State of Illinois
Office of the
Auditor General
Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

ILLINOIS HOUSING DEVELOPMENT AUTHORITY

Financial Audit | **Release Date: December 22, 2016**
For the Year Ended June 30, 2016

FINDINGS THIS AUDIT: 4	New	Repeat	Total
Category 1:	**0**	**2**	**2**
Category 2:	2	0	2
Category 3:	0	0	0
TOTAL	**2**	**2**	**4**

FINDINGS LAST AUDIT: 3

AGING SCHEDULE OF REPEATED FINDINGS

Repeated Since	Category 1	Category 2	Category 3
2015	**16-1**		
2014	**16-2**		

INTRODUCTION

This digest covers the Illinois Housing Development Authority (Authority) Financial Audit as of and for the year ended June 30, 2016. The Authority's Compliance Examination (including the Single Audit) covering the year ended June 30, 2016 will be issued in a separate report at a later date.

SYNOPSIS

- **(16-1)** The Authority has not established adequate internal controls over the financial reporting process.
- **(16-2)** The Authority was unable to support the historical detail assumptions used in its allowance for loan loss calculation for the multi-family loan programs. Additionally, the Authority has not established adequate internal controls over updating loan ratings with current information, documenting the rationale for certain loan ratings, and ensuring the allowance for loan loss is properly calculated and presented in its financial statements.
- **(16-3)** The Authority did not prepare month-end reconciliations of the Authority's cash and investment general ledger account balances to external bank account balances.

Category 1: Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).

Category 2: Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.

Category 3: Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Financial information is summarized on next page.}

ILLINOIS HOUSING DEVELOPMENT AUTHORITY
FINANCIAL AUDIT
For the Year Ended June 30, 2016

FINANCIAL POSITION - ALL FUNDS	2016	2015
Assets		
Cash and investments - unrestricted	$ 632,916,307	$ 763,931,751
Investments - restricted	513,741,455	306,216,011
Net Program loans receivable	1,406,475,640	1,446,255,292
Other	180,955,509	150,772,217
Total	2,734,088,911	2,667,175,271
Deferred Outflows of Resources	1,276,175	3,066,352
Liabilities		
Bonds and Notes Payable	1,080,340,780	1,083,981,566
Due to State of Illinois	348,946,834	348,224,403
Deposits held in escrow	143,067,342	150,156,886
Other	100,822,723	85,469,306
Total	1,673,177,679	1,667,832,161
Deferred Inflows of Resources	11,695,035	20,337,193
Net Position		
Net investment in capital assets	(2,214,380)	(3,649,521)
Restricted	873,984,731	829,268,394
Unrestricted	178,722,561	156,453,396
Total	$ 1,050,492,912	$ 982,072,269

ADMINISTRATIVE FUND OPERATIONS	2016	2015
Revenues		
Service Fees	$ 10,437,703	$ 11,756,295
Interest and investment income	24,072,985	29,718,341
Federal assistance programs	108,917,341	114,250,508
Other	18,399,136	13,789,513
Total	161,827,165	169,514,657
Expenses		
Salaries and benefits	16,916,703	15,935,708
Professional fees	1,775,058	2,310,043
Other general and administrative	2,553,244	4,266,213
Transfers, net	5,699,662	14,507,442
Financing Costs	637,329	633,667
Federal assistance programs	108,917,341	114,250,508
Provision for est. loss on loan receivable	631,697	78,356
Other	1,766,464	4,109,258
Total	138,897,498	156,091,195
Change in net position	$ 22,929,667	$ 13,423,462

EXECUTIVE DIRECTOR
During Engagement: Mary R. Kenney (until 9-18-15), Acting Director: Bryan E. Zises (9-18-15 to 1-15-16) Audra A. Hamernik (2-22-16 to present) Current: Audra A. Hamernik

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

NEED TO IMPROVE CONTROLS OVER FINANCIAL REPORTING

The Illinois Housing Development Authority (Authority) has not established adequate internal controls over the financial reporting process.

During our audit of the financial statements as of June 30, 2016, some of the items we noted are as follows:

Unearned revenue in the Administrative Fund was overstated by $1,526,081

- Unearned revenue in the Administrative Fund was overstated by $1,526,081 as of June 30, 2015 as payouts made under the National Foreclosure Mitigation Counsel Program were not properly recorded during fiscal year 2015. An adjustment was made by the Authority to adjust the June 30, 2016 unearned revenue balance of the Administrative Fund by $1,526,081. This adjustment resulted in other revenue being overstated by $1,526,081 for the year ended June 30, 2016. A proposed adjustment for this difference was not recorded by the Authority.

$281,798 of payroll and benefit expense was recorded in the wrong fiscal year

- The Authority incorrectly recorded $281,798 of payroll benefits expense related to fiscal year 2016 during fiscal year 2015 resulting in salaries and benefits expense within the Administrative Fund being understated by $281,798 for the year ended June 30, 2016. A proposed adjustment for this difference was not recorded by the Authority.

Program loans receivable and interest earned on program loans were overstated by $304,357 in the Administrative Fund

- The Authority inaccurately recorded three loan receivable balances in the Administrative Fund. As a result, program loans receivable and interest earned on program loans for the Administrative Fund were overstated by $304,357. A proposed adjustment for this difference was recorded by the Authority.

Real estate held for sale was understated and other assets were overstated by $1,936,940 in the Single Family Loan Program Fund

- The Authority incorrectly recorded cash advances related to real estate held for sale properties as other assets for the Single Family Loan Program Fund, when these amounts should have been included in the real estate held for sale balance. As a result, real estate held for sale was understated by $1,936,940 and other assets were overstated by $1,936,940. A proposed adjustment for this reclassification was not recorded by the Authority. (Finding 1, pages 85-87)

We recommended the Authority review its current internal control policies and procedures to ensure financial transactions are accurately reported in the general ledger and the financial statements.

Authority officials accepted the recommendation.

NEED TO IMPROVE CONTROLS OVER THE ALLOWANCE FOR LOAN LOSS

Controls over the Allowance for Loan Loss need improvement

The Authority was unable to support the historical detail assumptions used in its allowance for loan loss calculation for the multi-family loan programs. Additionally, the Authority has not established adequate internal controls over updating loan ratings with current information, documenting the rationale for certain loan ratings, and ensuring the allowance for loan loss is properly calculated and presented in its financial statements.

An analysis to substantiate the metrics used has not been performed

During our audit, we reviewed the allowance for loan loss methodology for the multi-family loan program and noted the Authority could not produce an analysis supporting the rationale for its calculation of the loan loss reserve factors (probability of default and expected loss) that are used in its allowance for loan loss calculation and has not recently performed an analysis to further substantiate the ongoing appropriateness of the metrics' used in the allowance for loan loss estimate.

Back-testing of the allowance not performed

The Authority has not documented how the loan loss reserve factors for the multi-family loan programs have been historically calculated and over what period the probability of default is measured. Further, the Authority did not perform back-testing (typically performed on at least an annual basis) on its allowance for loan loss estimates for the multi-family loan programs to determine whether the allowance for loan loss produces estimates that have been historically sufficient to cover incurred losses over a period of time that aligns with the period used to estimate the probability of default values.

Methodology for calculating the probability of default factors did not align with industry practices

Additionally, we reviewed the allowance for loan loss methodology for the single family loan program and noted that the methodology for calculating the probability of default factors did not align with industry practices. We also reviewed the allowance for loan loss methodology for the Hardest Hit program and found that the cash flow analysis provided by the Authority did not support the reserve rate used.

Furthermore, during our testing of 40 multi-family loan relationships risk ratings (62 loans) as of June 30, 2016, we noted differences in the ratings determined by the Authority on their loan rating scale compared to our independent ratings determined during our review.

Some loan ratings tested were not reasonable

We found the Authority's risk ratings to be reasonable on 29 of the 40 relationships (47 of the 62 loans) and we found the Authority's risk ratings to be unreasonable for 11 of the 40 relationships (15 of the 62 loans). These loan rating differences are primarily attributable to the Authority's application of various aspects of their allowance for loan loss rating policy and the timing of updating the loan risk ratings by the Authority.

Some of the differences in loan ratings are as follows:

Housing Trust Fund had an under reserve of $1,686,991

- Seven differences in Housing Trust Fund loan ratings resulted in an under reserve of $1,686,991 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for these differences was not recorded by the Authority.

Home Program Fund had an under reserve of $935,153

- Four differences in Home loan ratings resulted in an under reserve of $935,153 for the Home Program Fund. A proposed adjustment for this difference was not recorded by the Authority.

Administrative Fund had an under reserve of $620,000

- Two differences in Administrative loan ratings resulted in an under reserve of $620,000 for the Administrative Fund. A proposed adjustment for this difference was not recorded by the Authority.

Need to update loan ratings

Additionally, there were three loans where our testing indicated that the Authority had approved updated loan ratings for loan conditions existing as of year-end; however the Authority did not update the loan rating used to calculate the related loan reserves as of year-end. This resulted in the following differences:

- Two differences in Housing Trust Fund loan ratings resulted in a net over reserve of $8,229 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for this difference was recorded by the Authority.

- One difference in an ARRA loan rating resulted in an under reserve of $367,237 for the Nonmajor Governmental Funds. A proposed adjustment for this difference was recorded by the Authority.

Seven loans should have been fully reserved at year-end

Furthermore, there were seven loans where our testing indicated that the loans were in the write-off process as of year-end; however, the Authority did not fully reserve for the related loan losses as of year-end. This resulted in the following differences:

- Three differences in Housing Trust Fund loan ratings resulted in an under reserve of $22,060 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for this difference was recorded by the Authority.

- Four differences in Building Blocks loan ratings resulted in an under reserve of $239,655 for the Build Illinois Bonds Program. A proposed adjustment for this difference was recorded by the Authority. (Finding 2, pages 88-90) **This finding has been repeated since 2014.**

We recommended the Authority review its current policies and procedures to ensure the assumptions used in the allowance for loan loss calculations are appropriate, loan rating assessments are performed timely based on available financial information, and that loan ratings are adequately documented.

Authority officials accepted the recommendation. *(For the previous Department response, see Digest Footnote #1.)*

FAILURE TO RECONCILE CASH AND INVESTMENT ACCOUNTS

The Authority did not prepare month-end reconciliations of the Authority's cash and investment general ledger account balances to external bank account balances.

During our review of cash and investment reconciliations that should have been completed for the months during fiscal year 2016, we noted the Authority did not perform or complete reconciliations over its cash and investment accounts for the months of July 2015 to May 2016. (Finding 3, page 91)

We recommended the Authority review its current policies and procedures to ensure reconciliations over cash and investment accounts are prepared, completed, and reviewed on a monthly basis.

Authority officials accepted the recommendation.

OTHER FINDING

The remaining finding pertaining to inadequate segregation of duties for journal entries is reportedly being given attention by Authority Officials. We will review progress towards implementation of our recommendations in the next audit.

AUDITOR'S OPINION

Our auditors stated the financial statements of the Authority as of June 30, 2016, and for the year then ended, are fairly stated in all material respects.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:TLK

SPECIAL ASSISTANT AUDITORS

Our Special Assistant Auditors for this audit were KPMG LLP.

DIGEST FOOTNOTES

#1 – Need To Improve Controls Over The Allowance For Loan Loss Authority management concurs with the recommendations to continue improving the loan rating and allowance for loan loss processes. IHDA is reviewing current policies and procedures to ensure methodologies used in the allowance for loan loss calculation are appropriate. In addition, IHDA has performed an internal review of historical losses and is in the process of seeking a qualified financial services firm to conduct an independent verification and review of the Authority's allowance for loan loss system. The objective of the review will be to evaluate the policies and methodology of the loan loss system to ensure assumptions are accurate and appropriate based on GAAP standards, historical performance and the Agency's mission to finance the creation and preservation of affordable housing across Illinois. Additionally, as part of this review, IHDA will evaluate procedures to ensure reasonable timelines and documentation standards for loan ratings and allowances for loan loss are more clearly stated and achieved.