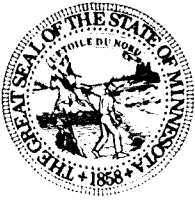


**MINNESOTA HOUSING FINANCE AGENCY
FINANCIAL AND COMPLIANCE AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1986**

JULY 1987

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Phillip J. Riveness, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

James J. Solem, Executive Director
Minnesota Housing Finance Agency

Audit Scope

We have completed a financial and compliance audit of the Minnesota Housing Finance Agency (MHFA) for the three years ended June 30, 1986. We did not audit the loan programs or the federal housing assistance payment program funds administered by MHFA or review legal compliance relating to those programs. These programs and the financial activities of MHFA are audited annually by a certified public accounting firm. Section I provides a brief description of the MHFA activities and finances. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on April 10, 1987.

The audit objectives were limited to:

- study and evaluate selected MHFA internal control systems, including a review of state appropriations, receipts, administrative disbursements, payroll, and fixed assets;
- verify that financial transactions were properly recorded in the statewide accounting (SWA) system for state appropriations, receipts, administrative disbursements, payroll, and fixed assets; and
- verify that financial transactions for state grant programs and administrative disbursements were made in accordance with applicable state laws, regulations, and policies, including Minn. Stat. Chapter 462A and other finance-related laws and regulations.

Management Responsibilities

The management of MHFA is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a

system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of MHFA is also responsible for compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by MHFA. The purpose of our testing of transactions was to obtain reasonable assurance that MHFA had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Audit Techniques

During our audit, we employed a variety of audit techniques. These included, but were not limited to auditor observation, interviews with MHFA staff, analytical reviews to identify unusual transactions or trends, and the examination of documentation supporting a representative number of transactions. Random sampling techniques were used to assure that representative samples of transactions were chosen. However, the use of random sampling did not prohibit us from reviewing additional transactions which may have come to our attention during the audit.

Conclusions

In our opinion, except for those issues raised in Section II, internal controls over state appropriation funds, receipts, administrative disbursements, payroll, and fixed assets in effect as of March 15, 1987, were sufficient to provide management with reasonable, but not absolute assurance, that assets are safeguarded against loss from unauthorized use or disposition, and that transactions relating to those systems are executed in accordance with management's authorizations.

Internal controls over the loan programs and the federal housing assistance payment program were not evaluated by us, and accordingly, we do not express an opinion on these systems. Because of the limited scope of our work, we also do not express an opinion on the system of internal accounting control of MHFA taken as a whole.

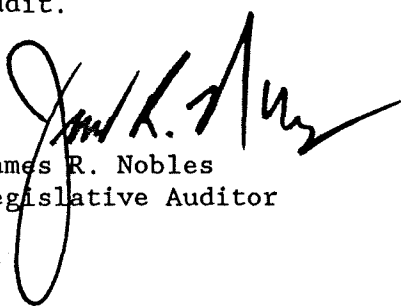
In our opinion, for the three years ended June 30, 1986, the MHFA properly recorded, in all material respects, its financial transactions on the statewide accounting system for state appropriations, receipts, administrative disbursements, payroll, and fixed assets.

Representative Phillip J. Riveness, Chairman
Members of the Legislative Audit Commission
James J. Solem, Executive Director
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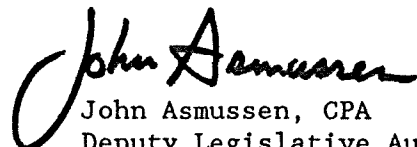
In our opinion, for the three years ended June 30, 1986, the MHFA administered its state grant programs and administrative disbursements in compliance, in all material respects, with applicable finance-related state laws, regulations, and policies.

Section II of this report contains the recommendations we developed during this audit. They are presented to assist MHFA in improving accounting procedures and controls. We will be monitoring and reviewing the progress on implementing these recommendations. Section III includes a summary of the progress on all recommendations developed during our audit of MHFA for the years ended June 30, 1980 and 1981.

We would like to thank the MHFA staff for their cooperation during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

July 22, 1987

MINNESOTA HOUSING FINANCE AGENCY

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Thomas Donahue	Audit Manager
Jerome McCallson, CPA	Auditor-in-Charge
Ellen Merlin	Staff Auditor
Mary Annala	Staff Auditor
Tammy Noren	Intern

EXIT CONFERENCE

The findings and recommendations in the report were discussed with the following staff of the Minnesota Housing Finance Agency at an exit conference held on April 24, 1987:

James J. Solem	Executive Director
Wayne J. Kaehler	Accounting Director

MINNESOTA HOUSING FINANCE AGENCY

I. INTRODUCTION

The Minnesota Housing Finance Agency (MHFA) was created by the Legislature in 1971 to assist in providing safe, decent, energy efficient, and affordable housing for low and moderate income people. MHFA has developed a variety of housing assistance programs that are financed primarily through the sale of tax-exempt bonds and appropriations from the Legislature. State appropriations to MHFA for the three fiscal years ended June 30, 1986 were \$32,035,000 for housing programs and \$14,439,300 for general administrative expenses.

The MHFA board consists of the Commissioner of Energy and Economic Development, the State Auditor, and five public members appointed by the Governor with the advice and consent of the senate. The agency is under the administrative control of an executive director who is appointed by the Governor. James J. Solem was the executive director during the period audited.

As of June 30, 1986, MHFA had total assets of \$2.060 billion and a liability for bonds payable of \$1.599 billion. Total revenues for fiscal year 1986 were \$163 million. The statutory authorized limit of outstanding bond principal is \$1.990 billion. Under Minn. Stat. Section 462A.14, the State of Minnesota shall not be liable on notes or bonds of the agency.

MINNESOTA HOUSING FINANCE AGENCY

II. CURRENT FINDING AND RECOMMENDATION

Controls over the handling and recording of receipts can be further strengthened.

The MHFA billing and collection functions for its loan programs are primarily performed by outside loan servicers. Collections are wire transferred to the proper trustee accounts for credit. However, some lender commitments, bankruptcy settlements, insurance proceeds, and grant and loan payoff checks are collected or directly received by MHFA.

We identified several problems associated with the collections directly received at MHFA. Specifically, current procedures do not require receipts to be deposited on a daily basis in accordance with Minn. Stat. Section 16A.275; many incoming checks are not restrictively endorsed immediately or are held until the proper trust account classification for deposit is determined; individual receipt tickets are not prenumbered; and trustee statements are used to post residential mortgage program commitment fees to the cash receipts journal.

We inspected and listed undeposited checks on hand at MHFA during our audit. After 10 business days, approximately \$500,000 remained on hand. This causes a loss of investment income. A continued effort is needed to maintain timely deposits. In addition, checks transferred and sent to the trustee accounts and servitor agents are not endorsed "for deposit only" because of their authority to deposit checks on behalf of MHFA. The failure of MHFA to endorse checks increases the risk to loss or theft. Perhaps a suspense account for checks held pending proper trust account determination could be established within the statewide accounting system or a trustee clearing account.

A complete listing of all incoming checks is prepared daily; however, the log pages of receipt tickets are not numbered, nor are individual tickets prenumbered by printer. The omission of prenumbered receipt forms prevents a complete accountability of all cash receipts.

MHFA properly posts its receipts to the trustee accounts except for commitment fee receipts of the residential mortgage account. These fees are posted to the MHFA cash receipts journal from amounts listed on the trustee statements. To adequately maintain MHFA accounting records and reconciliation of account balances, amounts posted to the cash receipts journal must be from internally created documentation such as MHFA remittance transmittal letters which provide proper account numbers. Ledger balances can be reconciled with trustee statements to verify receipts are properly accounted for and deposited correctly.

RECOMMENDATION:

1. MHFA should provide better internal control over cash receipts by:

MINNESOTA HOUSING FINANCE AGENCY

- restrictively endorsing all incoming checks "for deposit only" as soon as possible after being received, and depositing them in accordance with Minn. Stat. Section 16A.275;
- purchasing prenumbered individual receipt tickets for accountability of forms used; and
- recording commitment fees directly in cash receipts journal from transmittal letters for subsequent verification with trustee statements.

MINNESOTA HOUSING FINANCE AGENCY

III. STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Accounting procedures are not formalized.

1. MHFA should develop a comprehensive written accounting procedures manual.

RECOMMENDATION IMPLEMENTED. An agency policy and procedures manual has been established and maintained.

Receipt procedures should be strengthened.

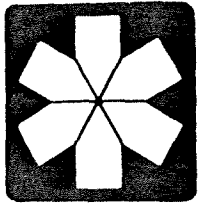
2. To provide better internal control over incoming receipts, MHFA should:
 - prepare a complete listing of all incoming checks as soon as possible after being received;
 - reconcile the listing of incoming checks to subsequent deposit slips; and
 - continue their efforts to deposit all incoming checks promptly in accordance with Minn. Stat. Section 16A.275.

RECOMMENDATION PARTIALLY IMPLEMENTED. See current recommendation #1.

Accountability for MHFA furniture, fixtures, and equipment (FFE) needs to be improved.

3. To improve FFE asset accountability, MHFA should implement the following:
 - the Statewide Fixed Asset Inventory System (SWAFAIS) listing should be updated to reflect all asset additions, disposals, and location changes;
 - physical inventories of FFE assets should be reconciled to the SWAFAIS and the general ledger control account; and
 - "sensitive" assets should be assigned asset numbers as required.

RECOMMENDATION IMPLEMENTED. MHFA has taken a physical inventory and updated its records, and has assigned asset numbers to "sensitive" assets.



**MINNESOTA
HOUSING
FINANCE
AGENCY**

July 22, 1987

Mr. James R. Nobles
Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

Dear Mr. Nobles:

This letter is Minnesota Housing Finance Agency's (MHFA) formal response to the findings and recommendations included in the Legislative Auditor's Report for the three years ended June 30, 1986.

The first finding in the auditor's report stated MHFA's current collection procedures do not comply with Minnesota Statute Section 16A.275, which requires that "except as otherwise provided by law, an agency shall deposit receipts totaling \$250 or more in the state treasury daily".

Before proceeding further, it should be noted that MHFA has two types of receipts. They include both cash and checks to be deposited either with the State Treasury or the bond resolution's designated trustee. For the most part, the undeposited checks referred to in the auditor's report -- lender commitments, bankruptcy settlements, insurance proceeds, and grant and loan payoff checks -- are deposited directly with the trustee.

Discussions with MHFA personnel indicated receipts which are to be deposited with the State Treasury normally are deposited within 24 hours of receipt. With respect to this type of receipt, there does not appear to be a time delay.

However, receipts which are to be deposited with the trustee have not been deposited in a timely manner. Before these checks can be deposited, the amount received must be verified. Even though this step results in lost interest income, it is critical because certain payors specifically state that endorsing the check constitutes full release of any further claims. Nevertheless, this step should not take 10 days as indicated in the auditor's report.

So, as a result, MHFA has established procedures whereby the Finance Division will notify the appropriate department's supervisor if a receipt has not been identified within 3 days of receipt. All receipts which have not been deposited within 5 days of receipt will be brought to the attention of the Finance Director.

The legislative auditor's second finding addresses restrictively endorsing incoming checks "for deposit only".

An officer's certificate accompanies each deposit sent to the trustee. A copy of the certificate signed by the trustee acknowledging their receipt of the deposit is matched with the unsigned copy retained by MHFA. If the copies are not matched within a day or two, then the situation is immediately investigated. If the checks were, in fact, lost or stolen, MHFA should be cognizant of this within 48 hours, if not earlier. In any event, the individual receipt tickets provide the necessary information to contact the drawer(s) of the check(s) involved, so that a stop payment order could be issued.

Since the trustee has been given the authority to endorse the checks on behalf of MHFA and MHFA's current procedures monitor this process, we do not feel it is necessary to restrictively endorse these checks at this time.

The third finding points out that MHFA's individual receipt tickets are not prenumbered, which prevents a complete accountability of all cash receipts.

MHFA's current procedures are such that two people open all incoming mail. For all cash receipts, one person completes the individual receipt ticket in the presence of the other person. If the related checks are not deposited soon thereafter, then the Finance Division will follow-up. With two people opening the mail, the risk is minimal that a check would not be recorded unless, of course, collusion was involved, in which case prenumbered forms would not prevent this from occurring.

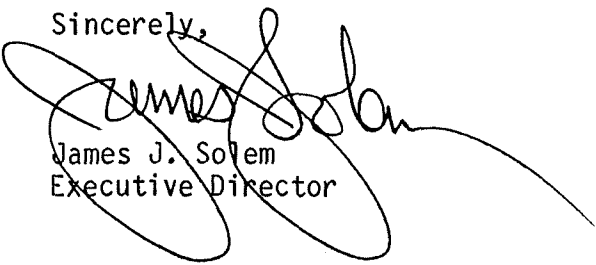
Another situation potentially could occur. The checks could be recorded, but never submitted to the Finance Division for deposit. The Finance Division's routine matching of the individual receipt tickets with the corresponding checks should identify any missing checks on a timely basis.

Since our current procedures already effectively minimize the risk of misappropriation, MHFA does not feel prenumbered receipt tickets are needed.

The fourth and final finding suggests commitment fee income received from the trustee is not reconciled to an independent source. This is not true. The Finance Division reconciles the trustee information to internally prepared source documents generated by other divisions of MHFA.

In conclusion, MHFA does not plan to implement recommendations two through four because they are not deemed to be cost-beneficial at this time. Meanwhile, to improve the situation described in the first finding, MHFA has established procedures to minimize the time delay involved in depositing certain incoming checks.

Sincerely,



James J. Solem
Executive Director