New York City Housing Authority
Department of Internal Audit & Assessment

Minutes of Audit Committee Meeting
May 13, 2019

Board and Audit Committee Members:
Victor A. Gonzalez, Co-Chair
Mark N. Kaplan, Independent Member
Richard P. Kuo, Independent Member

NYCHA Staff Members- Present:
PV Anantharam, Executive Vice President and CFO
Vilma Huertas, Special Advisor to the Chair, Office of the Chair
Dan Frydberg, Controller, Financial Reporting & Accounting Services
Hyacinth Jeffers, Acting Director, Department of Internal Audit & Assessment
Anil Agrawal, Assistant Director, Department of Internal Audit & Assessment
Jacqueline Palmer, Assistant Director, Department of Internal Audit & Assessment
Svetlana Cibic, Deputy Director, Treasury Operations
Mike Hudick, Assistant Director, GAAP Analysis, Financial Reporting & Accounting Services

Deloitte & Touche LLP – Present:
Jill Strohmeyer, Managing Director
Darshan Patel, Audit Specialist Leader
Megan Martin, Audit Senior Manager

A meeting of the Audit Committee members of the New York City Housing Authority (the "Authority") was held on May 13, 2019 at 10:00 AM in the Board Room of the Authority at 250 Broadway, New York, New York 10007.

Hyacinth Jeffers, Acting Director of the Department of Internal Audit & Assessment, commenced the meeting at 10:05 AM by referring to the agenda for the meeting.

I. Approval of Minutes:
Upon motion duly made and seconded, the Audit Committee Members unanimously approved the minutes of the April 18, 2019 Audit Committee meeting.

II. SAS 114 Letter from Deloitte:
Jill Strohmeyer, Managing Director from Deloitte discussed the Statement of Auditing Standards (SAS) 114 which covers the Independent Auditors' required communication with the Audit Committee and senior management. Key points relating to this communication are that:

- Deloitte is an Independent Auditor with respect to the Authority, and audited the financial statements for the New York City Housing Authority, NYCHA Public Housing Preservation I, LLC ("LLC I"), and NYCHA Public Housing Preservation II, LLC ("LLC II") for the year ended December 31, 2018.
- The report is expected to be dated on or about today (May 13, 2019).
- In 2018, the Authority adopted Governmental Accounting Standards Board ("GASB") Statement No. 83, *Certain Asset Retirement Obligations.* The impact on the financial statements is disclosed in Note 2 to the 2018 financial statements.
- There were no uncorrected misstatements or disclosure items identified during the audits of NYCHA and LLC I.
- During the testing of tenant revenue for LLC II for the year ended December 31, 2018, one error in the amount of $324 was identified. If extrapolated based on sample size and applied to entire population, this error could result in a potential overstatement of $516,234 in tenant revenue for the year ended December 31, 2018. Such potential unrecorded error was determined by management to be immaterial to the financial statements taken as a whole.
- There was no disagreement with management with regard to the financial statements, and the auditors received full cooperation from management and their team during the course of the audit.
- The audit was performed in accordance with generally accepted auditing standards, generally accepted government auditing standards, and the OMB Uniform Grant Guidance.
- The Deloitte's Independent Auditor report contains an unmodified opinion.
- There were no significant deficiencies noted during the audit.
- The emphasis of matter paragraph was added due to the adoption of Governmental Accounting Standards Board Statement No. 83, *Certain Asset Retirement Obligations.*
- Other-Matter paragraphs relate to the Required Supplementary Information per GASB.

Deloitte plans to issue the reports on the 2018 financial statements shortly after the Audit Committee meeting. However, there are three management representation letters attached as Appendix to the SAS 114 Letter, which will need to be signed by management prior to issuance of the audit reports.

Megan Martin, Audit Senior Manager from Deloitte provided a briefing on three accounting estimates tested during the course of audit. These accounting estimates relate to Pension Benefits, Other Post-employment Benefits (OPEB), and Estimated Liabilities arising from injuries to persons. Based on the procedures performed, amounts reported related to pension benefits as well as worker's compensation and general casualty reserves appear reasonable in the context of the financial statements taken as a whole.

Mr. Gonzalez raised concern whether there would be a quorum at the upcoming NYCHA Board meeting to approve the financial statements. Vilma Huertas, Special Advisor to the Chair stated that a quorum is expected for the next Board meeting.

Mr. Kuo inquired whether Deloitte had a chance to meet with the Acting (Interim) CEO. Ms. Strohmeyer, Managing Director from Deloitte, stated that they met the current Interim Chair last week, and had a very good meeting.

III. NYCHA's Consolidated Comprehensive Annual Financial Report (CAFR) for 2018:
Dan Frydberg, Controller provided highlights of the 2018 Consolidated Comprehensive Annual Financial Report (CAFR) for NYCHA. There were three significant events that impacted NYCHA's Financial Statements for the year ended December 31, 2018:

1. **Implementation of GASB Statement No. 83, Asset Retirement Obligations.** This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs) An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. The financial impact of implementing GASB 83 was a restatement of $52.7 million, reducing opening net position for 2017. This restatement resulted in the recognition of an asset retirement obligation liability mainly due to the decommissioning of fuel oil tanks. Also, under GASB 83, a deferred outflow is recognized over the used life of the assets. As of December 31, 2017, the asset retirement obligation liability was $70 million.

2. **Recognition of Pollution Remediation Obligations for Lead Paint and Mold**. Per HUD Regulations, an annual lead paint inspection is required of all target housing built prior to January 1, 1978. For NYCHA, the target housing consists of 135,000 units. Through 2018, NYCHA has completed visual inspections of all target units. The visual inspections identified areas with the possible presence of lead paint. To determine if lead paint is present in excess of legal thresholds, NYCHA has entered into contracts totaling $92 million to conduct x-ray fluorescence (XRF) testing at all units built prior to 1978. NYCHA cannot reasonably estimate the range of cleanup expenditure because it has not completed the lead paint testing. In addition, based on a 2018 settlement agreement, a liability in the amount of $8 million was recognized to remediate approximately 3,500 open work orders for mold.

3. **PACT Transactions.** PACT stands for "Permanent Affordability Commitment Together" program[1]. In 2018, the Authority entered into four real estate transactions involving nearly 2,500 units at 18 developments under the PACT program. The total lease amounts under these transactions was, $180 million, of which $20 million has been received. The Authority will recognize the cash received under this transaction as revenue over the shorter of the lease term or when the Purchase Option or Right of First Refusal can be exercised.

Further, Mr. Frydberg provided the following overview of the financial results for 2018:

- In 2018, NYCHA incurred a Loss Before Capital Contributions of $268 million, compared to a loss of $331 million for 2017.
- Operating Revenues decreased by $2 million.
- Tenant Revenue increased by $18 million due to an increase in the average monthly rent per unit.

[1] Permanent Affordability Commitment Together (PACT) program creates public-private partnerships to repair and manage the developments. It generates a sustainable funding source for extensive repairs and ongoing property management while guaranteeing permanent affordability and protecting tenant rights. PACT is New York City's implementation of the federal government's Rental Assistance Demonstration (RAD), which includes collaboration between NYCHA, residents, and housing advocates.

- Other Income decreased by $20 million due to lower developer fees received under development transaction and the reduction of certain liabilities that was recognized in 2017.
- Operating Expenses increased by $296 million, attributable to the following:
  - Housing Assistance Payments increased by $20 million, due to an increase in the cost per unit (from $1,000 in 2017 to $1,036 in 2018)
  - Utilities increased by $28 million, due to increases in electricity (price increase) and heating gas (consumption increase).
  - Maintenance and Operations increased by $202 million, due to higher pollution remediation costs, mainly for lead based paint and mold, other contracts, and materials.
  - General and Administrative increased by $52 million, due to adverse claim experience for prior year claims in NYCHA's self-insurance program.

- Non-Operating Revenues and Expenses increased by $361 million, mainly due to the following:
  - Section 8 HAP subsidy increased by $40 million, due to the increased need for housing assistance payments.
  - In 2018, City of New York subsidy increased by $86 million, primarily to cover the costs of XRF testing under the paint assessment program.
  - Federal Operating subsidy increased by $47 million due to higher subsidy eligibility and an increase in the HUD proration from 93.1% to 94.7%.
  - Capital Fund used for operating purposes increased by $66 million. Per HUD regulations, NYCHA is allowed to use 10 percent of the capital fund to cover central administrative costs.
  - Insurance Recoveries increased by $131 million due to a litigation settlement with NYCHA's insurance carriers relating to Superstorm Sandy.

Mr. Kaplan asked how much money was left in Capital Fund. PV Anantharam, CFO explained that total capital fund is about $528 million, and we still have resources available from prior years. The Mayor has committed $2.2 billion over 10 years per the federal Agreement. In addition, the New York State has allocated $450 million for capital improvements, which should be released soon with the appointment of the federal Monitor.

Mr. Kuo asked if money for administrative costs was used from capital fund. Mr. Anantharam elaborated that HUD allows 10 percent of the capital fund to cover central office administrative costs. The Authority opted not to utilize a portion of capital fund for such administrative costs in 2015 and 2016; however, we have now reverted back to use appropriately allocated portion for administrative costs as allowed per HUD regulations.

Mr. Gonzalez asked if NYCHA has received all the monies for Sandy recovery. Mr. Frydberg explained that NYCHA does not receive all the FEMA funds in advance. We draw the funds as money is expended for the contracts.

Mr. Kaplan raised an issue regarding sufficiency of depreciation amount in the financial statements, since the properties are not properly maintained. He asked: "Should description of depreciation be more pointed?" Mr. Frydberg explained that a descriptive section regarding deferred maintenance (physical needs) has been added in the Letter of Transmittal included in the package.

Mr. Kaplan asked why NYCHA is investing in municipal bonds, although it is a tax-exempt entity. Svetlana Cibic, Deputy Director of Treasury Operations responded that it is mainly related to federalization transaction financed through NYC Housing Development Corporation (HDC) and is based on HDC policy.

Further, Mr. Kaplan raised concern regarding a large amount of workers compensation liability of $350 million. Mr. Anantharam responded that it was based on actuarial assumptions and analysis.

Mr. Kaplan asked whether description of Pension Plan included in the financial statements is the same as what is included in the City's financials. Mr. Frydberg responded that NYCHA uses information received from the New York City Office of the Actuary.

Mr. Kaplan stated that he would provide a marked-up copy of the document to make grammatical corrections.

IV. Comprehensive Annual Financial Report (CAFR) for NYCHA Public Housing Preservation I, LLC ("LLC I") for 2018:

Mr. Frydberg provided the following background information regarding NYCHA Public Housing Preservation I LLC (LLC I):

1. It was created in 2010 and consists of an investor member (Wells Fargo) and an HDFC member who is wholly owned subsidiary of NYCHA. Through December 31, 2017 the investor member has contributed $228 million in tax credit equity payments.
2. Based on the Operating Agreement, NYCHA manages the operation of LLC I and is reimbursed by LLC I for operating expenses.
3. LLC I consists of 14,465 units which are funded as follows:
    a. 11,743 units received HUD subsidy
    b. 2,678 units received Section 8 funds
    c. 54 units received NYCHA subsidy.
4. In 2018, 24 NYCHA funded units were converted to Section 8.

In addition, Mr. Frydberg provided the following overview of the LLC I's financial results for the year ended December 31, 2018:

- LLC I's Loss Before Capital Contributions for 2018 was $28 million. However, the net cash flow from operating and financing activities was $12 million, which follows a trend for the past several years.
- There was an increase of $19 million in operating expenses compared to 2017, primarily because of pollution remediations costs, labor costs, and utilities (heating gas and electricity). The pollution remediation costs relate to roofing and Local Law 11 work begun is 2018 at Bay View Houses.

Further, Mr. Frydberg informed that during 2018, LLC I received capital contributions from the following sources:

- **NYCHA Contribution for Replacement Reserve –** Per the Operating Agreement, NYCHA is required to contribute $400 per unit for the public housing units in LLC 1. This amounted to $4.9 million in 2018.
- **Contribution Agreement** – Per the Contribution Agreement, City Capital funds expended by NYCHA on LLC I developments are considered contributions to LLC I. This amounted to $2 million in 2018.
- **Excess Operating Funds** - A portion of the excess funds from operations previously noted have been set-aside for capital work at LLC I. As of December 31, 2018, a total of $69 million has been budgeted from this source.
- For LLC I developments, total capital improvements in 2018 amounted to $30.3 million, mainly for Local Law 11 brickwork and façade work.

Mr. Gonzalez inquired who pays for the cost of scaffolding raised for tenant safety under Local Law 11 (for example, loose bricks) but there is no fund for repairs. Mr. Anantharam responded that there are funds appropriated for façade repairs, and NYCHA also receives some CDBG (Community Development Block Grant) funds from the City. Mr. Gonzalez expressed his concern regarding ongoing expenditure for scaffolding due to lack of funds for repairs.

V. Comprehensive Annual Financial Report (CAFR) for NYCHA Public Housing Preservation II, LLC ("LLC II") for 2018:

Mr. Frydberg provided the following background information regarding NYCHA Public Housing Preservation II LLC (LLC II):

1. NYCHA Public Housing Preservation II LLC (LLC II) was created in 2010 and includes NYCHA II Housing Development Fund Corporation, a wholly owned subsidiary of NYCHA.
2. NYCHA manages the operation of LLC II and is reimbursed by LLC II for operating expenses.
3. LLC II consists of 5,694 units which are funded as follows:
    a. 2,022 units received Section 8 funds
    b. 3,672 units received NYCHA subsidy
4. In 2018, 489 NYCHA-funded units were converted to Section 8, resulting in an increase of $5.8 million in Section 8 subsidy.
5. On December 28, 2018 the NYCHA HDFC exercised its Call Option to purchase the Partnership Community Housing Trust Co.'s membership interest in LLC II. This means that at the end of 2018, LLC II was wholly owned by NYCHA.

In addition, Mr. Frydberg provided the following overview of the LLC II's financial results for the year ended December 31, 2018:

- LLC II's Loss Before Capital Contributions for 2018 was $5.8 million, which was not a significant variance compared to 2017.

- On December 28, 2018, the Ground Lease between the Authority and LLC II relating to the Baychester and Murphy developments was terminated, thereby causing ownership of the properties to revert back to the Authority. As a result, the capital assets and associated HDC loans were transferred to NYCHA, and the outstanding NYCHA financing (ARRA Loan and NYCHA Loan A) for these developments was cancelled. These transfers and the cancellation of the financing is considered a special item for LLC II financial statements.

Further, Mr. Frydberg provided the following highlights regarding the capital contributions during 2018 for LLC II:

- LLC II has no required replacement reserve contribution from NYCHA. However, NYCHA has contributed funds from the Housing Affordability Fund (HAF) for capital improvements at LLC II. This amounted to $13 million in 2018 ($39 million cumulatively).
- Per the Contribution Agreement, City Capital funds expended by NYCHA on LLC II developments was $8 million during 2018.
- For LLC II developments, total expenditure for capital improvements amounted to $14.2 million in 2018, mainly for Local Law 11 brickwork and façade work.

VI. Management Representation Letters:

Jill Strohmeyer, Managing Director of Deloitte presented three Management Representation Letters, one each for NYCHA, LLC I and LLC II – consistent with last year. These letters were provided with Track Changes (black-lined) mode, per the Audit Committee Members' request.

Ms. Strohmeyer indicated that there are no significant changes compared to the last year's representation letters, except for changes related to adoption of new GASB (Governmental Accounting Standards Board) Statements.

Mr. Kaplan pointed out that the terms "NYCHA", "Authority" or "We" are used at different places in the letters. For consistency and to avoid inference of signing off in personal capacity, it is recommended to remove references to "we" and "NYCHA", and insert "the enterprise" or "the Authority".

Mr. Anantharam indicated that NYCHA would review the guidance and decide whether we need all the signatories currently required for these letters.

VII. Letter of Transmittal:

Dan Frydberg, the Controller discussed the Letter of Transmittal included in the package, since the Audit Committee was concerned regarding issue of disclosure related to deferred maintenance.

On page 8 of the Letter of Transmittal, there is a section entitled "Physical Needs Assessment" which provides an explanation regarding total projected cost all of all needs estimated to be about $32 billion. In addition, it provides briefing on "NYCHA 2.0" – a comprehensive plan to preserve public housing.

Mr. Gonzalez inquired whether Physical Needs Assessment is related to PHAS[2] inspections. Mr. Anantharam responded that HUD conducts PHAS inspections to assess conditions at selected developments. However, for Physical Needs Assessment, a consulting firm is engaged by NYCHA to perform an assessment of the complete NYCHA portfolio of buildings every 5 years or so, and to advise what it will take to bring buildings in good condition.

VIII. Report to Management:

Jill Strohmeyer, Managing Director of Deloitte discussed deficiencies in internal control over financial reporting that the Deloitte auditors noted during the audit of 2018 financial statements.

Ms. Strohmeyer stated that the first deficiency relates to an instance in which the collateral schedule provided did not agree to the underlying source documents, and Deloitte recommends that the management should enhance controls in the review process related to the preparation of the collateral schedule.

The second comment relates to review of tenant revenue documents. Some developments were not able to provide the source documents in a timely manner. Deloitte recommends implementing an electronic system for housing records. Mr. Kuo asked whether there was any deviation from tenant self-certification. Ms. Strohmeyer indicated that no such deviation was found in the sample.

The third comment relates to classification error, in which ending construction-in-progress balance was reduced by $15 million related to pollution remediation (GASB 49) projects instead of capital assets. The misclassification was corrected by management. Deloitte recommends implementing internal controls related to pollution remediation costs to avoid classification error.

The fourth comment relates to strengthening password complexity, and Deloitte recommends changing the password parameters to reflect the IT policy.

The last comment, related to succession planning, is not identified as a Deficiency; however, it is being brought to management's attention as Other Matter. Key individuals leading the financial statement preparation efforts are eligible for retirement. Deloitte recommends to determine if the accounting team is adequately staffed to meet financial closing and reporting deadlines. Mr. Kaplan remarked that it is interesting to note that he has seen management succession planning comment recently in several other reports.

Ms. Strohmeyer said that there were no other comments.

[2] HUD's Real Estate Assessment Center (REAC) measures the performance of a public housing agency (PHA) using the Public Housing Assessment System (PHAS). REAC electronically collects individual subsystem scores in the areas of (1) physical inspections, (2) financial condition, (3) management operations, and (4) resident satisfaction, and provides a composite score to the PHA. About 20,000 physical inspections are conducted each year to ensure that assisted families have housing that is decent, safe, sanitary and in good repair.

IX. Approval of Financial Statements:

The Audit Committee unanimously approved the financial statements and the related reports for (1) NYCHA, (2) LLC I and (3) LLC II. Mr. Anantharam thanked the Audit Committee.

Mr. Kuo inquired regarding Single Audit Report, and whether LLC I and LLC II are included. Mr. Frydberg responded that LLC I and LLC II are included in the Single Audit as part of Consolidated financial statements. There are separate financial statements for LLC I and LLC II, but there are no separate Single Audit Reports for LLC I and LLC II. Darshan Patel, Audit Specialist Leader from Deloitte added that the Single Audit Report for 2018 will be presented to the Audit Committee in September meeting, since HUD REAC has to review financial data information.

X. Update on Internal Audit:

Ms. Jeffers provided an update on Department of Internal Audit & Assessment. We are in the process of interviewing temps to help us with the audit plan that was presented to the Audit Committee previously. We have interviewed 4 or 5 candidates so far, and we are looking at other resumes. We expect to bring them on board by mid-June. The plan is to complete audits included in the 2019 audit plan. We will also present to the Audit Committee 2018 audits in the next meeting in June.

Mr. Gonzalez mentioned that there should be a timeframe on these audit assignments, so that they are completed in a timely manner. He asked why the auditors are not able to complete assignments in three months. Ms. Jeffers explained that we used to require one audit per quarter; however, it hasn't worked out due to staff turn-over as well as lack of information and records being received timely. In addition, at times, auditees have other priorities, which results in delays in completing the audits. Mr. Anantharam added that lack of staffing is a big problem and we are trying to rectify that and provide additional resources.

Ms. Jeffers stated that the Audit Committee members will select three internal audit reports for discussion in June meeting.

Executive Session:

The Audit Committee met in an executive session at 11:35 AM.

Adjournment:

The Audit Committee meeting resumed at 11:45 AM and was adjourned at about 11:50 AM.