(n), which applies to the Federal cost principles at 2 CFR Part 225, and provide a copy of the updated policies and procedures by October 10, 2015. HUD did not meet its target dates for completing its actions related to recommendations 1C and 1D. We will track HUD's resolution of these recommendations through the management decision process prescribed in HUD Handbook 2000.06, REV-4.

The State of New Jersey, Trenton, NJ, Community Development Block Grant Disaster Recovery-Funded Sandy Integrated Recovery Operations and Management System, Audit Report 2015-PH-1003, Issued June 4, 2015

The following recommendations were still open at the time of this report: 1A. Determine whether the documentation the State provided is adequate to show that the $36,992,675 contract price for the initial 2-year period was fair and reasonable and if not, direct the State to repay HUD from non-Federal funds any amount that it cannot support (excluding any amount repaid as a result of recommendations 1C and 1D); 1B. Determine whether the documentation the State provided is adequate to show that the price for the 3 additional option years is fair and reasonable and if not, direct the State to rebid for the additional option years, thereby putting $9,061,780 to better use; 1C. Determine whether the documentation the State provided is adequate to show that the $1,051,933 disbursed for software was a fair and reasonable price and if not, direct the State to repay HUD from non-Federal funds any amount that it cannot support; 1D. Determine whether the documentation the State provided is adequate to support the $467,659 disbursed for wages and salaries to the program by the contractors' employees and if not, direct the State to repay HUD from non-Federal funds any amount that it cannot support; and 1E. Direct the State to update its procurement processes and standards to ensure that they are fully aligned with applicable Federal procurement and cost principle requirements. For recommendation 1D, HUD agreed to review the adequacy of the documentation provided by the State and consider the range of remedies for noncompliance found in 24 CFR 570.496 by April 30, 2016. HUD did not meet its target date for this recommendation. We will track HUD's resolution of this recommendation

through the management decision process prescribed in HUD Handbook 2000.06, REV-4. For recommendations 1A, 1B, 1C, and 1E, we are working through the management decision process with HUD as prescribed in HUD Handbook 2000.06, REV-4.

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/
1A		$40,046,144[13]
1B	$128,990	
1C		2,377,970[14]
1D		516,560
1E		11,268
Totals	**$128,990**	**$42,951,942**

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ 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 the 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.

[13] To avoid double-counting, we reduced the amount shown as unsupported for recommendation 1A by the amounts discussed in recommendations 1B, 1C, 1D, and 1E. The $40,046,144 is the full $43,080,932 paid less the amounts cited in recommendations 1B ($128,990), 1C (2,377,970), 1D ($516,560), and 1E ($11,268).

[14] To avoid double-counting, we reduced the amount shown as unsupported for recommendation 1C by the amount of other direct costs also covered by recommendation 1B. The $2,377,970 is the full $2,388,510 discussed in the finding less the amount also counted in recommendation 1B ($10,540).

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

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CHRIS CHRISTIE
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The State of New Jersey's Response to the Office of Inspector General's Audit Findings on the Superstorm Sandy Housing Incentive Program

The State of New Jersey has reviewed the Department of Housing and Urban Development ("HUD"), Office of the Inspector General's ("OIG") audit report concerning the Community Development Block Grant – Disaster Recovery ("CDBG-DR") funded Superstorm Sandy Housing Incentive Program ("SSHIP"). On behalf of the State of New Jersey Department of Community Affairs ("DCA"), we appreciate the opportunity to provide comments and clarifications to several of the findings that we consider factually inaccurate or legally unsupported.

Summary

Comment 1

Many of the issues noted in the audit report are duplicative of the issues previously identified and corrected by DCA during the life of the SSHIP contract. In fact, the SSHIP contractor, Hammerman & Gainer, Inc. ("HGI"), submitted expenses to DCA totaling more than $57 million, but the State only paid HGI $43.5 million as a result of DCA's exhaustive efforts to manage the contract by reconciling invoices and costs, identifying performance issues, requiring additional expense documentation and making adjustments to invoices for unsupported expenses. As OIG's audit confirmed, the final amount paid was approximately $14 million less than the amount HGI considered adequate and fully supported, and $1.8 million less than the amount DCA actually found to be adequate and supported.

Comment 2

However, OIG's audit report also raises several concerns regarding costs that the State believes are fully supported by the existing documentation. For instance, the State disagrees with OIG's claim that funds disbursed under the SSHIP contract may not have met a national objective. DCA's methodology for allocating costs to programs and national objectives has already been reviewed and expressly approved by HUD. As it has done for the past three years, DCA will continue to work with HUD to ensure that the State is meeting its national objectives.

Comment 3

The audit report is also legally and factually inaccurate to the extent that it suggests that precontract costs are ineligible. On the contrary, precontract costs are expressly permitted by federal law. HGI's precontract costs were necessary "getting up to speed" costs incurred at HGI's own risk after the State issued its intent to award the SSHIP contract but before the final contract was fully executed. In fact, HGI's proposal specifically included these costs to ensure that its Sandy recovery team would be

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Comment 4

Comment 5

fully prepared to begin work on this urgent project upon formal contract execution. These precontract costs are clearly permissible under federal law and the SSHIP contract and, perhaps most importantly, represent an appropriate contracting practice when implementing emergent disaster relief programs.

OIG also continues to incorrectly assert that the State was required to follow federal, as opposed to State, procurement rules when it procured the SSHIP contract. Despite OIG's claim to the contrary, the State was not required to conduct a pre-bid cost estimate or post-bid cost analysis in strict compliance with certain federal regulations. Instead, federal law requires New Jersey to follow its own procurement practices. This issue has been raised previously by OIG in audit reports of the State's procurements for its Tourism Marketing Campaign and for the Sandy Integrated Recovery and Operations Management System. Final resolution of this issue is currently pending before HUD, yet OIG continues to include this unsupported finding in audit reports in the meantime as a means of questioning the entire contract value of every State procurement.

While the State is confident that DCA maintained adequate documentation to support all of the funds disbursed, and in fact, to support almost $1.8 million more than the amount disbursed, the State also took steps to safeguard CDBG-DR funds after the contract with HGI was terminated. Specifically, the State included a clawback provision in its contract settlement that requires HGI to repay any sums that are determined to be unsupported by HUD or OIG. This additional protective measure provides further assurances that the State's CDBG-DR funds are safeguarded.

Please allow the following to discuss these issues in more detail and to provide the full context of the SSHIP procurement and contract management.

I. Introduction

In the aftermath of Superstorm Sandy, the largest and most ferocious storm to ever hit New Jersey, the State was faced with the monumental challenge of quickly and effectively implementing programs to deliver critical relief to individuals, families, businesses and towns in New Jersey. The State's CDBG-DR Action Plan included multiple homeowner assistance programs to stabilize communities by helping Sandy-impacted homeowners stay in their communities, and repair and reconstruct their damaged residences. From the storm's initial landfall to the present, the State has worked tirelessly to ensure the successful implementation of each program.

a. The Superstorm Sandy Housing Incentive Program

The SSHIP contract called for the launch and administration of three major housing initiatives: the Homeowner Resettlement Program ("Resettlement"); the Homeowner Rehabilitation, Reconstruction, Elevation and Mitigation Program ("RREM"); and the Small Rental Program (also referred to as the "Landlord Rental Repair Program").

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Resettlement incentivized New Jersey homeowners to remain in their communities by providing grants to ameliorate Sandy-related financial pressures, such as increased insurance premiums. The program was a tremendous success. It expediently distributed much-needed $10,000 CDBG-DR grants to more than 18,500 New Jersey residents within the nine most-impacted counties (as designated by HUD) to address various non-construction related needs. In exchange, recipients agreed to reside in their home counties for at least three years post-storm. As a result, the State protected many vulnerable communities from the harmful effects of out-migration.

RREM provides grants to New Jersey homeowners whose primary residences were damaged or destroyed by the storm. Grant awards can fund necessary rehabilitation, reconstruction, elevation and mitigation related activities. Eligible homeowners can receive up to $150,000 to "fill the gap" between the cost of repairs and other funds the owner has received to repair the structure. Of the approximately 7,800 homeowners actively participating in RREM, all eligible applicants have signed their grant award agreement. To date, approximately $780 million of RREM funding has been disbursed to eligible homeowners. Notably, 97 percent of RREM homeowners have received at least one payment from the program; over 3,300 homeowners have completed construction; and nearly all of the remaining 4,500 homeowners have started construction.

The Small Rental Program seeks to increase the supply of affordable rental housing in Sandy-impacted areas by providing grants of up to $50,000 per unit to eligible property owners to repair storm-damaged rental properties. The property owners must then rent the program-assisted units to low-to-moderate-income ("LMI") individuals. Similar to RREM, award funds can be used to "fill the gap" between the cost of repairs and other funds the owner has received to repair the structure. Through the Small Rental Program, 743 rental units are receiving assistance, 227 of which have completed construction and are being leased to LMI individuals.

b. HGI Procurement

Due to the urgent need for housing services and the complexities of the Resettlement, RREM and Small Rental programs, the State needed a qualified and experienced contractor to manage the SSHIP program. On April 17, 2013, pursuant to applicable federal and State procurement statutes and regulations, the New Jersey Department of Treasury, Division of Purchase and Property ("DPP"), issued a Request for Quotation ("RFQ") on behalf of DCA to solicit quotes from prospective contractors to administer SSHIP.

The State received two proposals. HGI's proposal totaled $67.7 million and the proposal from a second bidder totaled more than $194 million. Not only was HGI's proposal technically responsive and about $126 million less than the next highest bid, but HGI offered substantially more prior experience administering similar disaster relief efforts in Louisiana and Mississippi after Hurricanes Katrina and Rita.

On May 8, 2016, the State awarded the contract to HGI to administer the SSHIP program for an amount not to exceed $67.7 million. For the Resettlement, RREM and Small Rental programs, HGI was

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responsible for all the start-up operations, leases and staffing of the housing recovery centers across the State. *See* SSHIP RFQ, section 3.1. HGI was also responsible for subcontractor supervision and was required to administer the program applicant intake process, verify and validate applicant eligibility information, make applicant eligibility determinations and recommendations, make recommendations on applicant appeals, conduct grant close-outs, coordinate information exchanges and be responsible for grant program quality assurance and control. *Id.* To facilitate these responsibilities, HGI was required to "[d]esign, develop and implement" an information technology ("IT") system of sufficient capacity, flexibility and ease of use to support the Resettlement, RREM and Small Rental recovery efforts. *Id.*

c. HGI's Performance

HGI succeeded in helping DCA launch many of its housing-related disaster recovery projects in the first 90 days of the contract, including the following significant milestones:

- Launched three major disaster recovery housing programs (Resettlement, RREM and Small Rental);
- Opened and staffed nine housing recovery centers and headquarters in the hardest-hit communities;
- Received 23,105 Resettlement applications, 15,477 RREM applications and 834 Small Rental applications;
- Answered 55,284 calls, served 821,252 page views on the website and serviced 20,670 walk-ins to the housing recovery centers;
- Conducted 8,524 Resettlement closings;
- Conducted 3,743 RREM appointments and transferred 987 files to RREM contractors; and
- Completed 25 mobile outreach events, distributed 18,099 flyers, and sent 134,000 reverse 911 calls.

HGI's work in these critical areas of SSHIP justified significant contract expenses.

Despite these accomplishments, HGI's performance also lagged in several key areas. By July 2013, less than three months after contract execution, deficiencies with HGI's performance became readily apparent. Most notably, HGI's IT platform ("eGrants") failed to function as required by the contract and DCA's internal monitoring revealed that HGI maintained unacceptably high error rates in applicant eligibility/ineligibility determinations.

In an effort to cure these contract deficiencies, DCA employees regularly met with their counterparts at HGI to discuss problems and propose solutions. For instance, during the summer of 2013, DCA staff had numerous conversations with HGI in an effort to obtain contract compliance. When these efforts proved unsuccessful, DCA senior management met with HGI executives in early August 2013 to discuss contract deficiencies. As a follow up to that meeting, DCA issued a letter to HGI senior management directing HGI to develop and agree to a detailed Corrective Action Plan to resolve

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identified deficiencies and adhere to contractual requirements. However, HGI denied that there were problems with its performance and the performance of eGrants.

DCA notified HGI of all of the areas where HGI's performance was deficient and calculated, as best that it could, the appropriate downward performance adjustment to invoices. DCA's difficulty in calculating the precise amount stemmed from HGI's sloppy invoicing. Also, many of the cures for HGI's poor performance were underway and thus not fully calculable at that time, and several of the forms of damages arguably overlapped or were alternative means of calculating damages for the same aspect of deficient performance. But, in an effort to preserve all of its arguments, DCA initially claimed the full amount of damages for each aspect of inadequate performance under the contract. Those performance adjustments included:

- Approximately $11 million to replace the eGrants system;
- A percentage reduction in the amounts payable under several sections of the Scope of Work to reflect what DCA deemed to be poor quality of work;
- Costs associated with DCA's re-review of HGI's eligibility/ineligibility determinations; and
- Approximately $9.5 million in liquidated damages under the contract because eGrants did not meet contract specifications.

HGI disagreed with all of DCA's performance adjustments and claimed that it had met all contract requirements.

d. The State's Review, Reconciliation and Adjustment of HGI's Invoices

While DCA's contract manager was working to enforce HGI's compliance with contractual commitments, DCA's fiscal unit was actively reviewing and reconciling HGI's invoices, which were poorly organized, missing supporting documentation and contained mathematical errors. Early on, payments to HGI went unapproved because the documentation HGI submitted to support its invoices was confusing, incomplete or missing. HGI's invoice review and reconciliation was so time-consuming and burdensome that it was not complete until April 2014.

To complicate matters, HGI never submitted a complete roster of all individuals working under the contract along with their labor titles and corresponding hourly rates. This added confusion and delay to the invoice review process because DCA had to develop its own SSHIP labor roster based on first-hand knowledge of the employees and projects.

To comply with State and federal cost principles and audit standards, DCA also took extraordinary efforts to review, reconcile and request additional documentation from HGI to support invoiced amounts. For instance, DCA discounted $1.38 million of HGI's invoiced costs due to:

- Missing invoice support (*e.g.*, timesheets or travel expense documentation);

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- Double billing (*e.g.*, an individual's time billed to more than one invoice); or
- Excessive billed hours.

DCA's invoice review also included a careful scrutiny of HGI's labor charges. As a threshold matter, DCA refused to pay any invoiced labor charges if HGI did not submit an approved timesheet from the individual that supported the invoiced labor charges. Furthermore, DCA performed its own individual-by-individual review of the 1,200+ employees who billed time under the contract to ensure that HGI's labor titles and corresponding hourly rates were appropriate. DCA refused to pay the hourly labor rate billed if it could not independently verify that the individual's work was commensurate with the labor title/rate assigned by HGI. As a direct result of this meticulous labor category remap, DCA discounted another $10.7 million of HGI billings. HGI strongly disputed DCA's labor category remap.

In sum, DCA determined that HGI could only support $45.3 million in invoiced costs, as opposed to the $57 million billed by HGI. DCA also recognized that HGI had performed a considerable amount of work that justified payment. The State consequently made payments to HGI during the life of the contract "subject to reconciliation and adjustment" in order to preserve the State's right to make future modifications.

e. Litigation and Settlement

Ultimately, due to HGI's inability to cure its deficiencies and comply with contractual requirements, the contract was terminated by mutual agreement with an effective end date of January 20, 2014. The contract was terminated less than nine months after the date of execution. Pursuant to a transition agreement, DCA replaced all of HGI's administrative functions and absorbed its responsibilities as SSHIP administrator.

By March 7, 2014, the State paid HGI $35.9 million, subject to reconciliation and adjustment, and determined that an additional $9.4 million of the invoices was supported by adequate documentation. However, after making downward adjustments for HGI's performance deficiencies, DCA claimed that HGI would be required to refund a portion of the $35.9 already paid. HGI disagreed and demanded that the State pay the full remaining amount of unpaid invoices, which HGI totaled at $21.7 million.

Unable to reach an agreement on these issues, the matter proceeded to arbitration. Numerous issues were joined in the litigation, including:

- The adequacy of the eGrants IT system;
- The lack of timely delivery of the eGrants IT system;
- Whether HGI's performance in several contract areas merited full payment;
- The costs incurred by DCA due to HGI's performance deficiencies;
- The applicability and proper amount of liquidated damages;
- Whether DCA's labor title/rate remap was accurate and fully supported; and
- HGI's cost overruns.

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HGI took the position that it was due the full remaining amount of unpaid invoices, totaling $21.7 million. DCA took the position that HGI owed back some portion of the $35.9 million already paid.

Given the myriad issues in dispute and the complexity of the proofs and evidence necessary for DCA to prevail on each position, there was a significant litigation risk that an arbitrator could have determined that DCA could not sustain its burden of proof. Settlement negotiations began and the parties suspended the discovery process, which was expensive, time-consuming and disruptive to DCA's operation of RREM and other vital recovery programs.

Because DCA carried the burden of proof on its labor title/rate remap, as well as whether and to what extent HGI's performance was deficient, it had to consider that the arbitrator could potentially award HGI the full $21.7 million at stake. As with any complex disputed matter, the State had varying levels of confidence that the arbitrator would find that DCA's invoice adjustments were appropriate and properly supported, particularly in light of the fact that HGI had performed adequately in a number of areas of the $67 million SSHIP contract. DCA also had to consider the typical litigation concerns, including the availability of witnesses, the costs of proceeding with litigation and the need to reserve current DCA personnel's time and focus for the continued administration of Sandy recovery programs.

Given the many disagreements over the invoice reconciliation, labor rates and whether and to what extent adjustments were appropriate for HGI's poor performance, settlement negotiations proceeded without reference to specific invoice amounts, labor titles/rates or performance adjustments. As such, the settlement was not correlated to specific invoices or performance adjustments. This type of settlement is expressly permitted by HUD handbook guidance. *See HUD Handbook No. 7460.8 REV 2*, Chpt. 11.6(C)(2).

After multiple rounds of negotiations, the State and HGI settled all remaining claims for a total of $7.6 million. Critically, however, the State prudently exercised its business judgment in agreeing to the settlement amount, taking into consideration:

- The settlement amount was $14.1 million less than the amount sought by HGI in litigation;
- The total disbursements (invoice payments and settlement amounts) of $43.5 were $14 million less than the amount HGI invoiced;
- Total disbursements were also $1.8 million less than the amount that DCA found to be accurate and supported;
- The significant cost of protracted litigation;
- The litigation risk involved in any complex dispute;
- The operational interference inherent with extensive discovery if settlement had not been reached;
- The anticipated time and expense involved in completing the arbitration process; and
- The potential for an arbitration award near to, at or in excess of $21 million to HGI.

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Taking all these factors into consideration, DCA exercised due care and settled with HGI in a good faith, honest and reasonable belief that the settlement was in the best interest of the State and HUD.

Furthermore, the State also required a clawback provision to be included in the settlement agreement with HGI. Pursuant to that provision, HGI is required to pay back any amounts disbursed under the SSHIP contract to the extent that HUD or OIG determines that any costs were ineligible or unallowable. Thus, HGI may still be required to pay back any portion of the $43.5[1] million disbursed under the SSHIP contract.

II. Response to OIG Findings

OIG disputes whether DCA properly procured services and supported costs under the SSHIP contract. As fully set forth herein, OIG's assertions are incorrect because DCA procured the SSHIP contract in compliance with all relevant State and federal requirements, and, as outlined above, took extensive measures to manage the SSHIP contract to ensure that all costs were fully supported and were fair and reasonable.

Comment 2

a. DCA's Allocation Methodology was Approved by HUD and Ensured that SSHIP Costs Met a National Objective

OIG does not question HGI's methodology for allocating costs to programs and national objectives, but simply asserts that the underlying support for these calculations must be supplied to HUD. As DCA has done over the past three years, it will continue to work with HUD to provide any documentation necessary to ensure that the State meets its Low-and-Moderate Income ("LMI") and Urgent Need ("UN") objectives.

It should also be noted that HUD has already approved DCA's methodology for allocating program costs to national objectives and that allocation approximates the method used by HGI. DCA's current allocation methodology is based on individual applicant data for phases one, two and three of the RREM program to designate RREM costs as either "LMI" or "UN." Importantly, applicant data for phase one (the only phase when HGI was under contract) of the RREM program indicated that 67% of applicants were categorized as LMI, while 33% were categorized as UN. Similarly, HGI's allocation methodology resulted in a split of 65% LMI and 35% UN, which is roughly equivalent to the allocation currently used by DCA and approved by HUD. Thus, HUD should have a reasonable assurance that the national objective allocation of the HGI expenditures is in line with the applicants served during the life of the SSHIP contract. OIG's assertion that HUD did not have any assurance that the $43.1 million disbursed under the SSHIP contract did not meet a national objective is inaccurate. Nevertheless, DCA

[1] The $43.5 million disbursed to HGI included $454,517 of Federal Emergency Management Agency ("FEMA") funds under the Hazard Mitigation Grant Program. These FEMA funds are not subject to review by HUD OIG. Thus, HUD OIG is only reviewing $43.1 million of CDBG-DR funds disbursed to HGI.

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Comment 3

has always recognized the importance of the national objective requirements and will continue to work with HUD to provide reasonable assurances that all national objectives are met and fully supported.

b. OIG Incorrectly Asserts that SSHIP Precontract Costs are Ineligible

On May 2, 2013, the State issued a notice of intent to award the SSHIP contract to HGI. The contract was officially awarded to HGI on May 8, 2013, and fully executed by the State and HGI on May 9, 2016. OIG claims that $128,990 of labor charges, travel charges and other direct costs incurred by HGI for otherwise eligible startup costs between May 2, 2013 and May 8, 2013 constituted ineligible precontract costs. This finding is legally and factually incorrect.

First, OIG's finding fails to recognize that federal contracting law expressly permits precontract costs. The Federal Acquisition Regulations ("FAR")[2] provide as follows:

> Precontract costs means costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. These costs are allowable to the extent that they would have been allowable if incurred after the date of the contract . . .
>
> 48 C.F.R. § 31.205-32 (emphasis added).

Accordingly, OIG's audit report is legally inaccurate to the extent that it suggests that precontract costs are *per se* ineligible.

Second, HGI's proposal[3] expressly anticipated costs for precontract activities. Regarding precontract costs, HGI's proposal provided as follows:

> The HGI Team will be prepared to begin work and for key staff as identified in the RFQ to be present in Trenton within one week of contract execution. However, in order to meet the requirements to begin outreach 10 days after contract award and to begin taking applications 30 days after contract award, the following (as a minimum) must be accomplished during the first two weeks following contract award concurrent with any needed contract negotiations.

---

[2] The FAR establishes "uniform policies and procedures for acquisition by all executive agencies." 48 C.F.R. § 1.101. HUD has published regulations that supplement and modify FAR, *see* 48 C.F.R. § 2401, but those regulations do not alter the FAR precontract costs rule. Thus, the FAR precontract costs principle applies to HUD contracts.

[3] The SSHIP Request for Quotation ("RFQ") provides that any language in the bidder's proposal shall become part of the contract with the State. *See* SSHIP RFQ, section 5.16.

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Comment 3

HGI Proposal, pg. 205.

In the first week after contract award, HGI anticipated finalizing all draft policies, approving an initial outreach strategy, beginning modifications of eGrants, defining website and network requirements, obtaining FEMA and other information databases, beginning recruitment of local staff and identifying potential housing center locations. *Id.* To meet these goals, HGI clearly needed to and expressly contemplated incurring precontract costs to meet SSHIP's tight program timelines and deliverables.

In permitting precontract costs, the FAR and SSHIP contract inherently recognize that allowing these types of costs represents a necessary and effective government contracting practice. *See, e.g., Best Foam Fabricators v. United States*, 38 Fed. Cl. 627, 639 n.10 (Fed. Cl. 1997) (precontract costs are allowable when there is an accelerated delivery schedule and in light of the government's urgent need). By authorizing precontract costs, the State allows contractors the flexibility to expediently begin startup work at their own risk on contracts like SSHIP with strict time constraints. This practice allows a contractor the option to begin work while a contract award is finalized with no risk to the State if the contract is not executed. On the other hand, if the State were to restrict otherwise eligible precontract costs on time-sensitive contracts, the State could unnecessarily delay the implementation of urgently needed disaster relief programs.

Clearly, HGI's otherwise eligible precontract costs should not be disallowed and this finding should be removed from the audit report.

c. DCA Exhaustively Reviewed Support for SSHIP Disbursements to Ensure that Costs were Reasonable and Necessary

Comment 4

Comment 6

OIG's finding that the State failed to ensure that SSHIP payments to HGI were reasonable and necessary is factually inaccurate and based on a misunderstanding of federal law and HUD handbook guidance. OIG continues to incorrectly claim that DCA should have followed federal, as opposed to State, procurement regulations. In fact, federal law requires New Jersey, like all other states, to follow state procurement regulations. Additionally, OIG improperly seeks to substitute its own judgment for the reasoned and fully supported business judgment of the State in resolving the SSHIP contract dispute with HGI. Both federal law and HUD handbook guidance provide that States are responsible, in accordance with good administrative practice and prudent business judgment, to resolve all claims or disputes arising under a federally funded contract.

1. The State Appropriately Followed New Jersey Procurement Rules as Required by 24 C.F.R. § 85.36(a)

Comment 4

The State was not required to conduct a pre-bid independent cost estimate ("ICE") or post-bid cost analysis in strict compliance with federal standards because federal law requires New Jersey, like all other states, to follow state procurement practices. In its audit report, OIG asserts that the State could not be assured that contract costs were reasonable and necessary because it did not perform an

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Comment 4

independent cost estimate or cost analysis in strict compliance with the federal procurement regulations found at 24 C.F.R. § 85.36(f). OIG's position is based on a misunderstanding of federal law. The State made it clear that although it considered its policies equivalent to those in the federal regulations, they were not identical. States (including New Jersey) are required under 24 C.F.R. § 85.36(a) to follow their own procedures in procurements when using federal grant funds; the standards enumerated in subsequent sections of that regulation, including the independent cost estimate and cost analysis requirements in section (f), apply only to other, non-state grantees. Because the State has not adopted that procedure as its own standard, it was legally bound to follow State processes. This is not merely the State's opinion, but was confirmed by HUD in 2013 when it certified that the State "has in place proficient financial controls and procurement processes." *See* Exhibit D to the State of New Jersey's HUD-Approved CDBG-DR Action Plan. It is entirely unclear why OIG continues to rely on inapplicable rules in evaluating the State's procurement processes as a basis to question the entire value of every procurement using CDBG-DR funds.

Comment 7

Comment 5

The legal analysis is straightforward and has been fully set forth in two of the State's prior responses to OIG's audit reports on the Tourism Marketing Campaign (Audit Report 2014-PH-1008) and the Sandy Integrated Recovery Operations and Management System (Audit Report 2015-PH-1003). Rather than repeating those full responses here, the State incorporates them by reference in its reply to this audit report.

Comment 5

It must also be noted that the final resolution of this issue is currently pending before HUD. Thus, no purpose is served by issuing audit reports based on a threshold legal question that has not been resolved and is based on questionable legal and factual grounds. Accordingly, the State requests that OIG refrain from continuing to include this questionable finding, which has been used to question tens of millions of dollars in CDBG-DR funded procurements, in its audit reports until this issue is resolved.

2. The State Performed an Extensive Review of the Reasonableness and Necessity of HGI's Charges

Comment 8

Contrary to OIG's assertion, the State took exhaustive efforts to review the accuracy, reasonableness and necessity of all payments to HGI under the SSHIP contract. As discussed above, HGI performed numerous tasks, including the initial launch of three major housing programs and all the work associated with initial applicant intake, during the early period of the SSHIP contract. These tasks justified significant payments to HGI. HGI's performance also lagged in several key areas, mostly related to its IT system and in errors determining applicant eligibility. HGI's documentary support for certain expenses was also lacking.

OIG's audit report fails to recognize or include DCA's extensive efforts to cure these deficiencies and make appropriate adjustments to the amounts requested by HGI as part of its contract management efforts. DCA's efforts, which are detailed in full in Section I(c)-(e) above, included:

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Comment 8

- Regularly meeting with HGI to discuss problems, cost overruns and propose solutions through corrective action plans;
- Notifying HGI of all of the areas in which HGI's performance was deficient and calculating the appropriate downward performance adjustment to the invoices;
- Reviewing and reconciling HGI's invoices, which were poorly organized, missing supporting documentation and contained mathematical errors;
- Discounting $1.38 million in HGI billings as a result of missing invoice support, double billing or excessive billed hours;
- Discounting another $10.7 million in HGI billings when DCA was unable to independently verify that numerous employees' work was not commensurate with the labor title/rate assigned by HGI;
- Making all payments to HGI subject to "reconciliation and adjustment";
- Developing a complete roster of all individuals working under the contract along with their labor titles and corresponding hourly rates based on first-hand knowledge of the employees and projects;
- Re-reviewing all of HGI's eligibility determinations to ensure that applicants were appropriately screened; and
- Assigning DCA's internal monitor to review HGI's performance and invoices and make recommendations for corrective actions.

OIG's audit report fails to recognize any of these exhaustive efforts, and thus improperly concludes that DCA did not take sufficient actions to ensure that SSHIP costs were reasonable and necessary. In fact, OIG's audit report highlights the fact that HGI *billed* the State more than $57 million in just nine month's as evidence of a lack of contract supervision. In doing so, OIG fails to grasp that the State never *paid* HGI $57 million. Instead, the State significantly discounted HGI's billings and only paid a total of $43.5 million, or about $14 million less than the amount HGI invoiced.

3. OIG's Conclusion Regarding the State's Application of Performance Adjustments is Inaccurate

Comment 9

In its audit report, OIG implies that the State failed to account for performance adjustments. *SSHIP Audit Report*, p. 12. This insinuation is incorrect. The settlement with HGI took into consideration all of the issues joined in the litigation, which included, among other things: performance adjustments, the applicability and amount of liquidated damages, the adequacy of the eGrants IT system, downward adjustments for questioned expenses and cost overruns. OIG appears to be misinterpreting the State's explanation of the settlement to support its faulty conclusion. On several occasions, the State explained to OIG that the settlement did not "reference" specific performance adjustments or invoice amounts due to the numerous issues joined in the litigation. But at no point in time did the State simply disregard HGI's performance issues. On the contrary, the State's identification of HGI's performance deficiencies and other contract issues allowed it to negotiate settlement terms and an amount (that was $14.1 million less than the amount sought by HGI) that were the most advantageous to the State and HUD.

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Comment 10

4. OIG Fails to Properly Apply the Business Judgment Standard to the State's Settlement with HGI

Furthermore, OIG is not evaluating the State's resolution of the disputed SSHIP contract claims according to the proper standard. Pursuant to federal regulations, HUD handbook guidance, and federal and state case law, HUD and OIG will only challenge the State's "business judgment" in resolving a contract dispute where the State fails to provide a rational basis for the decision. *See* 24 C.F.R. § 85.36(b)(11). The State has offered several rational reasons that justify its settlement of all claims and disputes with HGI. OIG is questioning several aspects of the settlement and framing those concerns in terms of reliance on auditing and accounting principles, which has the effect of negating the business judgment rule.

"Business judgment" is a well-settled legal principle that is frequently applied in corporate case law to protect reasoned corporate decision making from second-guessing by the courts. The business judgment rule operates as a presumption that, in making a decision, the directors of a corporation acted with due care (*i.e.*, on an informed basis) and in good faith in the honest belief that their action was in the best interest of the corporation. *FDIC v. Rippy*, 799 F.3d 301, 312 (4th Cir. 2015). Powerful deference is afforded to a decision by an informed corporate board. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 928 (Del. 2003), *citing* 8 Del. C. § 141 (2016). That deference will only be questioned by a court where the business decision cannot be attributed to any rational business purpose or the decision was motivated by self-interest. *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1287 (Del. 1989).

Although the business judgment rule was created by case law, federal agencies have adopted it into their procurement regulations and handbooks as a means of evaluating grantee resolutions of disputed claims arising under federally-funded contracts. For instance, HUD adopted the business judgment standard in its procurement regulations as follows:

> Grantees and subgrantees alone will be responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements. These issues include, but are not limited to source evaluation, protests, disputes, and claims. These standards do not relieve the grantee or subgrantee of any contractual responsibilities under its contracts.
>
> 24 C.F.R. § 85.36(b)(11) (emphasis added).

Notably, that same regulation goes on to state that "Federal agencies will not substitute their judgment for that of the grantee or subgrantee unless the matter is primarily a Federal concern." *Id.* (Emphasis added).

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Comment 10

Comment 11

As applied in the context of the State's settlement with HGI, the business judgment rule operates as a presumption that the State acted with due care and with a good faith belief that its actions in settling the contract dispute were in the best interests of the State and HUD. Indeed, HUD's procurement handbook specifically states that fair compensation for a terminated contract is "a matter of judgment and cannot be measured exactly." *HUD Handbook No. 7460.8 REV 2*, Chpt. 11.6(C)(2) ("Handbook")[4]; *see also Playing by the Rules: A Handbook for CDBG Subrecipients on Administrative Systems*, Section 3.1, Chpt. 8-3 (noting that federal contracts should be designed and managed consistent with sound business judgment). That Handbook explains that, when determining fair compensation, the State should apply "prudent business judgment . . . as opposed to strict accounting principles." *Handbook*, Chpt. 11.6(C)(2). In fact, the Handbook provides that the State and its contractor "may agree to a total amount to be paid to the contractor without agreeing on individual cost items or profit." *Id.* Thus, HUD explicitly recognizes that a settlement payment for contract disputes like the one at issue in the SSHIP program may not tie directly to invoice amounts, and, instead, should be evaluated pursuant to the business judgment rule.

In adherence to this guidance, the State applied sound business judgment when settling all claims under the SSHIP contract with HGI. HGI began work on the SSHIP contract beginning in May 2013. HGI succeeded in helping DCA launch many of its housing-related disaster recovery projects in the first 90 days of the contract, including many significant milestones that fully justified payments under the SSHIP contract. However, there were several disputes related to the adequacy of HGI's performance in other areas of the contract. DCA took extensive measures to work with HGI to cure these issues (including but not limited to allowing HGI to repeatedly supplement the documentation provided to support its invoiced labor rates and requiring HGI to develop a corrective action plan to deliver a fully functioning eGrants system) but ultimately could not resolve these matters before the contract was terminated by mutual agreement and litigation ensued. Numerous issues were joined in the litigation, including the issue of performance adjustments and liquidated damages.

Importantly, OIG is not questioning DCA's business judgment. Rather, OIG simply disregards the business judgment standard and, instead, evaluates the settlement amounts paid to HGI and all of the issues joined in the litigation based on strict auditing and accounting principles. OIG also simply substitutes its own judgment for that of the State regarding the application of performance adjustments. In doing so, OIG contradicts well settled case law, federal regulations and HUD's own guidance.

[4] The State recognizes that the Handbook is directed to Public Housing Agencies. However, HUD has not provided any other guidance on this topic to States or other grantees. In the absence of any other materials, the Handbook should be relied upon because it serves as the only HUD guidance on the settlement of contract disputes.

Auditee Comments and OIG's Evaluation

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d. The State Took Steps to Ensure that Other Direct Costs were Purchased at Fair and Reasonable Prices

Comment 12

The State agrees the contract required HGI to follow the federal procurement regulations at 24 C.F.R. § 85.36 for other direct costs, yet notes that HGI was performing under a very constrained timeline, and disagrees with the claim that HUD has no assurances that the prices were fair and reasonable.

1. Other Direct Costs Were Purchased at Fair and Reasonable Prices

By May 2013, more than six months after the storm, thousands of New Jersey citizens remained in desperate need of housing services. The State was moving as expediently as possible to launch necessary CDBG-DR funded programs. The State submitted its proposed CDBG-DR Action Plan to HUD on March 27, 2013, which HUD approved on April 29, 2013. Concurrent with this HUD approval process, the State issued the SSHIP RFQ on April 17, 2013. On May 9, 2013 just three weeks after the issuance of the RFQ and nine days after HUD's approval of the Action Plan, the State and HGI executed the SSHIP contract.

Comment 12

HGI was required to begin outreach 10 days after the contract award, secure building leases, purchase computer equipment and office furniture to ensure the housing recovery centers were operational 30 days from the date of contract, and begin taking applications online, in-person and over the phone 30 days after the contract award. *See* SSHIP RFQ, section 3.1.1. Under these constraints, appropriate steps were taken to ensure other direct costs purchased under the SSHIP contract were reasonably priced. HGI purchased used furniture and fixtures for the housing recovery centers from a pharmaceutical company that was going out of business and purchased its IT equipment at catalogue prices. DCA is currently compiling a comparison of purchase prices against market prices for these assets to confirm that these costs were reasonable.

Comment 13

DCA also disagrees with OIG's finding that the State did not provide purchase authorizations for other direct costs. The task orders issued by the State and signed by the contract manager and an HGI official authorized cost limits for labor, travel and other direct costs. The signed task orders serve as the purchase authorizations for the State contract manager. For example, Task Order 1 (which was signed by the State contract manager and HGI) listed out nine specific locations in each impacted county where HGI was required to secure leases and equipment to operate housing recovery centers. Task Order 1 authorized HGI to spend a maximum of $9.6 million for labor, other direct costs and deposits for the leases. Thus, the State contract manager provided authorization for these purchases.

Comment 14

2. The Audit Report Mischaracterizes HGI's Leases and Inaccurately Claims that HGI Overpaid for the Leases for the Housing Recovery Centers

Although OIG's audit report accurately summarizes instances where HGI's leased square footage and per square foot rates exceeded task order amounts, it fails to note the several other instances where

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Comment 14

HGI's leased square footage and per square foot rates were significantly lower than the amounts authorized by the task orders. As a result, the audit report fails to provide fully accurate information or acknowledge that HGI's negotiations actually resulted in overall savings to the State when compared to the approved square footage and lease rates in the contract. The following chart provides the complete lease information for HGI's housing recovery centers that is missing from OIG's audit report:

HGI Leased Square Footage Summary

	Amounts Authorized by Contract				Actual Amounts Negotiated		
Location	Square Ft.	$/SF	Total Authorized		Square Ft.	$/SF	Total Paid
Lakewood	15,200	$ 21.00	$ 319,200		15,200	$ 13.50	$ 205,200
Freehold	15,000	$ 21.00	$ 315,000		20,874	$ 23.00	$ 480,102
Egg Harbor	7,800	$ 21.00	$ 163,800		7,472	$ 20.00	$ 149,453
Springfield	4,634	$ 21.00	$ 97,314		3,335	$ 20.00	$ 66,700
Paramus	5,655	$ 21.00	$ 118,755		5,655	$ 22.50	$ 127,238
Edison	7,000	$ 21.00	$ 147,000		7,000	$ 20.00	$ 140,000
Cape May	1,560	$ 21.00	$ 32,760		1,521	$ 12.00	$ 18,252
			$ 1,193,829				$ 1,186,945

As the chart illustrates, HGI's lease negotiations actually resulted in savings (when compared to the amounts authorized by the task orders) of $6,884. And, overall, HGI rented space at an average rate of $20.23, or $0.77 less than the amount authorized for the leases in the SSHIP contract. OIG's report is factually inaccurate because it fails to provide the full context on this issue and fails to recognize that HGI's leasing efforts resulted in savings, as opposed to cost overruns, for the State. Accordingly, this audit finding should be removed or revised to accurately explain the aggregate cost savings and average rental rates.

e. SSHIP Labor Costs Were Fully Supported.

OIG identifies various issues with timesheets and asserts that $516,560 disbursed to HGI was unsupported. As discussed below, DCA disagrees with all of OIG's labor cost findings.

1. The State Located Many of the Purportedly Missing Timesheets

Comment 15

OIG incorrectly asserts that DCA is missing 20 time records. The State was first notified of these purportedly missing timesheets on May 9, 2016, almost nine months after the start of the SSHIP audit. The State has conducted an internal review and has already located 13 timesheets out of the 20 OIG alleges to be missing. The 13 timesheets already located support a total amount of $54,830. The State will locate the remaining 7 timesheets (for an approximate total of $15,266) and will ensure that all timesheets are available for HUD review.

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Comment 16

2. Timesheets from a Fully Automated Timekeeping System Do Not Require "Wet" Signatures.

The State has also reviewed the timesheets that OIG considers "unsigned" and found that 158 timesheets were submitted through a fully automated electronic timekeeping system and an additional 12 were reviewed and authorized by the employees' supervisors. OIG's finding ignores these additional indicia of reliability, as well as the realities of modern timekeeping. Although the identified timesheets lack "wet" signatures from the employees, they are sufficiently supported.

HGI and its subcontractors' use of a fully automatic electronic timekeeping system sufficiently accounts for each employee's use of time and satisfies federal cost principle requirements. The guidance document that supports the implementation of those federal cost principles instructs that a digital signature may be utilized if the personnel activity reports are fully computerized and paperless. *See Implementation Guide for Office of Management and Budget Circular A-87*, § 3-16. Further, a unique personal identification number (PIN) or password can constitute a valid electronic signature. *See IRS Pub. 1345*, at 19-20 (explaining that the Internal Revenue Service accepts a PIN as an electronic signature in lieu of a hand-written signature). HGI's fully automated timekeeping system adheres to this federal guidance by ensuring that timesheets are verified by an employee using a login and password system.

The remaining 12 timesheets were not signed by employees but were reviewed and authorized as accurate by the employees' supervisors. The supervisors' verifications provide a reasonable assurance that their employees performed all of the work identified in the timesheets.

This growing de-emphasis on "wet" signatures is demonstrated by the newly enacted Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards ("Uniform Guidance"), which supersedes the federal cost principles found at 2 C.F.R Part 225. *See* 2 C.F.R. § 200.104; 2 C.F.R. § 200.110; 2 C.F.R. § 2400.101. The Uniform Guidance applies to all HUD awards made on or after December 26, 2014, and streamlines and consolidates several regulations under Title 2 of the Code of Federal Regulations (including 2 C.F.R. Part 225) into one set of guidance. *See* 2 C.F.R. § 200.104; Uniform Guidance, 78 Fed Reg. 78590. These changes were intended to "make government more accountable to the American people while eliminating requirements that are unnecessary and reforming those requirements that are overly burdensome." Uniform Guidance, 78 Fed. Reg. 78591. In achieving these goals, the signature requirement relied upon by OIG in the superseded 2 C.F.R. Part 225, Appendix (B)(8)(h)(4), was evidently deemed unnecessary and overly burdensome, and was not included in the Uniform Guidance.

The timesheets submitted by HGI meet federal requirements because the employees clearly entered their time into computerized timekeeping systems or had their time approved by supervisors. These methods of verification ensure that costs are supported and are sufficient to comply with both the new and the superseded federal cost principles. Accordingly, this finding is inaccurate and any amounts questioned as a result of this finding should be removed from the audit report.

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Comment 17

3. Weekly Timesheets are Permissible Pursuant to Federal Cost Principles and the SSHIP Contract

OIG fails to provide any legal or contractual support for its finding that timesheets for 45 HGI employees were required to be submitted in a weekly format. On the contrary, the federal cost principles only require personnel activity reports to be prepared monthly. *See* 2 C.F.R. Part 225, Appendix B (8)(h)(5). Likewise, the SSHIP contract simply required the contractor to document the hours worked and tasks accomplished. *See* "New Jersey Standard Terms and Conditions," section 6.3(b). The State's Standard Terms and Conditions then provide a sample bi-weekly timesheet as "[a] form of timekeeping record that should be adapted as appropriate for the Scope of Work being performed." Nothing in the terms of the contract required HGI to provide weekly timesheets.

Nevertheless, the timesheets submitted by HGI contained a breakdown of the hours worked and activities performed by each employee on a daily basis, thus allowing DCA to review the charged labor costs at an even more granular level than contemplated by federal cost principles or the SSHIP contract. Of course, this also permitted the State to easily group the daily breakdown of labor costs by week if it chose to do so. As a result, the State appropriately accepted these timesheets, which reflected daily activity, as adequate to meet, both in substance and in spirit, the contractual requirement calling for the submission of documented hours worked.

Comment 18

4. The State's Reconciliation Fully Supported the Labor Charges

Overall, DCA ensured that payments made under the contract were fully supported despite OIG's findings to the contrary. DCA methodically reviewed and reconciled all of HGI's invoices and invoice support. Over 1,200 employees billed time under the HGI contract, and DCA performed an individual-by-individual review of every employee's time records to ensure that the labor titles and corresponding labor rates that HGI claimed for each individual were appropriate. DCA adjusted HGI's invoices down approximately $10.7 million to account solely for labor category discrepancies. DCA did not pay any invoiced labor charges if HGI did not submit an approved timesheet from the individual that supported the invoiced labor charges. Nor did DCA pay the labor rate billed if the individual's work was not commensurate with the labor title/rate assigned by HGI.

Comment 19

f. The Overwhelming Majority of Travel Costs are Already Fully Supported

DCA is reviewing OIG's findings for $11,268 in alleged missing support for travel expenses and will ensure that adequate support is provided to HUD to fully justify these expenses. Notably, OIG recognizes that $9,430 of the total amount questioned in this finding is supported by receipts but the audit report simply claims that these costs were mischaracterized as "travel expenses" when they should have been accounted as "office expenses" for printing and office supplies. DCA explained to OIG that these printing and supply expenses were incurred by an HGI employee while traveling, and thus were reasonably accounted as "travel expenses." DCA will re-categorize these expenses as appropriate, but

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these costs clearly represent eligible expenses under the contract that were fully supported and should not be considered to be questioned disbursements.

Comment 20

g. The State Appropriately Managed SSHIP Furniture and IT Assets

DCA maintains a comprehensive cataloguing system to properly manage and track all of the furniture and IT assets purchased under the SSHIP contract in compliance with State and federal requirements. DCA supplied OIG with printouts and databases from its electronic cataloguing systems which meticulously detailed the status of SSHIP assets, including up-to-date information on:

- Item descriptions;
- Manufacturer and model;
- Physical location;
- Serial numbers;
- Acquisition costs;
- Acquisition dates;
- Depreciation values;
- Current condition; and
- Asset barcoding.

DCA's practices stem from its internal policies, which dictate that these asset inventories must comply with federal regulations (24 C.F.R. § 85.32) and State guidance (New Jersey Department of Treasury Circular No. 08-03-DPP and Circular No. 13-18-DPP). As required by its policy, DCA also updates its inventories on a continual basis to reflect the movement or disposal of any SSHIP equipment. It is unclear why OIG appears to take exception to DCA's practice of updating its inventories. Nevertheless, DCA is confident that its comprehensive policies and procedures comply with both the letter and the spirit of State and federal asset management requirements.

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Thank you for your consideration of our positions. As always, we look forward to continuing our close partnership with HUD and OIG as we address these important disaster recovery issues.

Respectfully submitted,

Jordan E. Johnston
Deputy Attorney General
Superstorm Sandy Compliance Unit

OIG Evaluation of Auditee Comments

Comment 1 The State contended that many of the issues noted in the report are duplicative of the issues it identified and corrected during the life of the contract. We disagree. Because the State had identified several issues, we conducted our documentation review on amounts the State determined to be accurate and supported. Therefore, the issues and dollar amounts addressed in recommendations 1B, 1C, 1D, and 1E are not duplicative.

Comment 2 The State contended that its methodology for allocating costs to programs and national objectives was reviewed and approved by HUD and that the methodology used by HGI resulted in roughly the same distribution among national objectives. However, it provided no documentation to show that HUD approved its methodology, nor did it provide us documentation to support the cost allocation used by HGI among activities and national objectives and to show that it had achieved the selected national objectives. The State is responsible for maintaining documentation to show that it used funds for eligible program delivery costs that met the selected national objectives.

Comment 3 The State contended that the audit report is legally and factually inaccurate to the extent that it suggests that precontract costs are ineligible and cited regulations at 48 CFR 31.205-32 as its basis. However, 48 CFR applies to Federal executive agencies. As a grantee of disaster funds, 48 CFR does not apply to the State. Regardless, we did not question the precontract costs on their face value. We compared the costs to the executed contract and to the first task order. In this case, the labor, travel, and other direct costs were incurred between May 2 and May 8, 2013. However, the contract was not awarded until May 8, 2013, and not executed until May 9, 2013. Also, the first task order under the contract listed the performance period as starting on May 9, 2013. Although these expenses may be eligible under the program, they were not eligible in this instance because the contractor incurred them before the contract was executed and before it was authorized to do so under the first task order.

Comment 4 The State contended that we incorrectly asserted that it was required to follow Federal rather than its own procurement rules. It also contended that it was not required to conduct a prebid cost estimate or postbid cost analysis because Federal law required it to follow its own procurement practices. We disagree. As a condition of making any grant under the Disaster Relief Act, the HUD Secretary was required to certify in advance that grantees had in place proficient financial controls and procurement processes. To establish a basis for the Secretary to make the certifications required by the Disaster Relief Act, HUD required the State to either (1) certify that it had adopted the specific procurement processes identified in 24 CFR 85.36 and indicate the sections of its standards that incorporated the specific procurement standards identified in 24 CFR 85.36 or (2)

certify that it had a procurement process that was equivalent to the procurement standards at 24 CFR 85.36 and provide a crosswalk indicating which sections of its standards aligned with each procurement provision of 24 CFR 85.36. As discussed in the report, the State chose to certify that its policies and procedures were equivalent to the procurement standards at 24 CFR 85.36. Therefore, while Federal law allowed the State to use its procurement process, this was contingent upon the State's process being equivalent to each of the specific procurement provisions of 24 CFR 85.36. These provisions included requiring a prebid cost estimate and postbid cost analysis.

Comment 5 The State contended that we raised the cost estimate and cost analysis concerns in two previous audit reports and that final resolution of the issue is pending with HUD. It also questioned the basis for our finding, asserted that we planned to question the total dollar value of every State contract, and requested that we remove the finding until the issue is resolved. We did raise these issues in two previous audit reports, and we are working through the management decision process with HUD to resolve them. (See the Followup on Prior Audits section of this report.) However, OIG's mission is independent and objective reporting to the HUD Secretary and Congress to bring about positive change in the integrity, efficiency, and effectiveness of HUD operations. Since OIG is an autonomous provider of oversight, it is not unusual for program elements within HUD and our office to have differing views. That is why Congress placed inspectors general in an objective role to assess the facts and come to conclusions based on such disinterested analyses. We are not required to hold audit reports until issues from other audit reports are resolved. Instead, we include a section in the report addressing our followup on prior audits. Further, we note that the finding and recommendations in this report are not based solely on the lack of an independent cost estimate and cost analysis.

Comment 6 The State contended that we improperly sought to substitute our judgment for its judgment in resolving the contract dispute with HGI because Federal law and HUD handbook guidance provide that States are responsible to resolve all claims or disputes arising under a federally funded contract. We did not substitute our judgment for the State's judgment. The State was still required to comply with HUD, Federal, and other applicable requirements. We conducted our documentation review on amounts the State determined to be accurate and supported. We compared the documentation against Federal program, procurement, travel, and cost principle requirements and the State's contract documents. The State acknowledged our authority to classify costs as ineligible and unsupported when it included a clawback provision in the settlement agreement with HGI that required it to pay back any amounts disbursed under the contract to the extent that HUD, OIG, or any other Federal agency determines that any costs were ineligible or unallowable.

Comment 7 The State contended that HUD confirmed that it was legally required to follow its procurement process in 2013 when it certified that the State had a proficient procurement process in place. We acknowledge that HUD certified that the State had a proficient procurement process. Specifically, HUD staff completed a certification checklist in which it certified that the State's process was equivalent to each of the specific procurement provisions of 24 CFR 85.36. However, as noted in a recent internal audit report (2016-PH-0005, dated September 29, 2016), HUD did not always adequately evaluate the supporting documentation submitted by State grantees and did not always provide accurate and supported certifications of State disaster grantee procurement processes. Regardless of whether HUD's certification was accurate and supported, the State was required to ensure that its certification was accurate and supported and that its procurement process was equivalent to each of the specific procurement provisions in 24 CFR 85.36, as it indicated in the required crosswalk that it attached to its certification.

Comment 8 The State contended that it undertook exhaustive efforts to review the accuracy, reasonableness, and necessity of all disbursements made under the contract as part of its contract management efforts and claimed that the report failed to recognize or include these exhaustive efforts. For example, the State claimed that it regularly met with HGI to discuss problems, cost overruns, and proposed solutions. The State also claimed that while the report highlights the fact that HGI billed the State more than $57 million in just 9 months, we failed to understand that the State did not pay $57 million and instead discounted HGI's billings and paid only $43.5 million, which is $14 million less than the amount HGI invoiced. Pages 4, 11, 12, 14, and 15 of the report acknowledge that the State performed an invoice reconciliation and considered only $45.3 million as accurate and supported. We commend the State for adjusting HGI's billings for amounts that it did not believe were accurate and supported. However, these adjustments were related to the supporting documentation submitted by HGI and did not show that the State also considered the amounts paid against all applicable Federal requirements, the contract, and the contractor's performance. Further, our review of the amount the State considered accurate and supported for the selected invoice identified several issues. For example, the State did not always ensure that (1) other direct costs were fully supported and the prices paid were fair and reasonable, (2) labor costs were fully supported, and (3) travel costs were fully supported.

Comment 9 The State contended that we implied that it failed to account for performance adjustments on page 12 of the report. It further claimed that the settlement took into consideration all of the issues joined in the litigation, which included performance adjustments and the applicability and amount of liquidated damages, and contended that its identification of HGI's performance deficiencies allowed it to negotiate a settlement that was advantageous to the State and HUD. On page 12 of the report, we explained that the State incorporated performance requirements and penalties into the contract as required, identified performance

issues during the contract term, and notified HGI that performance adjustments would need to be made. We also acknowledged that the State later reached a settlement agreement with HGI that brought the total disaster funds paid to $43.1 million. We did not claim that the State failed to account for performance adjustments. On page 5 of its comments, the State listed more than $20.5 million in performance adjustments, including $11 million to replace the management information system, $9.5 million in liquidated damages because the system did not meet contract specifications, a percentage reduction in the amounts payable under several sections of the contract scope of work to reflect what the Department of Community Affairs determined to be poor quality of work, and costs associated with the State's re-review of HGI's eligibility and ineligibility determinations. The State also provided us with a June 2015 letter it sent to HUD listing the $20.5 million in performance adjustments identified and an August 2013 presentation showing earlier performance adjustment calculations that it presented to HGI. However, it did not provide documentation showing that the performance adjustment calculations were factored into the settlement. Further, regardless of how the settlement was reached and whether it considered the performance adjustment calculations, the State still needed to demonstrate that the amount it disbursed was reasonable and necessary to comply with Federal cost principle requirements. If the State had deducted the $20.5 million in performance adjustments that it had calculated to date[15] from the $45.3 million it had considered accurate and supported, only $24.8 million[16] would have been considered payable. Because the amount it disbursed under the contract was $18.3 million[17] more than this, we believe the State should have provided more justification to show that the $43.1 million it paid was reasonable and necessary.

Comment 10 The State contended that we did not evaluate its resolution of the contract claims according to the proper standard and should have considered the business judgment standard. To support this contention, it cited case law, regulations at 24 CFR 85.36(b)(11), HUD Handbook 7460.8, and a Block Grant guidebook. The State claimed that we disregarded the business judgment standard and instead evaluated the settlement amounts paid and all issues joined in the litigation based on strict auditing and accounting principles, while substituting our own judgement for that of the State. The case law the State cited discusses corporate law rather than rules surrounding Federal funds. Federal regulations at 24 CFR 85.36(b)(11) state that grantees and subgrantees alone are responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements and that Federal agencies will not substitute their judgment for that of the grantee or subgrantee

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[15] The $20.5 million calculated by the State included only the amount needed to replace HGI's system and liquidated damages. It did not consider the other types of performance adjustments it had identified.

[16] $45.3 million (amount the State considered accurate and supported) - $20.5 million (performance adjustments calculated by the State) = $24.8 million

[17] $43.1 million (total disaster funds disbursed for the contract) - $24.8 million = $18.3 million

unless the matter is primarily a Federal concern. However, the State was still required to comply with HUD, Federal, and other applicable requirements. While the HUD handbook the State cited states that public housing agencies should apply prudent business judgment when determining fair compensation for a terminated contract as opposed to strict accounting principles, the State is not a public housing agency. Lastly, the Block Grant guidebook the State cited states that the Federal guidelines for contracting are designed to help ensure that contracts are structured in a way that is consistent with good administrative practices and sound business practices. To be consistent with good administrative practices and sound business judgment, the State should have ensured that disaster funds it disbursed to HGI were for costs that were eligible, supported, reasonable, and necessary.

Comment 11 The State contended that we disregarded the business judgment standard and instead evaluated the settlement amounts paid and all issues joined in the litigation based on strict auditing and accounting principles, while substituting our own judgement for that of the State. We disagree. We did not apply strict accounting principles to evaluate the settlement amounts. For example, because payments were not always directly tied to invoices, we conducted our documentation review on amounts the State determined to be accurate and supported. We compared the documentation against Federal program, procurement, travel, and cost principle requirements and the State's contract documents. Further, the State acknowledged our authority to classify costs as ineligible and unsupported when it included a clawback provision in the settlement agreement with HGI that required it to pay back any amounts disbursed under the contract to the extent that HUD, OIG, or any other Federal agency determines that any costs were ineligible or unallowable.

Comment 12 The State agreed that the contract required HGI to follow Federal procurement regulations at 24 CFR 85.36 for other direct costs. It noted that while HGI was performing under a very constrained timeline, appropriate steps were taken to ensure that other direct costs purchased under the contract were reasonably priced. Specifically, the State claimed that HGI purchased used furniture and fixtures from a company that was going out of business and purchased information technology equipment at catalogue prices. However, the documentation it provided during the audit did not show that it purchased used furniture and fixtures from a company that was going out of business or that it purchased information technology equipment at catalogue prices. Further, the State could not support its claim that appropriate steps were taken to ensure that the prices paid were reasonable because its documentation did not show the procurement process used for each purchase. Therefore, it could not show that the transactions were conducted in a manner providing full and open competition and that its contractor prepared cost estimates and cost analyses when required. Regardless of the time constraints it was under, the State should have ensured that its contractor followed the requirements of 24 CFR 85.36 when making purchases

and that the contractor provided adequate documentation to show that the prices paid were fair and reasonable before disbursing funds to the contractor.

Comment 13 The State contended that the task orders issued by the State and signed by the contract manager authorized cost limits for other direct costs and served as purchase authorizations for the State contract manager. However, the contract required HGI to obtain authorization from the State's contract manager before making purchases and to submit documentation authorizing purchases with invoices. The first task order was not signed by the State's contract manager until May 30, 2016. However, before the task order was signed, HGI had spent $1.2 million for furniture and fixtures, temporary office space, computer equipment, software, office supplies, and legal services. It had also signed leases for the housing recovery centers. Therefore, the first task order could not have served as an authorization for these purchases. Further, besides listing locations for the leases, the first task order did not list the specific other direct costs for the State's contract manager to review before authorizing the purchase as required by the contract. The State should have ensured that HGI provided adequate documentation to show compliance with applicable requirements before disbursing funds to the contractor.

Comment 14 The State contended that although the report accurately summarized instances in which HGI's leased square footage and per square foot rates exceeded task order amounts, the report failed to provide the full context on this issue. The State noted that HGI's negotiations resulted in overall savings to the State, as opposed to cost overruns, because there were several instances in which the leased square footage and per square foot rates were significantly lower than the amounts authorized. However, because HGI was required to follow Federal procurement requirements for each purchase, we considered each lease individually. If HGI was able to negotiate a lower price per square foot for one location than it had listed in its proposal, we would have expected it to do so because it was conducting the procurement in a manner providing full and open competition. However, if after following applicable procurement requirements to ensure full and open competition, HGI was not able to obtain a space within the square footage and rates authorized by the State, it should have obtained approval from the State for the higher amount before executing the lease.

Comment 15 The State said it had located 13 of the 20 missing timesheets and would locate the remaining 7 timesheets. We disagree that the State located 13 of the 20 missing timesheets. During the course of the audit, we requested that the State provide all of the time records related to the invoice selected for review. While the documentation was not organized, we conducted a thorough review to compare each timesheet to the State's reconciliation spreadsheet. We provided the State with a list of the labor charges for which we did not have a corresponding timesheet. Although the State expressed having significant difficulty in locating them, it provided several timesheets for our consideration. We accepted several

of the timesheets provided and removed them from the results in the draft report. However, we did not accept the 13 timesheets in question because the names on the timesheets did not match the names listed in the State's invoice reconciliation for the 13 labor charges. In some instances, we found that the timesheet provided was for a name that was listed separately on the invoice reconciliation with charges for the selected invoice, so the names clearly identified separate employees. In other instances, we did not accept the timesheets because the names were significantly different from the names listed on the reconciliation spreadsheet. For example, the State submitted timesheets with the name "Precious" for "Leroy," "Clover" for "Simone," "Larry" for "Anne," and "Anthony" for "Monica." The State's difficulty in locating supporting documentation for labor charges that it previously determined were accurate and supported shows that it did not adequately review the timesheets with the invoice to ensure that they complied with all applicable requirements before disbursing funds for the labor charges.

Comment 16 The State contended that timesheets from a fully automated timekeeping system do not require wet signatures. It also claimed that we ignored timesheets that were submitted through a fully automated timekeeping system and timesheets that were reviewed and authorized by the employees' supervisors. It also cited newly enacted Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards. We agree that timesheets from a fully automated timekeeping system would not require wet signatures. However, the Federal cost principle requirements that apply to these funds required an employee signature, and the timesheets in question did not have wet or digital signatures from the employees.

Comment 17 The State contended that we failed to provide legal or contractual support for our finding regarding the requirement for weekly timesheets. The State further contended that Federal cost principle requirements required only monthly personnel activity reports and that the timesheets in question showing daily charges provided more detail than contemplated by Federal cost principle requirements and the contract. We agree that Federal cost principle requirements required the timesheets to be prepared at least monthly. However, section VIII of the "Method of Operation, Management, and Other Related Service for Superstorm Sandy Housing Incentive Program" required HGI to submit copies of weekly timesheets for employees assigned to do the work referenced in the invoice. In line with this requirement, the State provided weekly timesheets for 224 individuals related to the invoice selected. While the timesheets in question provide a daily accounting of time for the 45 individuals, they covered more than 1 month and were not signed by the employees. Because the timesheets were not signed by the employees at least monthly, they do not meet Federal cost principle requirements.

Comment 18 The State contended that it methodically reviewed and reconciled HGI's invoices and supporting documentation, performed an individual-by-individual review of each employee's time records to ensure that the labor titles and labor rates were appropriate, and did not pay any invoiced labor charges that were not supported by an approved timesheet. The State provided an invoice reconciliation spreadsheet related to its review. However, for the invoice that we reviewed, the documentation the State provided did not always match the amount it considered accurate and supported. For example, there were not always time records for employees named on the reconciliation spreadsheet, the hours on the timesheets did not always match the invoice reconciliation, and the timesheets were not always signed. As a result, we recommended that HUD direct the State to provide documentation to support $516,560 disbursed for wages and salaries or repay HUD from non-Federal funds for any amount that it cannot support.

Comment 19 The State said it would provide adequate support to HUD to fully justify the $11,268 in travel costs allegedly missing support. It also noted that while it would recategorize the $9,430 in office expenses incurred by an HGI employee while traveling, these costs were clearly eligible expenses under the contract that were fully supported and should not be questioned. We commend the State for its plan to provide adequate documentation to HUD to fully justify the $11,268 in travel costs identified in the report. However, we disagree that the $9,430 should not be questioned. If the State recategorizes the office expenses as other direct costs, it will need to provide required purchase authorizations and documentation showing that the prices paid for the services and products were fair and reasonable.

Comment 20 The State contended that it maintains a comprehensive cataloguing system to properly manage and track all of the furniture and information technology assets purchased under the contract in compliance with State and Federal requirements. The State further stated that it had provided us printouts and databases, which detailed the status of assets. However, as stated in the audit report, the inventories provided by the State did not always contain information required by its policy and did not always reconcile to previous equipment records. As part of the audit resolution process, HUD will need to assess any documentation the State provides to determine whether it has complete and up-to-date inventory and equipment records, including records of disposition of any assets.

Appendix C

Timeline of Key Dates

4/17/2013	The State issued the request for quotation.
4/29/2013	HGI submitted a bid for $68.8 million.
	Contractor B submitted a bid for $196.2 million.
4/30/2013	The State requested best and final offers from HGI and Contractor B by noon on May 2, 2013.
5/1/2013	HGI submitted its best and final offer of $67.7 million.
5/2/2013	Contractor B submitted its best and final offer of $194.4 million.
	The State evaluation committee conducted its evaluation of the best and final offers provided by HGI and Contractor B and recommended that the State select HGI.
	The State sent HGI and Contractor B letters notifying them of its intent to award the contract to HGI and requesting that any comments or protest be made by May 7, 2013.
5/8/2013	The State awarded the contract to HGI.
	The State debriefed Contractor B.
5/9/2013	The State executed the contract.
6/10/2013	Date of the first invoice submitted by HGI
8/5/2013	The State indicated that it met with HGI to discuss its performance and required it to develop a corrective action plan by August 12, 2013. The State subsequently created a corrective action plan, which is not dated or signed.
12/6/2013	The State and HGI reached a mutual agreement to terminate the contract. The agreement included a transition period and required the State to make interim payments totaling $10.5 million.
12/11/2013	The State made a $9 million interim payment to HGI.
12/18/2013	The State made a $1 million interim payment to HGI.
12/19/2013	The State made a $500,000 interim payment to HGI.
1/20/2014	Last day HGI worked under the contract
5/7/2015	The State reached a settlement agreement and release date with HGI.
6/12/2015	The State made a final payment of $7.6 million to HGI.