

# Audit Report

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## **Department of Housing and Community Development**

**Division of Development Finance  
Division of Credit Assurance  
Division of Neighborhood Revitalization**

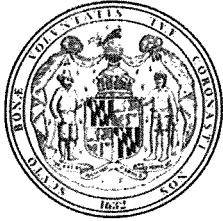
July 2012

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**OFFICE OF LEGISLATIVE AUDITS**  
**DEPARTMENT OF LEGISLATIVE SERVICES**  
**MARYLAND GENERAL ASSEMBLY**

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

July 19, 2012

Karl S. Aro  
Executive Director

Bruce A. Myers, CPA  
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Division of Development Finance, the Division of Credit Assurance, and the Division of Neighborhood Revitalization within the Department of Housing and Community Development (DHCD) for the period beginning March 1, 2008 and ending March 29, 2011. DHCD works with partners to finance housing opportunities and revitalize places for Maryland citizens to live, work, and prosper.

Our audit disclosed that reports used by DHCD to verify interest revenue received from title insurance company escrow accounts were not reviewed timely, and the reports did not always include documentation necessary to ensure that all interest due was received. Income received from escrow accounts totaled \$793,000 for fiscal year 2011 and was used to finance the operations of the Maryland Affordable Housing Trust. In addition, escrow interest revenue erroneously deposited with another State entity, totaling \$194,000, had not been recovered until our inquiries. Finally, discrepancies in amounts due from the federal government for Section 8 housing assistance administrative services DHCD provided had not been resolved.

DHCD's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by DHCD.

Respectfully submitted,

A handwritten signature in black ink, reading "Thomas J. Barnickel III", is positioned above the printed name.

Thomas J. Barnickel III, CPA  
Acting Legislative Auditor



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\* Denotes item repeated in full or part from preceding audit report

## **Background Information**

### **Agency Responsibilities**

The Department of Housing and Community Development (DHCD) works with partners to finance housing opportunities and revitalize places for Maryland citizens to live, work, and prosper. To deliver these services, DHCD is organized into six units. This audit report includes the operations of the following three units:

- Division of Development Finance
- Division of Credit Assurance
- Division of Neighborhood Revitalization

According to the State's records, during fiscal year 2011, DHCD expenditures totaled approximately \$322.3 million, of which \$308.1 million related to the units audited. The remaining units of DHCD (Office of the Secretary, Division of Finance and Administration, and Division of Information Technology) are included within the scope of a separate audit conducted by our Office.

The Division of Development Finance (DDF) consists primarily of the Community Development Administration (CDA). CDA works to increase the supply of affordable housing within Maryland for the disabled, the elderly, and families with low and moderate incomes. To assist in this mission, CDA provides loans for the purchase and/or rehabilitation of single family homes and for the acquisition, construction, renovation, and/or rehabilitation of multifamily rental housing, transitional housing, and emergency shelters. Approximately 98 percent of CDA's single family mortgage loans are insured or guaranteed to varying degrees by agencies of the United States government, the Maryland Housing Fund (discussed below), or private mortgage insurers and all of CDA's multifamily loans are insured or guaranteed. DDF also provides rehabilitation and weatherization assistance to improve basic livability, to increase energy conservation, and to meet unique housing needs, including lead paint hazard reduction, accessibility improvements for seniors, and financing of group homes. These housing programs are funded primarily by revenue bonds issued by CDA, State general obligation bonds, State appropriations, federal funds, and federal tax credits.

The Division of Credit Assurance is responsible for the Maryland Housing Fund (MHF) which was created in 1971 to insure certain mortgage loans issued by DHCD. According to audited financial statements, as of June 30, 2011, MHF's outstanding insurance commitments totaled approximately \$62.1 million for

single family mortgages and approximately \$104.9 million for multifamily mortgages, and MHF had total net assets of approximately \$79.8 million.

The Division of Neighborhood Revitalization provides funding and technical assistance to local governments, nonprofit organizations, community groups, and businesses. Through this assistance, DHCD revitalizes communities, improves basic infrastructure, creates small business and housing opportunities, rejuvenates traditional business districts and cultural amenities, reuses historic sites, and upgrades parks and playgrounds.

The following chart presents certain financial data pertaining to DHCD's outstanding loans as of June 30, 2011:

<b>Loans Outstanding as of June 30, 2011</b>				
<b>(in millions)</b>				
	<b>Single Family</b>	<b>Multifamily</b>	<b>Other</b>	<b>Total</b>
From State Funds	\$ 70.8	\$ 402.9	\$ 78.6	\$ 552.3
From Revenue Bonds	2,067.4	606.2	126.8	2,800.4
Total Loans Receivable	\$2,138.2	\$1,009.1	\$205.4	\$3,352.7

**Source:** Audited Financial Statements and DHCD records

## **Financial Statement Audits**

DHCD engaged independent accounting firms to perform audits of certain of its financial activities. Based on materiality and risk, we reviewed the following financial statements for the fiscal year ended June 30, 2011:

- CDA Single Family Housing Revenue Bonds
- CDA Revenue Obligation Funds
- CDA Multi-Family Mortgage Revenue Bonds

In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the related financial positions as of June 30, 2011, and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

## **Organizational Change**

Effective October 22, 2010, DHCD transferred the Maryland Affordable Housing Trust (MAHT) from DHCD's Office of the Secretary to DHCD's Division of Development Finance. The scope of this audit included the activities of MAHT.

## **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of the eight findings contained in our preceding audit report dated March 11, 2009. Because of the aforementioned organizational change, we also determined the status of one finding contained in our preceding audit report on DHCD's other units dated February 19, 2009. We determined that DHCD satisfactorily resolved eight of these findings. The remaining finding is repeated in this report.



## Findings and Recommendations

### Maryland Affordable Housing Trust

The Maryland Affordable Housing Trust (MAHT) is a charitable public corporation which operates under the direction of an 11-member board of trustees and is administered by the Department of Housing and Community Development (DHCD) to promote affordable housing in the State. It acquires funds primarily through interest earned on escrow accounts of the State's approximately 1,000 title insurance companies, and it awards grants to eligible applicants (such as nonprofit organizations and local government agencies) for activities such as the acquisition, construction, rehabilitation, and preservation of affordable housing. According to DHCD's records for fiscal year 2011, income received by MAHT totaled approximately \$1.7 million, of which the majority was interest earned on escrow accounts (\$793,000) and income from the State's general bond reserve fund (\$680,000). Grant expenditures for fiscal year 2011 totaled approximately \$2 million, and the program's year-end fund balance totaled \$2.5 million.

#### **Finding 1**

**Escrow reports submitted by title insurance companies were not reconciled on a timely basis to interest received, and the reports often lacked required supporting documentation.**

#### **Analysis**

Escrow reports submitted by title insurance companies were not reconciled on a timely basis to interest received on a quarterly basis from the applicable financial institutions, and several reports we examined lacked required supporting documentation. These annual reports are due by March 31 for the preceding calendar year and include financial data, such as the amount deposited and interest earned for each escrow account established, and are used by DHCD to help ensure that the correct amount of interest is received. We noted the following conditions:

- The reconciliation of escrow reports to actual interest received for calendar year 2008 was not performed until October 2009. In addition, the reconciliation for calendar year 2009 was not performed until September 2010 and unresolved discrepancies noted for this year had not been submitted to the Maryland Insurance Administration (MIA) for resolution as of May 2011.<sup>1</sup> According to DHCD's records for 2009, which we tested and determined were

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<sup>1</sup> Effective December 2006, MIA agreed to assist DHCD in monitoring and enforcing reporting compliance as part of its oversight responsibilities for title insurance companies.

reliable for our purposes, there were 36 unexplained discrepancies in which reported interest exceeded interest received by approximately \$78,000. At the time of our review in May 2011, the reconciliation for 2010 had not yet been prepared. A similar condition was commented upon in our preceding audit report.

- Our test of 10 calendar year 2009 escrow reports disclosed 4 instances in which documentation was not provided by the title insurance company nor obtained by DHCD to support bank service charges deducted from interest paid to DHCD. State regulations permit financial institutions to deduct reasonable and customary service charges from interest due DHCD, but prohibit the deduction of certain charges, such as overdraft fees. Because the reported service charges (\$54,000) exceeded the reported interest (\$32,800), MAHT received no interest for these four accounts. Without such documentation, such as an itemized statement of the charges incurred, there is a lack of assurance that only valid service charges were deducted from interest due DHCD. During fiscal year 2009, financial institutions claimed approximately \$390,000 in services charges. A similar condition was commented upon in our two preceding audit reports.

#### **Recommendation 1**

**We recommend that DHCD**

- a. perform reconciliations of interest earnings as reported in annual escrow reports to funds actually received, and report unresolved discrepancies to MIA in a timely manner (repeat); and**
- b. obtain adequate supporting documentation for service charges deducted from interest remitted by financial institutions (repeat).**

#### **Finding 2**

**MAHT funds erroneously deposited with another State entity had not been recovered until our inquiries.**

#### **Analysis**

DHCD did not request the return of MAHT funds totaling approximately \$194,000 mistakenly deposited by a financial institution with the Maryland Legal Services Corporation (MLSC), nor was adequate approval obtained to allow MLSC to keep the funds. These funds represented interest earned from 2006 through 2008 on an escrow account established by a title insurance company, and therefore should have been deposited with MAHT. According to management at MLSC, the bank notified MLSC in January 2009 that interest earned on the account had been mistakenly credited to MLSC, and MLSC subsequently advised MAHT personnel.

The error occurred, in part, because of similarities in revenue sources for MAHT and MLSC. Similar to MAHT's interest from title insurance escrow accounts, financial institutions submit interest earned on lawyer trust accounts to MLSC. MAHT advised us that a decision was made by MAHT personnel to allow MLSC to keep the funds. However, approval was not obtained from the Secretary of DHCD or MAHT's Board of Trustees. Since the law specifies that interest on title company escrow accounts is to be remitted to MAHT, we questioned whether MLSC should have been permitted to retain the funds, and whether such a decision should have been made without approval of the Secretary and Board of Trustees. Nevertheless, after our inquiries, these funds were recovered.

## **Recommendation 2**

**We recommend that, in the future, DHCD ensure that similar decisions are presented to the Secretary and Board of Trustees for approval.**

## **Administrative Service Fees**

### **Finding 3**

**Discrepancies in amounts due from the federal government have remained unresolved.**

### **Analysis**

Discrepancies in amounts due from the U.S. Department of Housing and Urban Development (HUD) for administrative services performed by DHCD regarding federal Section 8 housing assistance have remained unresolved. According to DHCD's records, as of March 31, 2011, fees due from HUD but not received totaled approximately \$421,000 and date back to September 2008. According to DHCD, this condition is primarily the result of certain differences in critical data (such as fair market rents) used by HUD and DHCD to determine fees due. According to its records, DHCD collected fees from HUD totaling approximately \$4.6 million from October 2010 through March 2011.

DHCD has contracted with HUD to administer Section 8 housing assistance agreements with owners of covered housing units. For example, DHCD conducts periodic site management and occupancy reviews of applicable housing units, reviews monthly vouchers for payments to unit owners, and provides HUD with certain reports and other required data. Fees paid to DHCD for these services are based primarily on the number of units under administration and the fair market rent for those units.

DHCD advised us that it has previously attempted to resolve these fee discrepancies with HUD, and that it continues to do so, but that it has very little leverage in dealing with HUD regarding this matter. The amount of the discrepancies may continue to grow until DHCD and HUD come to agreement on this matter.

**Recommendation 3**

**We recommend that DHCD continue its efforts to**

- a. resolve the reason for the discrepancies between calculated service fees due and fees actually received, and**
- b. collect any previously uncollected fees due.**

## **Audit Scope, Objectives, and Methodology**

We have audited the following units of the Department of Housing and Community Development (DHCD) for the period beginning March 1, 2008 and ending March 29, 2011:

Division of Development Finance  
Division of Credit Assurance  
Division of Neighborhood Revitalization

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DHCD's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included specific programs (such as loan insurance and other financing programs) used by DHCD to promote housing opportunities and revitalize localities throughout the State. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of DHCD's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

DHCD engaged independent accounting firms to perform audits of certain of its financial activities. Based on materiality and risk, we reviewed the following financial statements of the Division of Development Finance's Community Development Administration for the fiscal year ended June 30, 2011:

- Community Development Administration Single Family Housing Revenue Bonds
- Community Development Administration Revenue Obligation Funds

- Community Development Administration Multi-Family Mortgage Revenue Bonds

In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the related financial positions as of June 30, 2011, and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage of the aforementioned revenue bonds issued by DHCD's Community Development Administration. Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

Our audit did not include certain support services (such as payroll, maintenance of accounting records, and related fiscal functions) provided by DHCD's Division of Finance and Administration. These support services are included within the scope of our audit of the Division. In addition, our audit did not include an evaluation of internal controls for federal financial assistance programs and an assessment of DHCD's compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including DHCD.

DHCD's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DHCD's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes a finding regarding a significant instance of noncompliance with

applicable laws, rules, or regulations. Other less significant findings were communicated to DHCD that did not warrant inclusion in this report.

DHCD's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DHCD regarding the results of our review of its response.

## APPENDIX



MARTIN O'MALLEY  
*Governor*  
ANTHONY G. BROWN  
*Lt. Governor*  
RAYMOND A. SKINNER  
*Secretary*  
CLARENCE J. SNUGGS  
*Deputy Secretary*

July 11, 2012

Bruce A. Myers, CPA  
Legislative Auditor  
Department of Legislative Services  
Office of Legislative Audits  
301 West Preston Street, Room 1202  
Baltimore, MD 21201


Dear Mr. Myers:

Enclosed please find our response to the legislative audit report of the Department of Housing and Community Development (DHCD) - Division of Development Finance, Division Credit Assurance, and Division of Neighborhood Revitalization for the period beginning March 1, 2008 and ending March 29, 2011.

I have reviewed the findings and recommendations contained in the report and have committed the DHCD to a plan of corrective action, which is summarized in the attachment. Additionally, our plan of action documents the approximate time frame for compliance with the audit report's recommendations.

The DHCD views the correction of legislative audit findings with the utmost seriousness. You can be assured that every action will be taken to ensure compliance with the audit's recommendations. If you have any questions regarding our response, please do not hesitate to contact me or Mr. Gary Beaver, Internal Audit Manager, at 410-514-7032 or by email at [beaver@mdhousing.org](mailto:beaver@mdhousing.org).

Sincerely,

  
Raymond A. Skinner  
Secretary

Attachment

cc: Mr. Gary Beaver, Internal Audit Manager, DHCD





## **Maryland Affordable Housing Trust**

### **Finding 1**

**Escrow reports submitted by title insurance companies were not reconciled on a timely basis to interest received, and the reports often lacked required supporting documentation.**

### **Recommendation 1**

**We recommend that DHCD**

- a. perform reconciliations of interest earnings as reported in annual escrow reports to funds actually received, and report unresolved discrepancies to MIA in a timely manner (repeat); and**
- b. obtain adequate supporting documentation for service charges deducted from interest remitted by financial institutions (repeat).**

### **DHCD's Response:**

DHCD concurs with the finding and recommendations. The Department is working to clear a backlog of interest revenue discrepancies with the assistance of the MIA who regulates the title insurance companies. The calendar year 2010 reconciliation was completed and cases referred to MIA on June 30, 2011. The calendar year 2011 reconciliation will begin in the autumn of 2012.

DHCD is working with MIA to enforce the production of sufficient documentation related to the types of bank service charges being charged and to determine their appropriateness. DHCD and MIA have adopted a two-pronged approach to address this issue. First, in June 2011 DHCD reported 38 title insurance companies to MIA for enforcement action and reported 26 others whose banks deducted fees incorrectly from the interest earned on the title insurance companies' MAHT accounts. MIA is taking action on title insurance companies requiring them to provide additional details on the service charges on their MAHT accounts or face penalty, sanctions or other forms of regulatory enforcement by the Insurance Commissioner. Second, DHCD and MIA have consulted with the Maryland Office of the Attorney General to advise and assist in a strategy to directly approach several banks to demand clearer documentation on their service charges on MAHT accounts. This effort is used in cases where title insurance companies have experienced difficulties in obtaining sufficient documentation from their banks to resolve questions about service charges on MAHT accounts.

### **Finding 2**

**MAHT funds erroneously deposited with another State entity had not been recovered until our inquiries.**

### **Recommendation 2**

**We recommend that, in the future, DHCD ensure that similar decisions are presented to the Secretary and Board of Trustees for approval.**

## **DHCD's Response:**

DHCD concurs with the finding and recommendation. In a letter dated December 14, 2011 the Chairperson of the MAHT Board of Trustees wrote to the Executive Director of the Maryland Legal Services Corporation requesting the funds in question. In January 2012, DHCD received and deposited a reimbursement for MAHT in the amount of \$194,145. In the future, the Secretary and Board of Trustees will be informed of any such misrouting of MAHT funds for their consideration.

## **Administrative Service Fees**

### **Finding 3**

**Discrepancies in amounts due from the federal government have remained unresolved.**

### **Recommendation 3**

**We recommend that DHCD continue its efforts to**

- a. resolve the reason for the discrepancies between calculated service fees due and fees actually received, and**
- b. collect any previously uncollected fees due.**

DCHD concurs with the finding and recommendations. However, DHCD wishes to clarify some financial misinformation in the finding. The finding gives a misimpression that HUD owes or has under paid DHCD administrative service fees in the amount of \$421,000 for the time period in question. Most of this amount is due to a timing difference within the billing and payment cycle created by the HUD system. For example, HUD provides a "Monthly Summary ACC Amendment" to DHCD detailing occupied housing units for a given month for DHCD to determine, among other things, the amount of its administrative service fee billing based upon the unit counts on the Summary. This Summary is dated a full month prior to the actual billing month. However, HUD pays DHCD about two months later based upon its more current, updated occupancy data. For this part of the equation, DHCD is being paid a correct and final amount based upon actual occupancy data for the billing month.

However, DHCD and HUD were in dispute over the application of Fair Market Rents (FMR) to housing projects located in the city of Columbia which is located in Howard County, Maryland. There is an exception to Howard County FMRs for properties located in the city of Columbia which are much higher than those for Howard County generally. The HUD Baltimore office had not been applying them despite DHCD's repeated protests of being underpaid for its earned administrative service fees associated with those units. In early 2012, DHCD initiated an appeal to HUD headquarters in Washington DC to resolve the issue. As a result, HUD headquarters agreed with DHCD's position and reimbursed DHCD for the amount it had been underpaid based on the FMR dispute. In May 2012, HUD reimbursed DHCD the associated amount of \$159,710. Going forward, HUD will pay DHCD the correct FMR for these units located in the city of Columbia.

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