



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT

PERFORMANCE AUDIT  
OF

HOMEOWNERSHIP PROGRAMS

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY  
MICHIGAN STRATEGIC FUND

April 2014



THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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*<http://audgen.michigan.gov>*



Michigan  
Office of the Auditor General  
**REPORT SUMMARY**

*Performance Audit*

Report Number:  
271-0205-13

*Homeownership Programs*

*Michigan State Housing Development Authority  
Michigan Strategic Fund*

Released:  
April 2014

*The Michigan State Housing Development Authority (MSHDA) was established by Act 346, P.A. 1966, and is an autonomous entity within the Michigan Strategic Fund, except for budgeting, procurement, and related functions. MSHDA's mission is to provide financial and technical assistance through public and private partnerships to create and preserve decent, affordable housing for low-income and moderate-income residents and to engage in community economic development activities to revitalize urban and rural communities.*

**Audit Objective:**

To assess the effectiveness of MSHDA's efforts in providing financing to Michigan residents with low and moderate income for the purchase of single-family homes.

**Audit Conclusion:**

We concluded that MSHDA's efforts in providing financing to Michigan residents with low and moderate income for the purchase of single-family homes were effective. However, we noted one reportable condition (Finding 1).

**Reportable Condition:**

MSHDA did not comply with all U.S. Department of Housing and Urban Development quality control requirements related to its single-family mortgages (Finding 1).

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**Audit Objective:**

To assess the efficiency and effectiveness of MSHDA's efforts in providing assistance to Michigan homeowners under the Hardest Hit Fund (HHF) Program to help prevent foreclosures and stabilize housing markets.

**Audit Conclusion:**

We concluded that MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program to help prevent foreclosures and stabilize housing markets were efficient. However, we concluded that MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program were moderately effective. We noted two reportable conditions (Findings 2 and 3).

**Reportable Conditions:**

MSHDA did not ensure that HHF Program applicants met eligibility requirements before awarding HHF Program assistance (Finding 2).

MSHDA had not established sufficient access controls over its HHF Program systems (Finding 3).

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**Audit Objective:**

To assess the effectiveness of MSHDA's efforts in providing homeownership counseling to eligible Michigan residents.

**Audit Conclusion:**

We concluded that MSHDA's efforts in providing homeownership counseling to eligible Michigan residents were effective. Our audit report does not include any reportable conditions related to this audit objective.

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**Agency Response:**

Our audit report contains 3 findings and 3 corresponding recommendations. MSHDA's preliminary response indicates that it agrees with 2 recommendations and disagrees with 1 recommendation.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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**Thomas H. McTavish, C.P.A.**  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

April 23, 2014

Mr. Scott Woosley, Executive Director  
Michigan State Housing Development Authority  
735 East Michigan Avenue  
Lansing, Michigan  
and

Mr. R. Kevin Clinton, Chair  
Michigan State Housing Development Authority Board  
Richard H. Austin Building  
Lansing, Michigan

Mr. Michael A. Finney, President  
Michigan Strategic Fund  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Woosley, Mr. Clinton, and Mr. Finney:

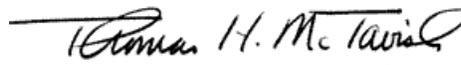
This is our report on the performance audit of Homeownership Programs, Michigan State Housing Development Authority, Michigan Strategic Fund.

This report contains our report summary; a description of agency; our audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; Hardest Hit Fund Program outcomes, presented as supplemental information; and a glossary of abbreviations and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

  
Thomas H. McTavish, C.P.A.  
Auditor General



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## Description of Agency

The Michigan State Housing Development Authority (MSHDA) was established by Act 346, P.A. 1966 (Sections 125.1401 - 125.1499c of the *Michigan Compiled Laws*). MSHDA is an autonomous entity within the Michigan Strategic Fund, except for budgeting, procurement, and related functions. MSHDA is governed by a Board of Directors that is composed of 8 members, 5 of which are appointed by the Governor, with the advice and consent of the Senate. The other three members are directors of State departments and consist of the State Treasurer, the director of the Michigan Department of Transportation, and the director of the Department of Human Services.

MSHDA's mission\* is to provide financial and technical assistance through public and private partnerships to create and preserve decent, affordable housing for low-income and moderate-income residents and to engage in community economic development activities to revitalize urban and rural communities.

Act 346, P.A. 1966, as amended, authorizes MSHDA to issue notes and bonds to finance multi-family housing projects, single-family housing units, and home improvements for persons of low and moderate income within the State of Michigan. MSHDA uses bond proceeds from its single-family revenue bonds to fund its homeownership programs for home mortgage and down payment assistance. MSHDA's other homeownership programs, such as homeownership counseling, home improvement, and foreclosure prevention, are funded with MSHDA operating funds and/or federal funds.

MSHDA primarily administered its homeownership programs within the Homeownership Division. As of June 30, 2013, MSHDA reported total expenses of \$917.5 million. As of June 30, 2013, MSHDA had 389 employees, of which 87 were housed within the Homeownership Division.

\* See glossary at end of report for definition.

## Audit Objectives, Scope, and Methodology and Agency Responses

### Audit Objectives

Our performance audit\* of Homeownership Programs, Michigan State Housing Development Authority (MSHDA), Michigan Strategic Fund, had the following objectives:

1. To assess the effectiveness\* of MSHDA's efforts in providing financing to Michigan residents with low and moderate income for the purchase of single-family homes.
2. To assess the efficiency\* and effectiveness of MSHDA's efforts in providing assistance to Michigan homeowners under the Hardest Hit Fund (HHF) Program to help prevent foreclosures and stabilize housing markets.
3. To assess the effectiveness of MSHDA's efforts in providing homeownership counseling to eligible Michigan residents.

### Audit Scope

Our audit scope was to examine the program and other records of the Michigan State Housing Development Authority related to homeownership programs. We conducted this performance audit 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. Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered the period July 1, 2010 through June 30, 2013.

As part of our audit report, we included supplemental information that relates to our audit objectives and findings (Hardest Hit Fund Program Outcomes). Our audit was not directed toward expressing a conclusion on this information and, accordingly, we express no conclusion on it.

\* See glossary at end of report for definition.

## Audit Methodology

We conducted a preliminary review of MSHDA's homeownership programs to formulate a basis for defining the audit objectives and scope. Our preliminary review included interviewing MSHDA staff; reviewing applicable laws, rules, regulations, policies, procedures, reports, board meeting minutes, and other information; analyzing available records and data; and obtaining an understanding of MSHDA's homeownership programs' internal control\* and operational activities.

To accomplish our first audit objective, we reviewed eligibility requirements for MSHDA's single-family loan program and MSHDA's processes for underwriting loans. We tested a sample of single-family loans for sufficient evidence that the loans met MSHDA and applicable U.S. Department of Housing and Urban Development (HUD) eligibility requirements. We reviewed MSHDA's quality control contract provisions and compared them with HUD quality control guidelines. We reviewed MSHDA's processes for monitoring its quality control contract and utilizing quality control review results to monitor participating lenders and its servicer. We obtained an understanding of MSHDA's processes for establishing single-family loan interest rates, and we compared these interest rates with MSHDA's borrowing costs.

To accomplish our second audit objective, we judgmentally selected 11 and randomly selected 10 HHF Program applications approved during our audit period. In addition, we selected a nonstatistical sample of 43 HHF Program applications approved during our audit period. We tested all 64 approved applications for compliance with applicable eligibility requirements and MSHDA policies and procedures. We also tested selected declined and withdrawn HHF Program applications to ensure that they were properly processed in accordance with MSHDA policies and procedures. In addition, we tested selected applications that were submitted over the telephone and applications submitted by homeowners who had received a notice of foreclosure to ensure that MSHDA processed these in a timely manner in accordance with its policies and procedures. We reviewed MSHDA's processes for compiling HHF Program outcomes, which are reported quarterly to the U.S. Department of the Treasury. We analyzed MSHDA's costs for administering the HHF Program, and we reviewed MSHDA's efforts to advertise and promote the HHF Program. We obtained an understanding of MSHDA's access controls over its HHF Program systems used for processing applications and

\* See glossary at end of report for definition.

payments to lenders for HHF Program assistance on behalf of eligible homeowners. We compiled and reviewed selected HHF Program outcomes data, included as supplemental information.

In Finding 2, we presented the results of testing these 64 applications. Because of the unique nature of each HHF Program application, we did not project the percentage of errors identified from our testing of the 43 sample items to the population of all approved applications.

To accomplish our third audit objective, we tested a selection of MSHDA-certified counselors to verify that they were properly certified and attended required annual training. We tested a selection of file audits conducted by MSHDA of its contracted housing counseling agencies to ensure that audits were properly documented and sufficient follow-up was performed of audit findings. We analyzed billings for services submitted by contracted housing counseling agencies to ensure that billing amounts did not exceed the maximum amount allowed for services. We reviewed the results of completed surveys returned to MSHDA by customers of the contracted housing counseling agencies and reviewed MSHDA's processes for following up on problems identified by individual customers. We also obtained an understanding of MSHDA's processes for referring homeowners who were denied HHF Program assistance to contracted housing counseling agencies.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary survey. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

### Agency Responses

Our audit report contains 3 findings and 3 corresponding recommendations. MSHDA's preliminary response indicates that it agrees with 2 recommendations and disagrees with 1 recommendation.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments at the end of our audit fieldwork.

Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require MSHDA to develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

COMMENTS, FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## **EFFECTIVENESS OF EFFORTS IN PROVIDING FINANCING FOR THE PURCHASE OF SINGLE-FAMILY HOMES**

### **COMMENT**

**Background:** From July 1, 2010 through June 30, 2013, the Michigan State Housing Development Authority (MSHDA) financed 2,932 single-family mortgages totaling \$200.8 million. Approximately 92% of these loans were insured by the Federal Housing Administration (FHA), U.S. Department of Housing and Urban Development (HUD). The remaining 8% were either insured by other governmental agencies or were uninsured.

**Audit Objective:** To assess the effectiveness of MSHDA's efforts in providing financing to Michigan residents with low and moderate income for the purchase of single-family homes.

**Audit Conclusion:** **We concluded that MSHDA's efforts in providing financing to Michigan residents with low and moderate income for the purchase of single-family homes were effective.**

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections and the resulting reportable condition\* noted in the comments, findings, recommendations, and agency preliminary responses section.

We noted one reportable condition in our review of MSHDA's processes for monitoring its quality control contract. In our professional judgment, this matter is less severe than a material condition\* but represents an opportunity for improvement in MSHDA's processes to ensure compliance with HUD requirements when originating and servicing single-family mortgages. The reportable condition relates to quality control reviews of single-family mortgages (Finding 1).

We applied our audit procedures via sampling of the 2,804 single-family mortgages purchased by MSHDA from July 1, 2010 through May 31, 2013. Also, we reviewed 27 origination reviews and 16 servicing reviews completed by MSHDA's quality control contractor during the period January 1, 2011 through June 30, 2013.

\* See glossary at end of report for definition.

In addition, we evaluated qualitative factors, such as MSHDA's development and implementation of its quality control plan and the fact that MSHDA's origination and servicing of its FHA-insured single-family mortgages are subject to oversight by HUD.

In reaching our conclusion, we considered the reportable condition in conjunction with other areas reviewed and the impact of the qualitative factors described in the preceding paragraph. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

## **FINDING**

### **1. Quality Control Reviews of Single-Family Mortgages**

MSHDA did not comply with all HUD quality control requirements related to its single-family mortgages. Noncompliance with specific HUD quality control requirements may result in sanctions and penalties by HUD's Mortgagee Review Board.

Chapter 7 of the FHA Title II Mortgagee Approval Handbook requires that FHA-approved mortgagees must implement and continuously have in place a quality control plan for the origination and/or servicing of insured mortgages as a condition of receiving and maintaining FHA approval. Also, Chapter 7 of the Handbook provides that a mortgagee contracting out any part of its quality control function is responsible for ensuring that the contractor meets HUD requirements.

In response to a 2010 desk review conducted by HUD, which cited MSHDA for failing to develop and implement a quality control plan, MSHDA contracted with an outside firm for quality control review services of the origination and the servicing of its single-family mortgages. Our review of MSHDA's contract monitoring processes disclosed:

- a. MSHDA did not ensure that the contractor reviewed single-family mortgages going into default within the first six payments due on the loan (also known as early payment defaults). As a result, MSHDA could not identify patterns of early payment defaults by location, program, loan characteristic, and loan correspondent or sponsor to address common problems in the mortgage origination process.

HUD provides that, in addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. MSHDA informed us that these reviews were not performed. MSHDA also informed us that it could not produce a historical report of early payment defaults occurring for loans originated prior to April 2013.

- b. MSHDA did not ensure that the contractor provided quality control reports in a timely manner. As a result, MSHDA could not initiate prompt action to resolve problems identified by the contractor.

Our review of all quality control reviews completed during the period January 1, 2011 through June 30, 2013 disclosed:

- (1) The contractor took longer than 90 days to provide quality control reports for 8 (30%) of the 27 origination reviews. On average, the contractor was late in providing these reports by 24 days, ranging from 4 to 65 days late.

HUD provides that mortgagees must perform origination quality control reviews within 90 days from the end of the month in which the loan closed. MSHDA's contract for quality control review services provides that the contractor must provide quality control reports to MSHDA within 90 days from the end of the month in which the loan closed.

- (2) The contractor took longer than 90 days to provide quality control reports for 12 (75%) of the 16 servicing reviews. On average, the contractor was late in providing these reports by 35 days, ranging from 15 to 61 days late.

HUD provides that mortgagees must perform servicing quality control reviews on an ongoing basis. In addition, we obtained clarification from MSHDA and the contractor that servicing quality control reports should be provided to MSHDA within 90 days from the end of the month reviewed.

MSHDA did not sufficiently monitor the contractor to ensure that it was meeting all HUD quality control requirements.

## **RECOMMENDATION**

We recommend that MSHDA comply with all HUD quality control requirements related to its single-family mortgages.

## **AGENCY PRELIMINARY RESPONSE**

MSHDA stated:

MSHDA agrees with the recommendation to comply with all HUD quality control requirements related to its single-family mortgages. A new early payment default process has been implemented as of May 2013 for April production, and on a monthly basis the special servicer now provides to the Homeownership Division a report identifying all loans that are classified or meet the definition of EPDs. Once received, these loans are requested for audit by a third party vendor. MSHDA also has implemented procedures to monitor and ensure timely receipts of contractor provided quality control reports for both origination and servicing quality control reviews.

## **EFFICIENCY AND EFFECTIVENESS OF EFFORTS IN PROVIDING ASSISTANCE UNDER THE HARDEST HIT FUND PROGRAM**

### **COMMENT**

**Background:** In February 2010, the U.S. Department of the Treasury (U.S. Treasury) established the Hardest Hit Fund (HHF) within the Troubled Asset Relief Program (TARP) to provide targeted aid to families in states hit hard by the economic and housing market downturn. TARP was established under the Emergency Economic Stabilization Act of 2008 (EESA). The U.S. Treasury awarded a total of \$7.6 billion to housing finance agencies in 18 states (including Michigan) and the District of Columbia to develop and implement innovative housing initiatives tailored to their local conditions to help prevent foreclosures and stabilize housing markets. The U.S. Treasury selected states for funding because they either struggled with unemployment rates at or above the national average or experienced steep home price declines greater than 20%. Each state's HHF program was designed and administered by that state's housing finance agency.

To meet the U.S. Treasury's eligibility requirements to receive funds under the HHF Program, MSHDA created the Michigan Homeowner Assistance Nonprofit Housing

Corporation (MHA) to administer the distribution of funds in Michigan. MSHDA's Board of Directors appointed five senior staff members from MSHDA and one MSHDA Board member to MHA's governing board. MHA was housed organizationally within MSHDA's Homeownership Division. As of June 30, 2013, there were 11 MSHDA employees and 56 contract staff assigned to MHA.

The U.S. Treasury awarded MSHDA and MHA \$498.6 million to operate the HHF Program, named Step Forward Michigan. MSHDA and MHA have until December 31, 2017 to utilize these funds.

MSHDA and MHA developed and administered four foreclosure prevention programs within its HHF Program during our audit period. These programs, which are outlined in MSHDA and MHA's agreement with the U.S. Treasury, include:

- Unemployment Mortgage Subsidy Program: This Program helps unemployed homeowners to stay in their homes by providing monthly mortgage payment assistance directly to their mortgage lender.
- Loan Rescue Program: This Program helps homeowners who have experienced a qualifying involuntary hardship that has caused them to fall behind on their mortgage and/or property taxes.
- Principal Curtailment Program: This Program helps homeowners who are struggling to pay their monthly mortgage payments and have loan balances that are higher than the value of their home, creating a negative equity situation.
- Modification Plan Program: This Program helps homeowners struggling to pay their monthly mortgage payments if the lender agrees to modify their existing mortgage terms to provide the homeowner a more affordable payment.

Under all programs, borrowers are required to sign a mortgage lien document and note. There is no interest or monthly payments required on the HHF Program loan, and the loan is forgivable, at a forgiveness rate of 20% per year, as long as the homeowner occupies the property as his/her principal residence for five years.

**Audit Objective:** To assess the efficiency and effectiveness of MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program to help prevent foreclosures and stabilize housing markets.

**Audit Conclusion:** We concluded that MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program to help prevent foreclosures and stabilize housing markets were efficient. However, we concluded that MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program were moderately effective.

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections and the resulting reportable conditions noted in the comments, findings, recommendations, and agency preliminary responses section.

We noted two reportable conditions related to our testing of approved applications, our review of processes for compiling HHF Program outcomes, and our review of access controls over HHF Program systems. In our professional judgment, the two reportable conditions are less severe than a material condition but represent either opportunities for improvement or significant deficiencies in internal control that impacted the effectiveness of MSHDA's efforts in providing HHF Program assistance. The reportable conditions related to the eligibility review process and system access controls (Findings 2 and 3).

We applied our audit procedures via sampling of the HHF Program applications processed during the period July 1, 2010 through April 30, 2013, which included 11,297 approved, 6,949 declined, and 2,743 withdrawn applications. Also, we evaluated qualitative factors, such as public perception and expectations of the HHF Program and the intent of the HHF Program to help prevent foreclosures and stabilize housing markets.

In reaching our first conclusion, nothing came to our attention that would have a significant impact on our conclusion regarding the processing of selected HHF Program applications in a timely manner or related to MSHDA's costs for administering the HHF Program; therefore, we concluded that MSHDA's efforts in providing assistance to Michigan homeowners under the HHF Program were efficient. In reaching our second

conclusion, we considered the two reportable conditions and the impact of these conditions on MSHDA's efforts in providing HHF Program assistance to Michigan homeowners. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

## **FINDING**

### 2. HHF Program Eligibility Review Process

MSHDA did not ensure that HHF Program applicants met eligibility requirements before awarding HHF Program assistance. As a result, MSHDA may have provided HHF Program assistance to homeowners who were not hit hardest by the economic and housing market downturn.

The U.S. Treasury's HHF Program guidelines require that MSHDA, in designing Michigan's HHF Program, implement a system of internal control to minimize the risk of fraud, mitigate conflicts of interest, and maximize operational efficiency and effectiveness.

From July 1, 2010 through April 30, 2013, MSHDA distributed HHF Program assistance totaling \$71.0 million on behalf of 11,297 homeowners. Our review of a selection of 64 HHF Program applications approved for assistance disclosed:

- a. MSHDA approved HHF Program assistance without sufficiently verifying that 12 (19%) of the 64 homeowners had experienced a qualifying involuntary hardship and/or that the hardship was directly responsible for causing the homeowner's delinquency in mortgage payments. MSHDA distributed \$71,206 on behalf of these homeowners.

MSHDA's HHF Program policies provide that homeowners must have experienced a qualifying involuntary hardship that is directly responsible for causing the homeowner's delinquency in mortgage payments. MSHDA defines a qualifying involuntary hardship as an unexpected event beyond the homeowner's control (job loss, reduction of income, medical condition, death, divorce, disability, one-time critical expense, etc.) that impacts the homeowner's ability to maintain payments. The homeowner must submit a signed hardship affidavit explaining the reason for the hardship and certify that the information is truthful.

Our review of the hardship affidavits and other documentation collected by MSHDA for these homeowners disclosed that 4 homeowners provided explanations of hardships that did not appear to be involuntary. Also, 8 homeowners did not provide sufficient documentation to support the existence of their hardships and/or to demonstrate that the hardships were directly responsible for the mortgage deficiencies.

- b. MSHDA approved HHF Program assistance without sufficiently verifying the liquid assets and household income of 14 (22%) of the 64 homeowners. MSHDA distributed \$82,110 on behalf of these homeowners. Two of these homeowners provided explanations of hardships that did not appear to be involuntary and 3 of these homeowners did not provide sufficient documentation that their hardships existed, as noted in part a.

MSHDA's HHF Program policies provide that homeowners must have limited cash reserves on hand but be able to sustain their monthly mortgage payment with HHF Program assistance based on their housing ratio (percentage of mortgage payment to household income). Homeowners applying for HHF Program assistance must provide documentation to support income for the last 30 days (e.g., pay stubs) and copies of their bank statements of their liquid accounts for the last two months. MSHDA's HHF Program policies required staff to evaluate bank statements for large deposits and excessive withdrawals for potential undisclosed income and cash reserves and obtain explanations from the homeowner when necessary.

However, MSHDA did not follow its own policies related to verifying liquid assets and household income prior to awarding HHF Program funds for these 14 homeowners. Our review of the applications and bank statements collected by MSHDA from these 14 homeowners disclosed:

- (1) Nine homeowners had significant unexplained deposits, which indicated potential additional income that the homeowners did not disclose in their HHF Program applications.

- (2) Four homeowners had significant unexplained withdrawals, which indicated potential additional cash reserves that the homeowners did not disclose in their HHF Program applications. Two of these homeowners also had significant unexplained deposits, as noted in part b.(1).
  - (3) Two homeowners did not disclose cash reserves in other bank accounts in their HHF Program applications. This was indicated by transfers to other bank accounts appearing on their bank statements.
  - (4) One homeowner resubmitted an application three months after being denied assistance because of exceeding the liquid asset reserve limit. In the resubmitted application, the homeowner's bank statements showed that the balance had decreased by a significant amount. Upon our notification, MSHDA followed up with this homeowner and determined that the funds had been transferred to an undisclosed bank account.
- c. MSHDA approved HHF Program assistance without following up on large, abnormal, and/or luxury expenses reported in the bank statements of 3 (5%) of the 64 homeowners as required by its policies. MSHDA distributed \$8,067 on behalf of these homeowners. One of these homeowners did not provide sufficient documentation that a hardship existed and another of these homeowners had significant unexplained deposits and withdrawals in his/her bank statements, as noted in parts a. and b., respectively.

MSHDA's HHF Program policies required staff to review bank statements submitted by homeowners for large, abnormal, or luxury expenses (e.g., travel expenses). Although the policies did not specifically require staff to obtain explanations from homeowners regarding these types of expenses, MSHDA informed us that it was intended to instruct staff to review these along with significant withdrawals and obtain explanations from homeowners if adding the significant withdrawals to the homeowner's bank account balances resulted in the homeowner exceeding the cash reserve limit.

MSHDA's HHF Program operating procedure manual was over 500 pages in length and often contained unclear guidance and outdated information. Also, MSHDA relied primarily on the signed hardship affidavit as evidence that the homeowner

reasonably met the hardship requirement and believed that requiring too much documentation would prevent it from providing HHF Program assistance in an efficient manner.

### **RECOMMENDATION**

We recommend that MSHDA ensure that HHF Program applicants meet eligibility requirements before awarding HHF Program assistance.

### **AGENCY PRELIMINARY RESPONSE**

MSHDA stated:

MSHDA and the Michigan Homeowner Assistance Nonprofit Housing Corporation (MHA) agree with the recommendation and emphasize that they have always placed a priority on continuous improvement in order to be good stewards of federal government funds that they have been entrusted with. To further ensure that MSHDA and MHA continue to provide assistance to only eligible homeowners, MSHDA and MHA have implemented the following: In March 2013, an existing resource module, already available to all Program staff to identify participating partners (i.e., mortgage lenders, mortgage servicers, county treasurers) was enhanced to include an easily accessible operating manual. As of September 2013, internal controls were implemented requiring all proposed operating manual revisions to be reviewed and approved by management before distribution to staff. Additionally, in April 2013 MSHDA and MHA designed and initiated an internal quality control process (scorecard) which allows earlier identification of concerns in case level eligibility determinations. And by year end 2013, the MHA compliance team was expanded to a total of five staff members who review a random selection of all cases approved for Program assistance prior to releasing HHF funds to participating partners. Lastly, in May 2013, a more extensive training schedule for existing staff members assigned to the Eligibility Review teams was implemented, along with the expansion of the new staff training period implemented January 2014, and recently weekly training classes for existing staff were set up to reinforce operation guidelines, procedures and best practices. MSHDA and MHA would like to note that since the first HHF Program disbursement in July 2010 through December 2013, MSHDA and MHA have assisted 17,171 Michigan households by providing HHF funds directly to Program partners to prevent mortgage or property tax foreclosure which has allowed Michigan residents to stay in their homes.

## **FINDING**

### **3. HHF Program System Access Controls**

MSHDA had not established sufficient access controls\* over its HHF Program systems. As a result, MSHDA could not ensure that it could prevent or detect errors or irregularities that may be caused by users performing unauthorized activities.

MSHDA contracted with external vendors for its Counselor Direct and Treasury Edge systems. MSHDA used the Counselor Direct system, an automated homeowner intake system, to assist in the processing of HHF Program applications. MSHDA used the Treasury Edge system, an automated cash management system, to process bank transactions related to HHF Program assistance.

Department of Technology, Management, and Budget (DTMB) Administrative Guide policy 1335 and related technical standards provide that management of State agency information systems should implement sufficient system access controls to ensure that users perform only authorized activities relevant to their respective job requirements.

Our review of MSHDA's access controls over its HHF Program systems disclosed:

- a. MSHDA did not sufficiently monitor user activity in its Counselor Direct and Treasury Edge systems, including the activity of system administrators, to ensure that users performed only authorized activities relevant to their respective jobs and positions.

DTMB Administrative Guide policy 1335 and related technical standards provide that management should perform a regular review of all accounts and related privileges.

MSHDA informed us that, although the Counselor Direct system has a user activity log, MSHDA did not have a process to review the user activity log for unusual activities. Also, the user activity log did not track the activity of system administrators because of a system programming error. MSHDA also

\* See glossary at end of report for definition.

informed us that it began performing reviews of the status change logs within the Counselor Direct system in May 2013. However, our review noted that this log did not identify whether a user made unauthorized changes to an HHF Program application.

MSHDA further informed us that, although the Treasury Edge system has a user audit activity report, MSHDA had never reviewed this report.

- b. MSHDA did not ensure the protection of passwords in the Counselor Direct system from unauthorized use by requiring users to change their passwords after a system administrator assigns them or by requiring users to periodically change their passwords. Also, MSHDA disclosed initial passwords to the supervisors of users by copying the supervisors on e-mails sent to users, which contained the users' passwords.

DTMB Administrative Guide policy 1335 and related technical standards recommend immediate changes to new passwords after the assignment of temporary passwords and the enforcement of changes in passwords at least every 90 days.

### **RECOMMENDATION**

We recommend that MSHDA establish sufficient access controls over its HHF Program systems.

### **AGENCY PRELIMINARY RESPONSE**

MSHDA stated:

MSHDA and MHA disagree with the recommendation. MSHDA and MHA take their program administration responsibilities seriously and have already established sufficient controls over its HHF Program systems. Staff is only provided the access level required to perform their tasks for their specific job functions:

- a. MSHDA and MHA disagree with the finding that they did not sufficiently monitor user activity in the Counselor Direct and Treasury Edge systems. Counselor Direct and Treasury Edge have sufficient levels of user access controls, limiting the user's activity to only their respective tasks related to their position which in itself, prevents

unauthorized activity. MSHDA and MHA rely on the status change log within Counselor Direct, not the activity log. The status change log provides a historical record of the application activity. While MSHDA and MHA do not currently utilize the activity log within Counselor Direct to look for unusual activity, the MHA does utilize various security controls within the Counselor Direct system to prevent unauthorized activities. One of these security controls include the segregation of access to the Counselor Direct system based upon each users role. It is MSHDA's and MHA's belief that such segregation aids in preventing unusual activities from occurring in the first place. Lastly, MSHDA and MHA contract with a third party to aid in verifying the effectiveness of internal controls as it relates to Counselor Direct. Based upon the MHA's most recent third party review, and as referenced in the BDO Letter dated September 20, 2013 and again in the BDO Letter dated December 30, 2013, no material weaknesses of internal controls were cited. The cited DTMB policy states that management of State agency information systems implement sufficient system access controls; MSHDA and MHA believe they have in place sufficient system access controls.

For Treasury Edge, there are approximately 10 users in the MHA Bank of New York Mellon Treasury Edge System; including one user that can only pull account activity for the bank reconciliation. The MHA System Administrator establishes users in accordance to Bank of New York Mellon security recommendations; where each user has limited access and transactions entered by each user requires a second level approval, (i.e., no one can enter a payment transaction, establish or change a user and establish a payment or payment recipient without having to have a second level approval in the Bank of New York Mellon System). These built-in internal controls in the Bank of New York Mellon's Treasury Edge system are effective preventive security measures. Although MSHDA and MHA believe the current controls that are in place are sufficient, as a compensating control, management will begin reviewing the Treasury Edge User ID report and the User Audit Activity report on a monthly basis to ensure no unauthorized activity has occurred. Management will provide timely and adequate notification to Treasury Services should any discrepancies be noted.

- b. MSHDA and MHA agree that it could strengthen the process to ensure the protection of passwords in Counselor Direct. MSHDA and MHA have been in discussion with their third party vendor regarding changes to the system. MSHDA and MHA have asked the third party vendor to implement changes to the system that would force a

password change upon initial sign-in as well as require a password reset every 90 days. MSHDA and MHA estimate that changes to the system will be implemented within the third quarter of 2014.

## **OFFICE OF THE AUDITOR GENERAL EPILOGUE**

Although we agree with MSHDA's assertion that the establishment of sufficient levels of user access controls aids in preventing users from performing unauthorized activities, we do not agree that segregation of duties alone is sufficient to ensure that users are performing only authorized activities. According to the U.S. Government Accountability Office's Federal Information System Controls Audit Manual\* (FISCAM), segregation of duties alone will not ensure that personnel perform only authorized activities. FISCAM provides that periodic management reviews of system activities are essential to ensure that employees are performing their duties in accordance with established policies. FISCAM also provides that periodic reviews of activities are particularly important for reviewing system administrator activities and activities that are not controlled through system access controls.

In addition, with regard to MSHDA's statement related to the third party review to aid in verifying the effectiveness of internal controls as it relates to Counselor Direct, our audit identified that, although the third party performed limited testing of user roles in Counselor Direct, the report disclaimed an opinion on the effectiveness of internal controls.

## **EFFECTIVENESS OF EFFORTS IN PROVIDING HOMEOWNERSHIP COUNSELING TO ELIGIBLE MICHIGAN RESIDENTS**

### **COMMENT**

**Background:** MSHDA works with a network of housing counseling agencies, both to implement specific homeownership counseling functions and to support its lending functions by providing required prepurchase education and counseling.

\* See glossary at end of report for definition.

**Audit Objective:** To assess the effectiveness of MSHDA's efforts in providing homeownership counseling to eligible Michigan residents.

**Audit Conclusion:** We concluded that MSHDA's efforts in providing homeownership counseling to eligible Michigan residents were effective.

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections. Our audit report does not include any reportable conditions related to this audit objective. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

# SUPPLEMENTAL INFORMATION

## Hardest Hit Fund Program Outcomes

This section of our audit report presents Hardest Hit Fund (HHF) Program outcome statistics for homeowners who were approved and funded by the Michigan State Housing Development Authority's (MSHDA's) HHF Program as of June 30, 2013.

The U.S. Department of the Treasury requires housing finance agencies participating in the HHF Program to compile and report quarterly borrower characteristic data and Program specific performance data.

The HHF Program outcomes data presents the number and percentage of households no longer in the HHF Program categorized by program completion, transition, or alternative outcome. Alternative outcomes include borrowers that transitioned out of the HHF Program into a foreclosure, a deed in lieu of foreclosure, a short sale, or other cancellation. In cases of foreclosure, deed in lieu of foreclosure, and short sale, the borrowers were unable to maintain ownership of the home after obtaining HHF Program assistance.

This homeowner retention data presents the number of households assisted by the HHF Program in which the borrowers retain ownership of their homes after 6, 12, and 24 months post receipt of initial assistance. Homeowners counted in the 6-month and 12-month intervals are not mutually exclusive (i.e., homeowners counted in the 12-month and 24-month intervals are also counted in the smaller month interval(s)).

The outcomes presented in this supplemental information are based on notifications voluntarily sent to MSHDA regarding recorded transfers of ownership for which MSHDA holds a secondary lien under the HHF Program. State statutes do not require the mailing of notices of foreclosure to secondary lienholders on mortgages. Therefore, the homeownership retention rates shown may not be fully representative.

UNAUDITED

HOMEOWNERSHIP PROGRAMS

Michigan State Housing Development Authority, Michigan Strategic Fund  
 Hardest Hit Fund (HHF) Program Outcomes  
As of June 30, 2013

HHF Program Outcomes	Loan Rescue	Principal Curtailment	Unemployment Mortgage Subsidy	Loan Modification	Total
Borrowers no longer in the Program due to completion, transition, or alternative outcome	7,095	281	2,805	39	10,220
Transitioned out of Program into a foreclosure	19	1	10		30
Disqualified or voluntarily withdrew from Program without reemployment or other intended transition	4		432		436
Transitioned out of Program into a deed in lieu of foreclosure	3		1		4
Transitioned out of Program into a short sale	4		4		8
Transitioned out of Program into another loan modification Program		35		39	74
Transitioned out of Program due to regaining employment and/or appropriate levels of employment		N/A	568	N/A	568
Transitioned out of Program due to reinstatement or payoff of mortgage	7,065	10	92		7,167
Other - Transitioned out of Program and still maintains ownership of home		235	1,698		1,933

HOMEOWNERSHIP PROGRAMS  
Michigan State Housing Development Authority, Michigan Strategic Fund  
Hardest Hit Fund (HHF) Program Outcomes  
As of June 30, 2013

*Continued*

<u>Homeownership Retention</u>	<u>Loan Rescue</u>	<u>Principal Curtailment</u>	<u>Unemployment Mortgage Subsidy</u>	<u>Loan Modification</u>	<u>Total</u>
Cumulative number of borrowers assisted as of December 31, 2012	4,697	264	4,185	11	9,157
Borrowers still in their homes after 6 months	4,671	263	4,168	11	9,113
<i>Percentage</i>	<i>99.4%</i>	<i>99.6%</i>	<i>99.6%</i>	<i>100.0%</i>	<i>99.5%</i>
Cumulative number of borrowers assisted as of June 30, 2012	2,724	199	2,806	N/A	5,723
Borrowers still in their homes after 12 months	2,698	198	2,791	N/A	5,687
<i>Percentage</i>	<i>99.0%</i>	<i>99.5%</i>	<i>99.5%</i>	<i>N/A</i>	<i>99.4%</i>
Cumulative number of borrowers assisted as of June 30, 2011	392	49	620	N/A	1,061
Borrowers still in their homes after 24 months	371	48	607	N/A	1,026
<i>Percentage</i>	<i>94.6%</i>	<i>98.0%</i>	<i>97.9%</i>	<i>N/A</i>	<i>96.7%</i>

N/A = not applicable.

Source: The Office of the Auditor General compiled this summary based on the aggregate HHF Program information in the U.S. Department of the Treasury report for the second quarter of 2013.

# GLOSSARY

## Glossary of Abbreviations and Terms

access controls	Controls that protect data from unauthorized modification, loss, or disclosure by restricting access and detecting inappropriate access attempts.
Control Objectives for Information and Related Technology (COBIT)	A framework, control objectives, and audit guidelines published by the IT Governance Institute as a generally applicable and accepted standard for good practices for controls over information technology.
DTMB	Department of Technology, Management, and Budget.
EESA	Emergency Economic Stabilization Act of 2008.
effectiveness	Success in achieving mission and goals.
efficiency	Achieving the most outputs and the most outcomes practical with the minimum amount of resources.
Federal Information System Controls Audit Manual (FISCAM)	A methodology published by the U.S. Government Accountability Office (GAO) for performing information system control audits of federal and other governmental entities in accordance with <i>Government Auditing Standards</i> .
FHA	Federal Housing Administration.
HHF	Hardest Hit Fund.
HUD	U.S. Department of Housing and Urban Development.

internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
MHA	Michigan Homeowner Assistance Nonprofit Housing Corporation.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
MSHDA	Michigan State Housing Development Authority.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition

A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

TARP

Troubled Asset Relief Program.

U.S. Treasury

U.S. Department of the Treasury.





