STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

ILLINOIS HOUSING DEVELOPMENT AUTHORITY

Financial Audit
For the Year Ended June 30, 2017

Release Date: November 8, 2017

FINDINGS THIS AUDIT: 2

	New	Repeat	Total
Category 1:	**0**	**1**	**1**
Category 2:	**0**	**1**	**1**
Category 3:	**0**	**0**	**0**
TOTAL	**0**	**2**	**2**

FINDINGS LAST AUDIT: 4

AGING SCHEDULE OF REPEATED FINDINGS

Repeated Since	Category 1	Category 2	Category 3
2015		17-2	
2014	**17-1**		

INTRODUCTION

This digest covers the Illinois Housing Development Authority (Authority) Financial Audit as of and for the year ended June 30, 2017. The Authority's Compliance Examination (including the Single Audit) covering the year ended June 30, 2017 will be issued in a separate report at a later date.

SYNOPSIS

- **(17-1)** 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 for ensuring the allowance for loan loss is properly calculated and presented in its financial statements.

- **(17-2)** The Authority has not established adequate internal controls over the financial reporting process.

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, 2017

FINANCIAL POSITION - ALL FUNDS	2017	2016
Assets		
Cash and investments - unrestricted	$ 746,499,987	$ 632,916,307
Investments - restricted	745,588,980	513,741,455
Net Program loans receivable	1,306,871,453	1,406,475,640
Other	176,593,285	180,955,509
Total	2,975,553,705	2,734,088,911
Deferred Outflows of Resources	688,821	1,276,175
Liabilities		
Bonds and Notes Payable	1,147,673,217	1,080,340,780
Due to State of Illinois	340,321,548	348,946,834
Deposits held in escrow	141,574,862	143,067,342
Other	131,911,001	100,822,723
Total	1,761,480,628	1,673,177,679
Deferred Inflows of Resources	8,278,172	11,695,035
Net Position		
Net investment in capital assets	273,370	(2,214,380)
Restricted	1,001,365,319	873,984,731
Unrestricted	204,845,037	178,722,561
Total	$ 1,206,483,726	$ 1,050,492,912

ADMINISTRATIVE FUND OPERATIONS	2017	2016
Revenues		
Service Fees	$ 9,234,024	$ 10,437,703
Interest and investment income	30,629,303	24,072,985
Federal assistance programs	97,716,978	108,917,341
Other	17,611,636	18,399,136
Total	155,191,941	161,827,165
Expenses		
Salaries and benefits	18,847,698	16,916,703
Professional fees	1,840,593	1,775,058
Other general and administrative	1,735,059	2,553,244
Transfers, net	5,239,999	5,699,662
Financing Costs	751,585	637,329
Federal assistance programs	97,716,978	108,917,341
Provision for est. loss on loan receivable	1,757,569	631,697
Other	141,538	1,766,464
Total	128,031,019	138,897,498
Change in net position	$ 27,160,922	$ 22,929,667

EXECUTIVE DIRECTOR
During Engagement: Audra A. Hamernik Current: Audra A. Hamernik

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

INADEQUATE ALLOWANCE FOR LOAN LOSS METHODOLOGY AND LOAN RATING REVIEW PROCESS

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 for ensuring the allowance for loan loss is properly calculated and presented in its financial statements.

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.

Back-testing of the allowance was 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.

Additionally, we 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 (66 loans) as of June 30, 2017, 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 18 of the 40 relationships (26 of the 66 loans) and we found the Authority's risk ratings to be unreasonable for 22 of the 40 relationships (40 of the 66 loans).

Some of the differences in loan ratings are as follows:

- 15 differences in Housing Trust Fund loan ratings resulted in an under reserve of $66,772 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for these differences was not recorded by the Authority.

- 11 differences in HOME loan ratings resulted in an under reserve of $1,344,064 for the HOME Program Fund. A proposed adjustment for these differences was not recorded by the Authority.

HOME Program Fund had an under reserve of $1,344,064

- Five differences in Housing Bonds loan ratings resulted in an under reserve of $1,053,269 for the Mortgage Loan Program Fund. A proposed adjustment for these differences was not recorded by the Authority.

Additionally, the Authority identified 19 loans which were reserved for incorrectly at June 30, 2017. The following are some of the differences attributable to calculation errors when applying the Authority's allowance for loan loss rating policy:

Housing Trust Fund had an under reserve of $4,105,709

- 14 differences in Housing Trust Fund loan ratings resulted in an under reserve of $4,105,709 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for these differences was recorded by the Authority.

- One difference in a HOME loan rating resulted in an under reserve of $128,436 for the HOME Program Fund. A proposed adjustment for this difference was recorded by the Authority.

Administrative Fund had an under reserve of $1,799,250

- Three differences in Administrative loan ratings resulted in an under reserve of $1,799,250 for the Administrative Fund. A proposed adjustment for these differences was recorded by the Authority.

Additionally, there were four Housing Trust Fund 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 an under reserve of $317,124 for the Illinois Affordable Housing Trust Fund. A proposed adjustment for these differences was not recorded by the Authority.

Authority misclassified the allowance for estimated losses

Furthermore, the Authority misclassified the allowance for estimated losses of six Single Family loans as real estate held for sale, which resulted in an over reserve of $135,824 for the allowance for estimated losses - real estate held for sale and an under reserve of $41,264 for the allowance for estimated losses – program loans receivable. A proposed adjustment for these differences was recorded by the Authority. (Finding 1, pages 83-85) **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 and that loan ratings are adequately documented.

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

INACCURATE 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, 2017, we noted the following:

Reclassification entry between current and noncurrent liabilities totaled $21,450,000

- The Authority incorrectly recorded $21,450,000 of bank note cash collateral within the Administrative Fund as a current liability as of June 30, 2017, when the amounts were due to be paid more than one year after June 30, 2017. As a result, noncurrent liabilities were understated by $21,450,000 and current liabilities were overstated by $21,450,000. A proposed adjustment for this reclassification was recorded by the Authority.

- The Authority incorrectly recorded $4,200,000 of operating expenses, $1,043,311 of depreciation, $550,098 of capital expenditures, and $350,000 of prepaid expenses related to a capital asset as reductions to other income within the Mortgage Loan Program Fund. As a result, other income was understated by $6,143,409, other general and administrative expenses were understated by $5,244,377, fixed assets (net) were understated by $549,032, and other assets were understated by $350,000. A proposed adjustment for these differences was recorded by the Authority. (Finding 2, pages 86-87) **This finding has been repeated since 2015.**

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. *(For the previous Authority response, see Digest Footnote #2.)*

AUDITOR'S OPINION

Our auditors stated the financial statements of the Authority as of June 30, 2017, and for the year then ended, are fairly stated in all material respects.

SIGNED ORIGINAL ON FILE

Jane Clark
Division Director

This report is transmitted in accordance with Section 3-14 of the Illinois State Auditing Act.

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

Multi-Family Allowance: The Authority is in the process of updating its Loan Rating Policy (along with the related forms and procedures) to ensure the allowances for loan loss are appropriately calculated and recorded. While none of the loan losses actually incurred have ever exceeded the loan loss allowances over the same period of time, the Authority strives to be a prudent fiscal administrator and accurately report on the expected value of its loans. As part of the process to update the Loan Rating Policy, IHDA completed an independent assessment of the policy in 2016 using a nationally recognized accounting firm specializing in affordable housing. In addition to addressing the recommendations from that review, IHDA is incorporating helpful suggestions from KPMG received during this audit as well as historical performance of the loans into a revised policy that is expected to be completed in the 1st Quarter of 2017. The Authority has reviewed KPMG's detailed findings for each of the loan rating differences and is committed to implementing a practical and effective loan rating policy that addresses the identified concerns.

Single Family Allowance:
In regards to the Single Family Loan Loss default rates, IHDA will continue to calculate the loan emergence period (LEP) as the average time in which a loan incurs its first charge-off (REO paid in full) back to the determined loss event. We will then take all 60, 90 and 120 day delinquent loans at the start of the LEP and determine the number of these loans that complete the REO paid in full process by the end of the period. This loan count divided by the starting loan count will provide the default rates for the 60, 90 and 120 day buckets as recommended by KPMG to conform to industry standards.

<u>#2 – Inaccurate Financial Reporting</u>

Unearned revenue overstatement:
The staff member responsible for recording the NFMC Program was new to the Accounting department, and did not fully understand how the Program's payouts were to be recorded. The payouts for this program required a 4-line entry, and the staff member only recorded 2 of the 4 necessary journal entry lines. Additionally, the new hire's work was not checked thoroughly for accuracy by the Supervisor, so the oversight that created this recording error went unnoticed. Training has occurred specific to this program, between the staff member and the immediate Supervisor. The full entry was explained and identified, and a journal entry template was provided that identifies all accounts impacted by program payouts for NFMC. During the following fiscal year (FY2016), the Program's general ledger was reviewed for accuracy, subsequent to each payout, and it was determined that all payouts were subsequently recorded accurately.

Payroll benefits recorded in incorrect year:
The year-end payroll accrual was processed as a FY15 payable instead of a FY16 payable. The accounts payable accrual was created and reviewed however this item was an oversight.

Incorrect allocation of payroll expense from Admin Fund to Housing Trust Fund and Rental Housing Support Program Fund:
The staff member responsible for calculating salary\benefits allocations, for the government funded programs, accidentally copied rates that are associated with "percentage of time worked on program", of full-time RHSP program staff, to subsequently listed IHDA staff, staff that only worked on the RHSP on a part-time basis. The allocation reports are maintained in Excel, and the accident that involved applying the rates to subsequent staff, was a manual error.

For the following fiscal year, there were recalculations done on FY2014 and FY2015 salary\benefit allocations, for RHSP, and the funder received credits for the amounts that were overpaid related to the original errors.

The staff member responsible for gathering and completing the salary\benefit allocations has stated that a greater level of accuracy can be ensured with a new cross checking system. The staff member now reviews each IHDA staff's percentage rate, against rates that have been listed with other programs to ensure that the individual's rate do not exceed 100%. This procedure is only done for IHDA staff that are charging to the government funded programs. The Human Resources department is currently evaluating a module within the payroll system to automate the allocation calculation.

Loans receivable overstatement:
A staff member reconciled the administrative loans accounts in April and found that $304,337 in loans was distributed but not recorded on the ledger. The staff member made the adjustment to record the three loans. The May loan reports included the $304K but another staff member missed it thus the double recording. The Authority made the appropriate adjustment to adjust the overage. Account reconciliations are completed before the end of the subsequent month and reconciling variances are investigated, identified and cleared within 30 days.

REO overstatement:
The Authority advances funds to cover various types of insurance and repairs for single family and real estate held for sale properties and has traditionally recorded all of the advances in "other assets". REO proceeds are not recorded against the open ledger balances until all of the proceeds from various sources are collected (i.e., insurance and sales). Traditionally, the unfinalized proceeds are recorded as an "other liability". The Authority will reclass the unfinalized REO proceeds against the REO receivable for reporting purposes until the sale is final at which time the REO proceeds will offset the REO receivable account.