Minnesota Housing Finance Agency

Financial Audit
For the Period July 1, 1995, through June 30, 1997

July 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-41

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STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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Minnesota Housing Finance Agency

Members of the Board of Directors
Minnesota Housing Finance Agency

Ms. Katherine G. Hadley, Commissioner
Minnesota Housing Finance Agency

We have conducted a financial related audit of selected activities of the Minnesota Housing Finance Agency for the period July 1, 1995, through June 30, 1997. We emphasize that this was not a complete audit of all Minnesota Housing Finance Agency programs. Our audit scope included aspects of the Affordable Rental Investment Fund, payroll, and administrative expenditures. The following Summary highlights the audit objectives and conclusions. We discuss these issues more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards also require that we design the audit to provide reasonable assurance that the Minnesota Housing Finance Agency complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Minnesota Housing Finance Agency is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

We intend this report to be for the information of the Legislative Audit Commission and the management of the Minnesota Housing Finance Agency. We do not, however, limit the distribution of this report, which we released as a public document on July 24, 1998.

James R. Nobles
James R. Nobles
Legislative Auditor

Claudia J. Gudvangen
Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 24, 1998

Report Signed On: July 20, 1998

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SUMMARY

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Minnesota Housing Finance Agency

Financial Audit
For the Period July 1, 1995, through June 30, 1997

Public Release Date: July 24, 1998 No. 98-41

Agency Background

In 1971, the state Legislature created the Minnesota Housing Finance Agency (the agency) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. The Minnesota Housing Finance Agency provides funds to assist in the purchase, rehabilitation, and rental of housing by qualifying individuals. Ms. Katherine Hadley has served as commissioner since July 1, 1994.

Audit Scope and Objectives

Our audit scope included aspects of the Affordable Rental Investment Fund expenditures, payroll, and other administrative expenditures for the period July 1, 1995, through June 30, 1997. Our audit objectives included reviewing internal controls over financial activities of the agency and determining compliance with laws and regulations. This was not a complete audit of all Minnesota Housing Finance Agency programs.

Conclusions

The Minnesota Housing Finance Agency properly authorized and accurately reported Affordable Rental Investment Fund expenditures in the accounting records. However, the agency had not performed inspections of some completed projects funded by Affordable Rental Investment Fund deferred loans.

Payroll and other administrative expenditures were authorized, made for a proper purpose, and accurately recorded in the state's accounting system. However, the agency had an inadequate separation of duties over the payroll process. For the items tested, the Minnesota Housing Finance Agency processed its payroll and other administrative expenditures in accordance with applicable legal provisions.

In response to the audit report, the Minnesota Housing Finance Agency agreed with the audit report's findings and recommendations and has taken action to resolve the issues.

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Carl Otto, CPA, CISA	Auditor-in-Charge
Karen Klein, CPA	Auditor
Dale Ogren, CPA, CISA	Auditor

Exit Conference

We discussed the issues presented in this report with the following staff of the Minnesota Housing Finance Agency at an exit conference held on July 6, 1998:

Robin Hanson	Deputy Commissioner
Patricia Hippe	Director, Finance Division
Jack Jenkins	Managing Director, Multifamily Division

Chapter 1. Introduction

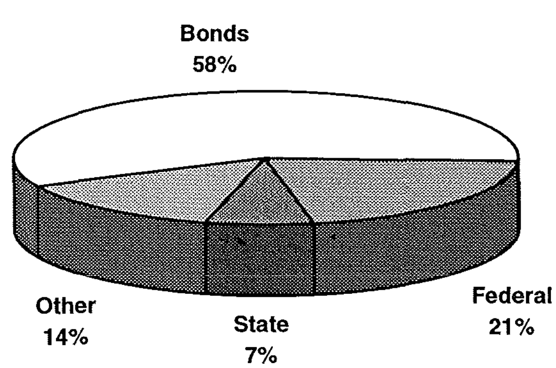
In 1971, the state Legislature created the Minnesota Housing Finance Agency (the agency) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. Since that time, the agency has allocated funds to assist in the purchase, rehabilitation, and rental of housing by qualified individuals. *Minnesota Statutes,* Chapter 462A, define the agency's duties and responsibilities. The Legislature limits the amount that the agency may expend for administrative costs.

The governing board of the agency 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 agency's commissioner. Ms. Katherine Hadley has served as commissioner since her appointment in July 1994.

The Minnesota Housing Finance Agency contracts with a certified public accounting firm to perform annual audits of its financial statements and federally funded programs. The 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 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.

The Minnesota Housing Finance Agency funds its programs through a diverse combination of resources. Bond sales provide the majority of the program funding. Other funds come from the federal government, state appropriations, and accumulated reserves. The agency prepares a biennial report, the Affordable Housing Plan, that sets forth their overall financing plan. Figure 1-1 shows the agency's program funding sources, as stated in that plan prepared for the 1996-1997 biennium.

Figure 1-1
Program Funding Sources



Source: Minnesota Housing Finance Agency's Affordable Housing Plan, 1996-1997.

Chapter 2. Affordable Rental Investment Fund

Chapter Conclusions

The Minnesota Housing Finance Agency properly authorized and accurately reported Affordable Rental Investment Fund expenditures in the accounting records. However, the agency had not performed inspections of completed projects funded by Affordable Rental Investment Fund deferred loans.

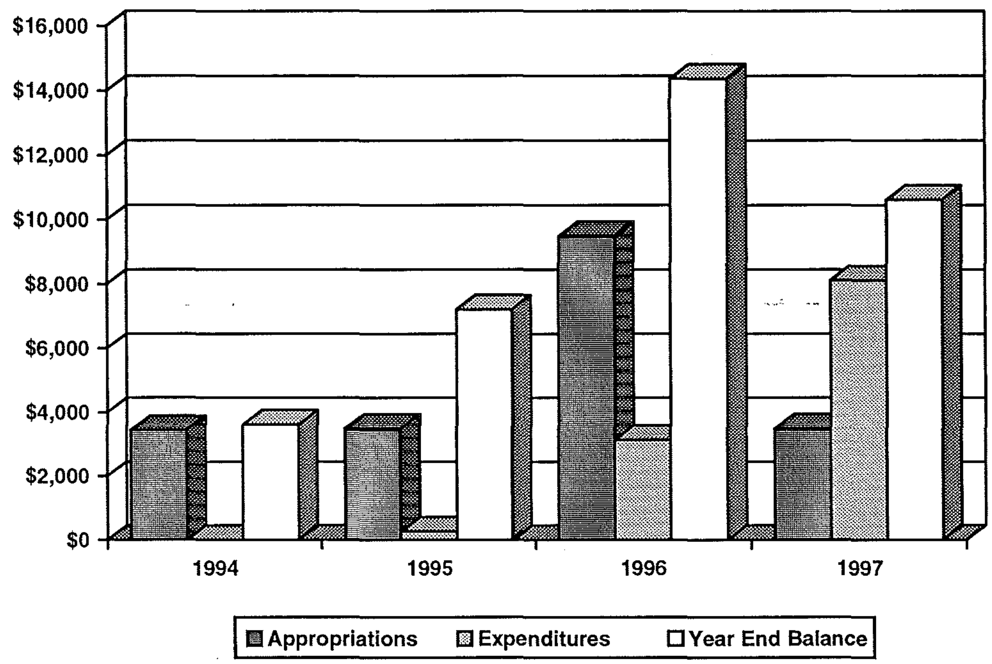
The Minnesota Housing Finance Agency states that it has provided $4.2 billion in housing loans and subsidies to over 185,000 Minnesota households. The agency designs its programs to make housing more affordable, improve the condition or quality of housing, or make the housing more accessible or energy efficient. The agency obtains funding for its programs through bond sales, the federal government, and state appropriations. The state Legislature has made General Fund appropriations to the agency for loans, grants, debt service, and a number of innovative and creative housing programs. One of these programs is the Affordable Rental Investment Fund.

Affordable Rental Investment Fund

The Affordable Rental Investment Fund is the largest and fastest growing program in the agency's Multifamily Division. The agency uses these funds to provide first mortgage loans and deferred loans to finance the construction, acquisition and/or rehabilitation of rental housing. Qualifying borrowers repay first mortgage loans over a 20 to 30 year repayment period. Deferred loans are also for a 20 to 30 year period. The agency can, however, forgive deferred loans at the end of the term if the borrower complies with the loan agreement requirements.

The Legislature first provided funds for the Affordable Rental Investment Fund in fiscal year 1994, appropriating $3,443,000 for fiscal year 1994 and $3,493,000 for fiscal year 1995. The agency spent only $270,011 through the end of fiscal year 1995, carrying the remainder over to future periods. (The Legislature gave the agency the authority to carry fund balances over to future periods in Minn. Stat. Section 462.21, Subd. 10.) For fiscal year 1996, in addition to its base level of program funding ($3,493,000), the Legislature appropriated $6,000,000 to equalize the financing of housing units between the metropolitan and nonmetropolitan areas. For fiscal year 1997, the agency received $3,493,000. As approved projects reached completion in fiscal years 1996 and 1997, the Minnesota Housing Finance Agency disbursed program funds. Figure 2-1 shows the appropriations, expenditures, and year end balances for fiscal years 1994 through 1997.

Figure 2-1
Affordable Rental Investment Fund Financial Transactions
Fiscal Years 1994 - 1997
(In Thousands)



Source: Appropriations Laws, Minnesota Accounting and Procurement System, and the Statewide Accounting System..

Objectives and Methodology

For the two years ended June 30, 1997, we focused on the following objectives for the Affordable Rental Investment Fund:

- Did the agency properly authorize and record disbursements of the Affordable Rental Investment Fund on the state's accounting system?

- Did the agency develop a process to ensure that borrowers used the funds for the program's intended purpose?

To answer these questions, we reviewed the agency's policies and interviewed agency staff to gain an understanding of the controls in place over the disbursements from the Affordable Rental Investment Fund. We also tested selected transactions from the Affordable Rental Investment Fund to verify that the agency properly authorized, documented, and reported transactions in the state's accounting system.

Minnesota Housing Finance Agency

Conclusions

The Minnesota Housing Finance Agency properly authorized and reported Affordable Rental Investment Fund expenditures in the accounting records. As discussed in Finding 1, the agency had not performed inspections of completed projects to determine that borrowers of deferred loan funds complied with the terms of the loan agreements.

1. The Minnesota Housing Finance Agency did not have a process to inspect all facilities funded from Affordable Rental Investment Fund loans.

As part of the Affordable Rental Investment Fund program, the agency issues first mortgage loans and deferred loans. The agency did not monitor the use of appropriated funds for the deferred loans issued for this program. The agency's policy is to perform inspections of these facilities within one year after final closing. For the deferred loans issued as part of the Affordable Rental Investment Fund, staff had not performed inspections for the projects completed since the inception of the program in fiscal year 1994. Although many projects had recently closed or were nearing closure, agency staff identified four properties with closing dates over a year old that they had not inspected.

The agency did not clearly assign the inspection responsibility to specific staff. The agency was using two separate tracking systems, one for deferred loans and one for developments with first mortgage loans. Staff relied on the first mortgage tracking system to monitor all the Affordable Rental Investment Fund loans since a majority of them were made in conjunction with a first mortgage. As a result, however, staff did not track deferred loan developments.

Recommendation

- *The Minnesota Housing Finance Agency should develop a process to ensure that developments which receive Affordable Rental Investment Fund loans receive an initial monitoring inspection within one year of completion.*

Chapter 3. Payroll and Other Administrative Expenditures

Chapter Conclusions

Payroll and other administrative expenditures were authorized, made for a proper purpose, and accurately recorded in the state's accounting system. However, the agency had an inadequate separation of duties over the payroll process. For the items tested, the Minnesota Housing Finance Agency processed its payroll and other administrative expenditures in accordance with applicable legal provisions.

Table 3-1 highlights the Minnesota Housing Finance Agency's administrative expenditures. The agency's largest administrative expenditure was payroll. Other major expenditure areas included rent, other fixed charges, and information system development and maintenance.

Table 3-1
Administrative Expenditures
Fiscal Years 1996 and 1997

	1996	1997
Payroll	$6,828,403	$7,373,674
Fixed Charges	1,380,118	1,516,240
Information System Costs	1,039,740	1,332,761
Rent	726,871	783,131
Equipment	595,429	43,279
Supplies	302,669	375,524
Attorney General	274,881	266,750
Indirect Costs	145,477	195,030
Other	1,091,946	1,286,264
Total Expenditures	$12,385,534	$13,172,653

Source: Minnesota Accounting and Procurement System as of September 30, 1997.

Payroll

Payroll expenditures for fiscal years 1996 and 1997 totaled approximately $14.2 million. The agency employs approximately 170 staff. The agency uses the state's personnel and payroll system.

Minnesota Housing Finance Agency

Objectives and Methodology

In our review of payroll processing, we focused on the following questions:

- Did the Minnesota Housing Finance Agency design and implement internal controls to provide reasonable assurance that it properly recorded its payroll transactions in the state's accounting system?

- Did the Minnesota Housing Finance Agency accurately process payroll transactions in accordance with applicable bargaining agreements and legal provisions?

To answer these questions, we interviewed the agency's personnel and payroll staff to gain an understanding of the controls over payroll expenditures. We tested a sample of payroll transactions to determine whether the agency properly authorized, processed, and recorded these transactions. We also reviewed payroll expenditures to determine if the agency complied with material finance-related legal provisions and bargaining unit agreements.

Conclusions

The Minnesota Housing Finance Agency accurately recorded payroll transactions on the state's accounting system. For the items tested, the agency accurately processed payroll transactions in accordance with applicable bargaining agreements and other legal provisions. However, Finding 2 discusses a weakness in the internal control structure for the payroll process.

2. The Minnesota Housing Finance Agency had an inadequate separation of duties over the payroll process.

All four employees with personnel and payroll duties had full personnel and payroll security clearance. Two of these employees had the ability to change their own records in the personnel and payroll system. In addition, one of these employees was responsible for reviewing payroll reports to verify the accuracy of the processed data. To ensure a proper separation of duties, someone independent of the payroll process should be responsible for verifying the accuracy of the payroll, including changes in employee pay rates. Without an adequate separation of duties, errors or irregularities in payroll could occur and go undetected.

Recommendations

- *The Minnesota Housing Finance Agency should have an independent person review payroll and personnel transactions.*

- *The agency needs to review access to the personnel and payroll system to prevent unauthorized transactions from occurring.*

Other Administrative Expenditures

Minnesota statutes limit the amount that the Housing Finance Agency can spend on administrative costs. The statutes add, however, that the administrative cost limitation does not apply to:

> ...debt service, amortization of deferred financing costs, loan origination costs, professional and other contractual services, any deposit or 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.

Minnesota Laws of 1995 limited the agency's administrative costs to $10,493,000 for fiscal year 1996 and $9,911,000 for fiscal year 1997. For these fiscal years, the agency incurred approximately $9.7 and $9.9 million, respectively, excluding contractual service expenditures for computer system development, computer production and maintenance, attorney general fees, and fixed charges for county administration of loans.

Objectives and Methodology

We focused on the following objective for administrative expenditures:

- Did the Minnesota Housing Finance Agency accurately process and properly record its administrative expenditures on the state's accounting system?
- Did the Minnesota Housing Finance Agency design internal controls to provide reasonable assurance that the agency's expenditures complied with the legal provisions of the appropriation and other applicable finance related legal provisions?

The methodology used to evaluate these audit objectives included analytical reviews, tests of transaction details and balances, and tests of compliance. We reviewed the support for accounting data and substantiated account balances.

Conclusions

The Minnesota Housing Finance Agency accurately processed and properly recorded its administrative expenditures on the state's accounting system. In addition, for the items tested, the agency complied with material finance related legal provisions, including the administrative cost limit established by the Legislature.

Status of Prior Audit Issues
As of April 24, 1998

Most Recent Audits

Legislative Audit Report 94-45, issued in September 1994, covered the two fiscal years ended June 30, 1993. The report contained two findings. First, the agency had not resolved some differences with the servicers' loan records on a timely basis. The office has corrected this finding. Second, the agency administrative cost limitation established by the Legislature did not clarify the types of expenditures to be included. The agency discussed this issue with certain legislative members. No statutory changes were made and the issue has been dropped.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. Finance continues the follow-up process until it is satisfied that the department has resolved the issues. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. Finance does not apply the follow-up process to audits of the University of Minnesota, any quasi-state organizations, such as the Metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

MINNESOTA HOUSING FINANCE AGENCY

July 10, 1998

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
1st Floor South, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

This is in response to the audit report prepared by your office summarizing the results of the audit work of selected activities of the Minnesota Housing Finance Agency (the Agency) for the three years ended June 30, 1997.

Chapter 2, Management Response

The Agency takes very seriously the monitoring of its loan portfolio. We have in place two separate loan tracking systems, one for deferred loans and one for first mortgage loans. Staff has relied on the first mortgage tracking system to monitor the Affordable Rental Investment Fund (ARIF) loans, since the majority of these loans are originated in conjunction with our first mortgage loans. As you have noted in your audit work, a few of the ARIF loans slipped through the system as they were originated without an underlying first mortgage.

As soon as you brought the problem to our attention, we did the following: 1) we transferred the monitoring for the ARIF loans to the Agency's deferred loan tracking system to ensure that all developments will receive an initial monitoring inspection within one year; and 2) we either scheduled or completed inspections for all developments which had not received an initial inspection.

Chapter 3, Management Response

The Agency has a small Human Resources staff, a total of four people. The small number of people involved and the practical reality of scheduled and unscheduled staff absences make it difficult to have an ideal segregation of duties. Nonetheless, the Agency is committed to trying to further separate the duties in this area as follows:

1) Prospectively, the Human Resources Director will have view only SEMA4 capabilities. She will in turn be the primary person responsible for reviewing payroll and personnel transactions. In her absence, these responsibilities will be performed by the Deputy Commissioner.

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2) In addition, the computer access privileges for the remaining three staff have been modified so that they cannot change their own records.

Sincerely,

Katherine G. Hadley
Commissioner

KGH:RH:jmw