MINNESOTA HOUSING FINANCE AGENCY

SELECTED SCOPE FINANCIAL AUDIT

FOR THE TWO YEARS ENDED JUNE 30, 1993

SEPTEMBER 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-45

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

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SELECTED SCOPE FINANCIAL AUDIT FOR THE TWO YEARS ENDED JUNE 30, 1993

Public Release Date: September 9, 1994 No. 94-45

AGENCY BACKGROUND

In 1971 the state legislature created the Minnesota Housing Finance Agency (MHFA) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. MHFA provides funds to assist in the purchase, rehabilitation, and rental of housing by qualifying individuals. Mr. James Solem served as commissioner from 1978 to June 30, 1994. On July 1, 1994 Ms. Katherine Hadley, the former deputy commissioner, was appointed to the position of commissioner.

SELECTED AUDIT AREAS

- *Purchases of Single Family Mortgage Loans*

MHFA has effective controls over purchasing single family mortgage loans. Clear lender policies and internal loan review procedures help protect the agency from purchasing ineligible mortgage loans. FHA insurance, VA guarantees, and primary mortgage insurance minimize the risk of loss due to borrower defaults. Complex computer applications help employees control payments to participating lenders.

- *Repayments of Single Family Mortgage Loans*

MHFA has established controls over the repayments of single family mortgages. Although FHA insurance, primary mortgage insurance, and VA guarantees minimize MHFA's losses from most borrower defaults, it must provide diligent and timely oversight of the repayment process to ensure that it does not violate the bond resolutions and that it has sufficient funds to meet debt service requirements. For the most part, we found MHFA's oversight of these areas to be adequate. However, we cited a few instances when MHFA was not enforcing timely correction of errors identified in the loan servicer records.

- *Administrative Costs*

Minnesota statutes limit the use of funds for general administration of agency programs by MHFA. The amounts recorded by MHFA in its administrative accounts for fiscal years 1992 and 1993 are within the statutory limitation. The statute excludes a number of types of expenditures, including all "professional and other contractual services" from the administrative cost limitation. However, the statute does not specify the types of expenditures to include in the cost ceiling. We believe that the lack of specifying the costs subject to the limitation diminishes the effectiveness of statutory control.

Contact the Financial Audit Division for additional information.
296-1730

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Michael Finch, Chairman
Board of Directors, Minnesota Housing Finance Agency

Members of the Board of Directors
Minnesota Housing Finance Agency

Ms. Katherine Hadley, Commissioner
Minnesota Housing Finance Agency

Audit Scope

We have completed a financial related audit of selected activities of the Minnesota Housing Finance Agency (MHFA) for the two years ended June 30, 1993. We emphasize that we did not conduct a complete audit of all financial activities of the Minnesota Housing Finance Agency. We limited our audit to the financial operations outlined below and discussed in the Introduction.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider MHFA's internal control structure in order to plan our audit of the selected activities, and that we perform tests of MHFA's compliance with certain material provisions of laws, regulations, contracts and grants. However, it was not our objective to provide an opinion on MHFA's internal control structure or on its overall compliance with finance-related legal provisions.

For purposes of this report, we have classified the internal control structure policies and procedures we reviewed into the following categories:

- Purchases of Single Family Mortgage Loans
- Repayments of Single Family Mortgage Loans

For these internal control structure categories, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

In addition, we reviewed the agency's compliance with statutory limitations for its administrative expenditures.

Management Responsibilities

MHFA's management is responsible for establishing and maintaining the internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. In fulfilling this responsibility, management uses estimates and judgments to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal regulatory provisions, as well as management's authorization; and
- transactions are recorded properly in the corporation's general ledger system.

Due to the inherent limitations of any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions

MHFA has effective controls over purchasing single family mortgage loans. Clear lender policies and internal loan review procedures help protect the agency from purchasing ineligible mortgage loans. FHA insurance, VA guarantees, and primary mortgage insurance minimize the risk of loss due to borrower defaults. Complex computer applications help employees control payments to participating lenders.

MHFA has established controls over the repayments of single family mortgages. Although FHA insurance, primary mortgage insurance, and VA guarantees minimize MHFA's losses from most borrower defaults, it must provide diligent and timely oversight of the repayment process to ensure that it does not violate the bond resolutions and that it has sufficient funds to meet debt service requirements. For the most part, we found MHFA's oversight of these areas to be adequate. However, we cited a few instances when MHFA was not enforcing timely correction of errors identified in the loan servicer records.

Minnesota statutes limit the use of funds for general administration of agency programs by MHFA. The amounts recorded by MHFA in its administrative accounts for fiscal years 1992 and 1993 are within the statutory limitation. The statute excludes a number of types of expenditures, including all "professional and other contractual services" from the administrative cost limitation. However, the statute does not specify the types of expenditures to include in the cost ceiling. We believe that the lack of specifying the costs subject to the limitation diminishes the effectiveness of statutory control.

We have prepared this report for the information of the Legislative Audit Commission and the management of the Minnesota Housing Finance Agency. We do not intend this restriction to limit the distribution of this report, which we released as a public document on September 9, 1994.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 3, 1994

Report Signed On: August 31, 1994

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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
Renee Redmer, LPA	Audit Manager
Cecile Ferkul, CPA	Auditor-in-Charge
Chris Buse, CPA	Staff Auditor
Mary Jacobson, CPA	Staff Auditor

The issues in this report were discussed with the following individuals of the Minnesota Housing Finance Agency at the exit conference held on August 15, 1994.

Katherine Hadley	Commissioner
Robin Hanson	Deputy Commissioner
Wayne Kaehler	Accounting Director
Beverly Turner	Assistant to the Commissioner
Michael Haley	Director of Home Mortgage

Chapter 1. Introduction

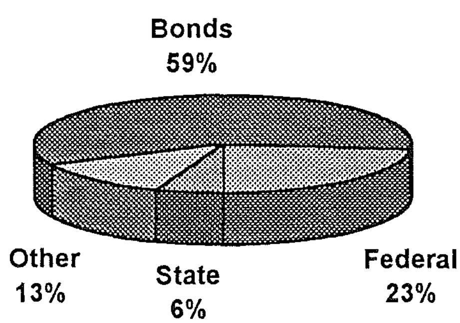
In 1971 the state legislature created the Minnesota Housing Finance Agency (MHFA) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. Since that time, MHFA has allocated funds to assist in the purchase, rehabilitation, and rental of housing by qualifying individuals. Minnesota Statutes Chapter 462A define the agency's duties and responsibilities. The legislature limits the amount that MHFA may expend for administrative costs. In Chapter 4 we analyze these costs and determine whether MHFA complied with the legal limitation.

The governing board of the MHFA consists of the commissioner of Trade and Economic Development, the state auditor, and five public members appointed by the governor. The governor also appoints the administrative head of the agency, the commissioner. Mr. James Solem served as MHFA's commissioner from 1978 to June 30, 1994. On July 1, 1994, the governor appointed Ms. Katherine Hadley, the former deputy commissioner, to the position of commissioner.

MHFA has annual audits of its financial statements and federally funded programs by a certified public accounting firm. The main objective of the financial audit is to determine if the agency has fairly presented its financial information in accordance with generally accepted accounting principles. The main objective of the federal audit is to ensure compliance with federal regulations. We designed our audit approach to supplement rather than duplicate the work done as part of these two audits.

MHFA relies upon tax exempt mortgage revenue bonds for the majority of its program funding. Other funds come from the federal government, state appropriations, and accumulated MHFA reserves. Figure 1-1 shows MHFA's program funding sources.

Figure 1-1
Program Funding Sources



Source: MHFA's Affordable Housing Plan, 1992 - 1993.

The sale of mortgage revenue bonds provides MHFA with the funds to purchase qualifying loans from participating lenders. The participating lenders make the direct loans to qualified loan recipients. The loan recipients make monthly loan repayments to loan servicers who contract with MHFA. The loan servicers remit the loan repayments to MHFA's trustee bank. The trustee bank uses the loan repayments, along with investment earnings, to make the required debt service payments to bondholders.

The frequency and amount of bond sale activity are dependent upon the demand for the funds and the financial market. The low interest rates of recent years resulted in frequent and large bond sales, both to provide money for new loans, and to refinance bonds issued previously at higher rates. MHFA recorded mortgage revenue bond proceeds totaling $418,196,000 in fiscal year 1992, and $227,066,000 in fiscal year 1993. MHFA issues each bond in accordance with a resolution adopted for a specific type of program. Our audit focused on the financial activity of the Single Family Mortgage Program, administered by MHFA's Homeownership Division.

Table 1-1 shows bonds issued by bond resolution for fiscal years 1992 and 1993.

Table 1-1
Bond Proceeds by Bond Resolution

Bond Resolution	FY 1992	FY 1993
Housing Development Fund	$ 58,405,000	$ 0
Rental Housing	13,621,000	39,646,000
Single Family Mortgage	326,600,000	163,910,000
State Assisted Home Improvement	19,570,000	19,570,000
Home Improvement	0	3,940,000
Total Bond Proceeds	$418,196,000	$227,066,000

Source: MHFA's Fiscal Year 1992 and 1993 Audited Financial Statements.

One of MHFA's main responsibilities is to ensure that only eligible loan recipients receive loans. Achievement of this goal is critical to maintaining the tax exempt status of the bonds. Thus, as discussed in Chapter 2, our testing of the single family loan purchase process focused on policies, procedures and practices that MHFA has designed to detect and prevent the purchase of ineligible loans. Another major responsibility of MHFA is to ensure that loan repayments are properly collected, deposited and credited to the appropriate bond series resolution. Chapter 3 discusses the loan repayment process for single family mortgage loans.

Chapter 2. Purchases of Single Family Mortgage Loans

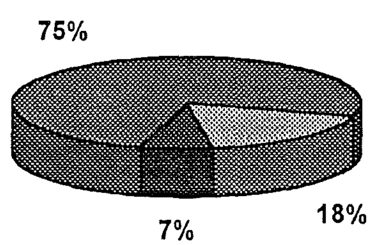
Chapter Conclusions

MHFA has effective controls over purchasing single family mortgage loans. Clear lender policies and internal loan review procedures help protect the agency from purchasing ineligible mortgage loans. FHA insurance, VA guarantees, and primary mortgage insurance minimize the risk of loss due to borrower defaults. Complex computer applications help employees control payments to participating lenders.

Overview of the Single Family Mortgage Programs

MHFA sells tax exempt mortgage revenue bonds to finance its single family mortgage programs. Bond proceeds are used to purchase eligible mortgages on the secondary market. However, the agency also directly originates some loans for several of the smaller single family mortgage programs. The Minnesota Mortgage Program and the Minnesota City Participation Program are the largest single family mortgage programs, with fiscal year 1992 and fiscal year 1993 loan purchases totaling $226,318,494. As Figure 2-1 illustrates, these two programs account for 93 percent of the single family mortgage loans purchased by MHFA.

Figure 2-1: FY92 & FY93
Single Family Mortgage Loans



Source: Auditor calculation based on MHFA internal data.

Minnesota Housing Finance Agency

The agency purchases Minnesota Mortgage Program and Minnesota City Participation Program loans on the secondary market. This means that lending institutions are responsible for underwriting loans and disbursing funds to borrowers. The agency then purchases these loans from the lending institutions if they followed all guidelines in the MHFA Mortgage Program Procedure Manual. To become a participating lender, institutions must meet specific mortgage banking standards and enter into an application commitment agreement with MHFA. Lenders also must pay a participation fee, which ranges from $200 to $3,000.

Audit Objectives

Our audit objective was to determine if MHFA has effective controls over purchasing single family mortgage loans. We focused our work on the following questions:

- Does the agency have controls to ensure that the loans it purchases comply with applicable legal requirements?

- Does the agency require adequate insurance and guarantees to protect itself against the risks associated with borrower defaults?

- Does the agency have controls to ensure the accuracy of loan purchase prices and interest rates?

- Does the agency have procedures to control payments to participating lenders?

We concentrated our efforts on the Minnesota Mortgage Program and Minnesota City Participation Program because of their materiality.

Legal Compliance Requirements and Controls

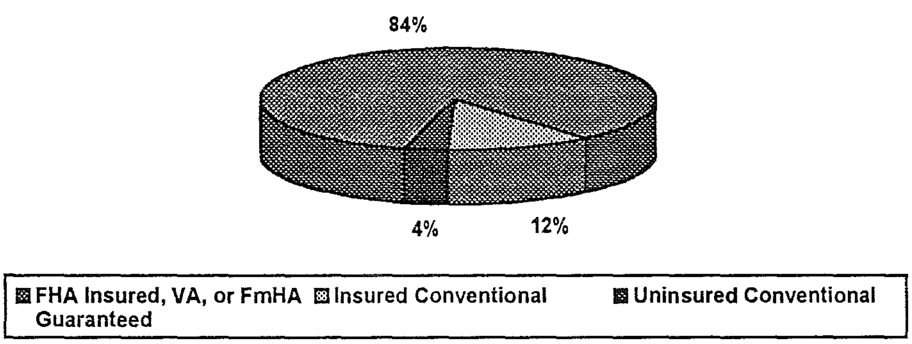
MHFA sells tax exempt mortgage revenue bonds to minimize its interest costs. The agency then passes on these cost savings to borrowers in the form of loans with below market interest rates. Section 143 of the Internal Revenue Code restricts the use of tax exempt mortgage revenue bond financing. Specifically, the code limits these loans to first time home buyers who plan to occupy the property as their principal residence. Also, borrower income and property acquisition costs must not exceed specified limits. These legal provisions apply to all of MHFA's bond-funded single family mortgage programs.

In its bond and series resolutions, the agency covenants that it will develop procedures to safeguard the tax exempt status of its single family bond issues. The Mortgage Program Procedure Manual documents these procedures and contains forms to ensure compliance with bond eligibility requirements. MHFA hires an independent bond counsel to examine these procedures each time it sells bonds. In the opinion of the bond counsel, the agency's procedures are adequate to secure the tax exempt status of its single family mortgage issues. The bond counsel assumes compliance with the resolutions and the procedure manual when rendering its opinion.

MHFA mortgage officers use a computerized application and checklists to review loans and authorize purchases. These tools help facilitate complete and consistent loan reviews. We tested specific loans purchased under the Minnesota Mortgage and Minnesota City Participation Programs. Loans tested complied with the bond eligibility requirements outlined in the MHFA Mortgage Program Procedure Manual.

Mortgage insurance helps insulate the agency from borrower defaults. In general, MHFA will not purchase loans unless they are insured privately or by the Federal Housing Administration (FHA), or guaranteed by the Veterans Administration (VA), or the Farmers Home Administration (FmHA). However, the agency will purchase uninsured conventional loans if the borrower's down payment is at least 25 percent of the property value. As Figure 2-2 illustrates, 96 percent of the new loans purchased during fiscal years 1992 and 1993 were insured or guaranteed.

Figure 2-2: FY92 & FY93
Loans Purchased By Type



Source: Auditor calculation based on MHFA internal data.

When reviewing loans, MHFA mortgage officers confirm that the files contain the appropriate type of mortgage insurance certificate. None of the loan files we examined were missing these certificates.

Title insurance and security interests also minimize the agency's risk of loss. MHFA will only purchases loans if the agency has a valid first lien on the property. When reviewing loans, the agency's mortgage officers verify that all files contain a recorded mortgage deed and assignment of mortgage. They also confirm that all loan files contain a title insurance policy with MHFA as a named insured. The Minnesota Mortgage Program and Minnesota City Participation Program loan files we reviewed included these documents.

MHFA has a computerized loan reservation system. This system helps employees control the allocation of funds and monitor available balances. The agency begins by creating commitment pools for each program and assigning each pool a unique program identification code. Participating lenders reserve funds by calling the agency and giving their lender code, the program identification code, and pertinent borrower and loan information. The system then assigns a loan number and the appropriate interest rate to the transaction. It also generates individual commitment statements for lenders to review. MHFA will not purchase loans from lenders who did not reserve funds in advance.

MHFA also has a computerized loan purchasing system. This system identifies all loans approved for purchase by the agency's mortgage officers. It then calculates the appropriate purchase prices and generates reports for the agency, lenders, loan servicing companies, and the trustee. Lender reports list the loans the agency is purchasing along with the purchase price calculations. These reports show the lender how much money they can expect to receive from the trustee. Trustee reports detail the amount of money to wire transfer to each lender as well as the specific bank accounts to use. MHFA accountants reconcile the actual trustee wire transfers to amounts the agency authorized to be paid. This reconciliation confirms the accuracy of payments to lenders. We feel that this procedure adequately controls payments to lenders.

Chapter 3: Repayments of Single Family Mortgage Loans

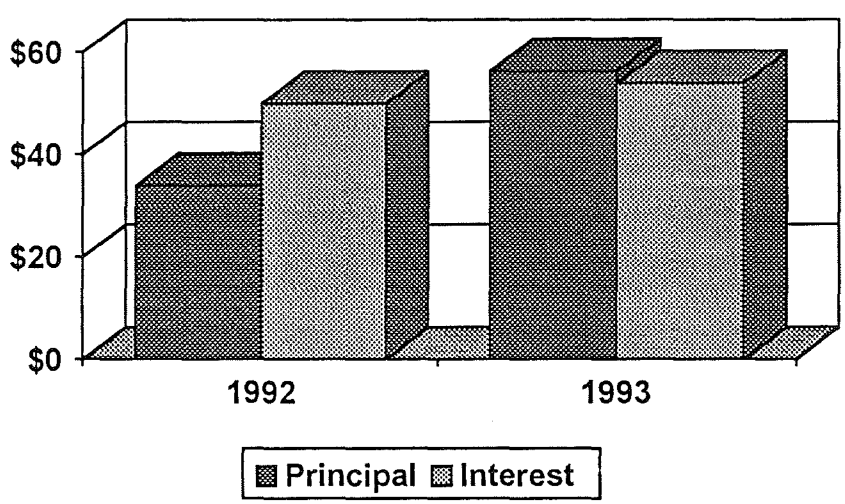
Chapter Conclusions

MHFA has established controls over the repayments of single family mortgages. Although FHA insurance, primary mortgage insurance, and VA guarantees minimize MHFA's losses from most borrower defaults, it must provide diligent and timely oversight of the repayment process to ensure that it does not violate the bond resolutions and that it has sufficient funds to meet debt service requirements. For the most part, we found MHFA's oversight of these areas to be adequate. However, we cited a few instances when MHFA was not enforcing timely correction of errors identified in the loan servicer records.

Overview of the Single Family Mortgage Repayment Process

Loan repayments are a major financial activity for the Minnesota Housing Finance Agency. Figure 3-1 shows the amounts reported as principal and interest repayments for single family mortgages on MHFA's annual financial statements. As diagrammed, the principal repayments are substantially higher in fiscal year 1993 than in 1992. This was a result of the large amount of refinancing during that fiscal year.

Figure 3-1: Single Family Loan Repayments (in millions)



Source: MHFA's Audited Financial Statements for fiscal years 1992 and 1993.

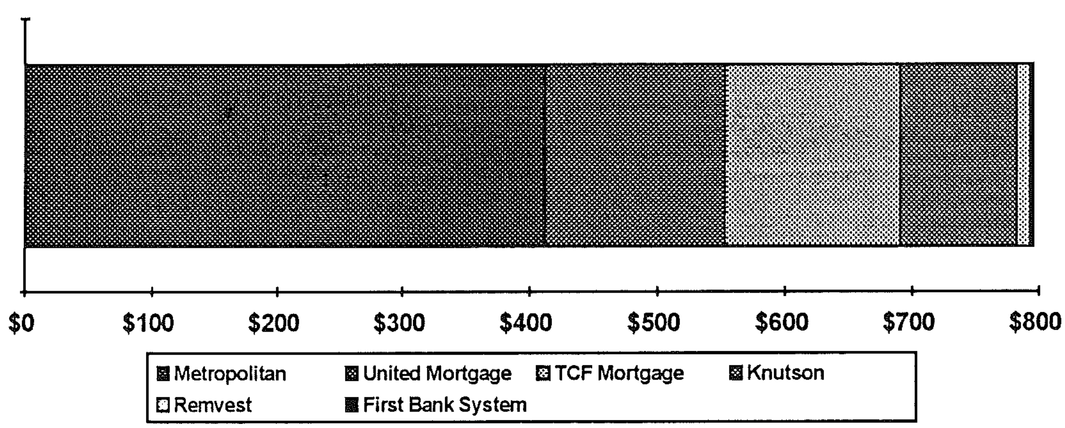
MHFA has ultimate responsibility for collecting and pursuing repayments from borrowers. The agency delegates much of this responsibility to loan servicers. The servicers' duties generally include, but are not limited to:

- collection of payments,
- maintenance of tax and insurance escrow accounts,
- customer service,
- processing of loan satisfactions,
- delinquency and foreclosure servicing,
- assumption processing, and
- preparation of various financial reports and accounting documents.

MHFA currently solicits eligible organizations each program year to perform loan servicing. An eligible organization is any financial institution actively participating as a lender in MHFA's programs, which is also an established loan servicer. Through fiscal year 1993, MHFA had contracts with six different loan servicers. During fiscal year 1994, four of these organizations submitted bids to add new loans to their portfolios. MHFA accepted all four bids. MHFA completes an agreement with each servicer that outlines the responsibilities and performance expectations of the servicers. In return for the servicer's performance, MHFA pays a loan servicing fee that is a percentage of the amount of interest collected. The servicers net the fee amount against the deposits transferred to the trustee. The service fees vary slightly by servicer.

There currently are six servicers that perform collection procedures for MHFA. Figure 3-2 identifies the servicers and their share of the single family loan portfolio as of March 31, 1994. Metropolitan Federal Bank services approximately 52 percent of all outstanding single family mortgages. Remvest and First Bank Systems no longer receive new loans; they service only the loans currently held in their portfolios.

Figure 3.2
Loans Receivable by Loan Servicer
(in Millions)



Source: MHFA Single Family Loan Receivable Records as of March 31, 1994.

Audit Objectives

Our audit objective was to determine whether MHFA has effective controls over single family mortgage loan repayments. To fulfill this audit objective, we focused our work on the following questions:

- Does the agency have controls to ensure it recovers the balance due on single family mortgage loans?
- Does the agency have controls to ensure that servicers deposit money collected for the single family mortgage loans to the bond series from which the mortgage originated?
- Does the agency have controls to ensure that servicers deposit money collected with the trustee?

Legal Compliance Requirements and Controls

Pursuant to the Single Family Bond Resolution, Article IV, Section 401, loan servicers must deposit all revenues derived from mortgage loans, including defaulted mortgage loans, with the trustee, or with depositories in the name of the trustee, on the date of receipt or as soon thereafter as practicable. MHFA has established procedures for the servicers to ensure timely depositing of loan repayments. The loan servicers collect payments from borrowers and initially deposit money into their own custodial accounts. Generally, the servicers electronically transfer money to the trustee accounts twice a week. However, there are specific instances when MHFA directs the servicers to transfer money daily.

Section 301 (B) of the Bond Resolution for Single Family Mortgages, requires the trustee to maintain separate accounts for each bond series. As a result, MHFA requires the servicers to maintain separate accounts for each bond series and within the bond series, each interest rate. MHFA does not have detailed loan records. The agency maintains totals of outstanding loans by series. Each month, the servicers remit accounting reports to MHFA that detail the amount of principal and interest outstanding. The reports also identify the amounts collected and transferred as well as the amount of their service fee. MHFA reconciles the servicers' reports to its own report of estimated principal and interest payments. MHFA uses this reconciliation process to ensure proper recording. MHFA also reconciles the amounts deposited to the trustee bank records. This ensures proper depositing of loan repayments. Our testing revealed instances where the agency failed to enforce the servicers' timely correction of some errors identified in the servicers' loan records.

1. MHFA did not resolve some differences with the servicers' loan records on a timely basis.

MHFA reconciles in the aggregate to the servicers' detail loan records. The reconciliation is MHFA's detective control to ensure servicers maintain accurate loan records and remit appropriate money to the trustee. The reconciling items are generally a result of timing differences between the time MHFA adds or removes loans to its system versus when the loan servicers add or remove loans to their systems.

In two instances, the reconciliation revealed that a servicer had not recorded a new loan on a timely basis. MHFA did not require the servicer to adjust their loan records timely. The first instance pertained to a $63,533 loan purchased by MHFA in May 1992. The servicer did not add the loan to its records until September 1993, 17 months later. The servicer collected money during this time but did not remit any funds to the trustee until it added the loan to its system. Another instance involved a $64,532 loan purchased by MHFA in April 1993 that was not added to the servicer's records until August 1993, five months later. Again the servicer was collecting money during this time but did not remit funds to the trustee until it added the loan to its system. The bond resolution requires timely deposit of funds.

We noted another instance where a loan servicer recorded a loan under the incorrect bond series. MHFA purchased the loan in March 1992 and the servicer recorded the loan incorrectly until May 1993. During that time the payments were going to the trustee but under the wrong series. MHFA has since transferred the payments to the correct bond series. MHFA needs to ensure timely correction of errors in the servicer's loan records.

Recommendation

- *MHFA needs to take prompt action to ensure timely correction of errors noted during the monthly reconciliation process.*

The bond and series resolutions also require the agency to ensure diligence in the collection of mortgages outstanding. As discussed in Chapter 2, MHFA's main assurance against loss on these loans is the mortgage insurance or FmHA or VA guarantees required at the time of purchase. It is also important that the loan servicers promptly detect borrower defaults and take appropriate, timely action. The MHFA Single Family Servicing Manual documents the procedures to ensure servicers perform adequately. MHFA distributes the manuals to the servicers. The manuals are part of the servicing agreement. MHFA performs semi-annual performance reviews of the loan servicers to ensure servicers are meeting specific performance standards. MHFA ranks the servicers quarterly performance for delinquency, foreclosure and portfolio administration performance as well as evaluating the annual audits of the servicers. MHFA has the authority to order an in-depth inspection of the servicers records if the performance review indicates serious deficiencies. We reviewed the performance reviews conducted for the four quarters ending December 31, 1993. MHFA has identified some areas that need improvement and appeared to be taking measures to improve the overall performance of its servicers.

Chapter 4. Administrative Costs

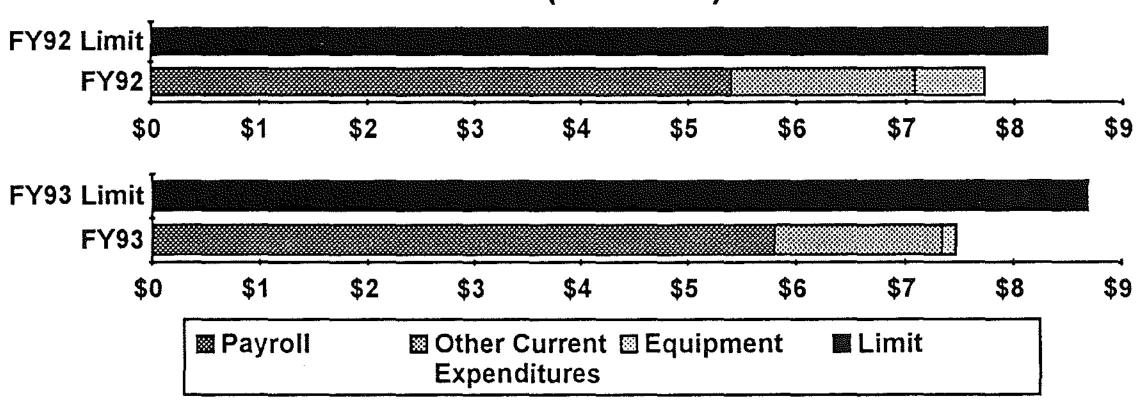
Chapter Conclusions

Minnesota statutes limit the use of funds for general administration of agency programs by MHFA. The amounts recorded by MHFA in its administrative accounts for fiscal years 1992 and 1993 are within the statutory limitation. The statute excludes a number of types of expenditures, including all "professional and other contractual services" from the administrative cost limitation. However, the statute does not specify the types of expenditures to include in the cost ceiling. We believe that the lack of specifying the costs subject to the limitation diminishes the effectiveness of statutory control.

Minnesota Statute 462A.20, Subd. 2(e), limits MHFA's general administrative costs to amounts stated in law. We believe the legislature established this limitation to control MHFA's growth and ensure that it uses excess program funds to enhance programs.

Minnesota Laws of 1991, Chapter 292, Section 17, set the limits for fiscal years 1992 and 1993 at $8,305,000 and $8,686,000, respectively. MHFA established a separate account on the statewide accounting system for paying its administrative costs. Expenditures charged to the account fell short of the legal limit by $574,817 in fiscal year 1992 and by $1,220,361 in fiscal year 1993. Figure 4-1 compares MHFA's administrative costs to the legal limits for fiscal years 1992 and 1993.

Figure 4-1
Comparison of Actual MHFA Administrative Costs to the Legal Limit (in Millions)



Source: State of Minnesota Statewide Accounting System.

2. State law governing MHFA's general administrative cost limitation does not specify the types of expenditures to include in the cost ceiling, which diminishes the effectiveness of the statutory control.

MHFA can, according to the statute, exclude certain costs from its general "administrative costs". Minn. Stat. Section 462A.20, Subd. 2(e) provides that:

> Cost of general administration of agency programs does not include debt service, amortization of deferred financing costs, loan origination costs, professional and other contractual services, any deposit of expenditure required to be made by the provisions of a bond or note resolution or indenture, or any deposit or expenditure made to preserve the security for the bonds or notes.

Because of this provision, MHFA does not record professional and other contractual services in its general administrative account, but rather in other accounts in the statewide accounting system. We reviewed these other accounts to identify the professional and other contractual services not recorded in the administrative account. We found that the majority of these costs are for program operations such as trustee costs and payments to local housing authorities. We believe other costs, such as Attorney General fees and Department of Administration computer consultants, arguably might be considered costs of general administration. Table 4-1 summarizes these costs.

Table 4-1
Summary of Contractual, Professional and Technical Service Costs Not Included as Administrative Costs
Fiscal Years 1992 and 1993

Trustee Bank	$1,170,516
Local/Community Housing Agencies	1,668,989
Auditing Services	67,679
Attorney General	228,880
Computer Consultants	939,097
Other	359,219
Total	$4,434,380

Source: State of Minnesota Statewide Accounting System.

We believe that the lack of an enumerated list of items to include in the cost limitation on the general administration of the agency diminishes the statutory control. Since the legislation was enacted in 1977, the technical and legal environment has become more complex, resulting in significant costs for computer consultants and attorneys. To more fully control the administrative costs of MHFA, it may be appropriate for the legislature to reevaluate which costs are subject to the general administrative cost limitation and which are not.

Recommendation

- *MHFA should work with the Legislature to:*
  - *reevaluate the purpose of the statutory administrative cost limitation; and*
  - *clarify the types of administrative costs to include in the administrative cost ceiling.*

MINNESOTA
HOUSING
FINANCE
AGENCY

August 31, 1994

Ms. Renee Redmer
Audit Manager
Office of the Legislative Auditor
Centennial Building
St. Paul, MN 55155

Dear Ms. Redmer:

This is in response to the audit report prepared by the your office summarizing the results of the financial related audit of selected activities of the Minnesota Housing Finance Agency for the two years ended June 30, 1993.

Chapter 3. Management Response

The three discrepancies noted in Chapter 3 have since been resolved, albeit not on a timely basis.

Earlier this year, in recognition of the Agency's fiduciary responsibility and nearly $1 billion investment in homeownership loans, the Agency realigned its accounting personnel so that additional resources could be devoted to the homeownership loan servicer reconciliation process. This has enabled the Agency's accounting staff to better communicate reconciling items and to work with the loan servicers to resolve discrepancies on a more timely basis.

Chapter 4. Management Response

The Agency understands the concerns raised by Chapter 4 and will work with the Legislature to review the purpose of the general administrative cost limitation and to clarify which costs should be included as general administrative costs. Since the general administrative cost ceiling was established in 1977, the Agency has always adhered to the legislative construction of that original cost ceiling.

As part of the legislative review, it will be important to revisit the legislative history of the general administrative cost limitation. We believe that the reason for the cost limitation cited by this report -- "to control MHFA's growth and ensure that it uses excess program funds to enhance programs" -- is not accurate. In 1977 when the general administrative cost limitation was established, the areas of greatest growth and activity at the Agency were in those program operational areas which the Legislature specifically and deliberately excluded from the general administrative cost limitation.

Sincerely,

Katherine G. Hadley

Katherine G. Hadley
Commissioner

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