



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

*Family Housing Programs
Michigan State Housing Development Authority
Department of Treasury*

Report Number:
641-0205-07

Released:
January 2011

The Michigan State Housing Development Authority (MSHDA) was established by Act 346, P.A. 1966. During our audit, MSHDA was an autonomous unit within the Department of Energy, Labor & Economic Growth (DELEG), except for budgeting, procurement, and related functions. Effective May 30, 2010, Executive Order No. 2010-02 transferred MSHDA intact from DELEG to the Department of Treasury. MSHDA offers financial and technical assistance through public and private partnerships to create and preserve affordable housing for low and moderate income Michigan residents.

Audit Objective:

To assess the effectiveness of MSHDA's efforts in monitoring compliance with program requirements for multifamily housing developments.

Audit Conclusion:

We concluded that MSHDA's efforts in monitoring compliance with program requirements for multifamily housing developments were moderately effective. We noted two material conditions (Findings 1 and 2) and two reportable conditions (Findings 3 and 4).

Material Conditions:

MSHDA's process for allocation of federal Low Income Housing Tax Credits did not give preference to projects serving the lowest income tenants and projects obligated to serving qualified tenants for the longest period of time (Finding 1).

MSHDA had not established and exercised effective criminal history screening practices for housing assistance programs (Finding 2).

Reportable Conditions:

MSHDA did not maintain complete tenant data for MSHDA-financed and tax credit financed housing developments (Finding 3).

MSHDA had not identified and updated on a timely basis its records of deceased tenants at federal project-based housing developments. Also, MSHDA had not recovered on a timely basis subsidy overpayments made on behalf of deceased tenants. (Finding 4)

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Audit Objective:

To assess the effectiveness of MSHDA's administration of the Housing Choice Voucher (HCV) Program.

Audit Conclusion:

We concluded that MSHDA was effective in its administration of the HCV Program. However, we noted one material condition which is reported in Finding 2 under our first audit objective.

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Audit Objective:

To assess the efficiency of utilizing independent housing voucher agents to oversee the HCV Program.

Audit Conclusion:

We concluded that it was efficient to utilize independent housing voucher agents to oversee the HCV Program. Our audit report does not include any reportable conditions related to this objective.

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Audit Objective:

To analyze selected financial information regarding MSHDA and its programs.

Audit Conclusion:

We analyzed selected financial information regarding MSHDA and its programs. We noted two material conditions (Findings 5 and 6) and four reportable conditions (Findings 7 through 10).

Material Conditions:

Former members of MSHDA's senior management, while employees of MSHDA, acted as officers and directors of the Michigan Magnet Fund (MMF) and represented MSHDA's interests in MMF activities without the knowledge and consent of the MSHDA Board (Finding 5).

MSHDA was not effective in precluding conflicts of interest or restricting postemployment activities of its employees (Finding 6).

Reportable Conditions:

MSHDA needs to seek an Attorney General Opinion regarding MSHDA's authority to use Housing Development Fund repayable grants to create and support the Great Lakes Capital Fund (Finding 7).

MSHDA's management circumvented Michigan Civil Service Commission Rules and the MSHDA Board's authorization by using a Homeless Initiatives Grant to procure a personal services contract from an employee of a grantee (Finding 8).

MSHDA had not established and exercised effective controls over its grants activities (Finding 9).

MSHDA had not established an effective control environment over the procurement of an integrated accounting and management information system (Finding 10).

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Agency Response:

Our report includes 10 findings and 11 corresponding recommendations. MSHDA's preliminary responses indicated that it disagrees with 4 recommendations, partially agrees with 5 recommendations, and agrees with 2 recommendations and has complied or will comply with them.

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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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January 7, 2011

Mr. Gary Heidel, Executive Director
Michigan State Housing Development Authority
Department of Treasury
735 East Michigan Avenue
Lansing, Michigan
and
Mr. Andy Dillon, State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Heidel and Mr. Dillon:

This is our report on the performance audit of Family Housing Programs, Michigan State Housing Development Authority, Department of Treasury.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to address 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 will 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.

AUDITOR GENERAL

TABLE OF CONTENTS

FAMILY HOUSING PROGRAMS MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY DEPARTMENT OF TREASURY

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
Description of Agency	7
Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up	8
COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES	
Compliance Monitoring for Multifamily Housing Developments	12
1. Allocation of Federal Low Income Housing Tax Credits (LIHTCs)	13
2. Criminal History Screening	15
3. Tenant Data for Housing Developments	27
4. Identification of Deceased Tenants at Federal Project-Based Housing Developments	29
Administration of the Housing Choice Voucher (HCV) Program	31
Housing Voucher Agent Oversight of the HCV Program	32
Financial Information Regarding MSHDA and Its Programs	33
5. Michigan Magnet Fund (MMF)	35
6. Conflicts of Interest and Postemployment Activities of MSHDA Employees	39
7. Housing Development Fund Repayable Grants to the Great Lakes Capital Fund (GLCF)	44

8. Use of a Homeless Initiatives Grant to Procure a Personal Services Contract	49
9. Controls Over Grants Activities	51
10. Procurement of an Integrated Accounting and Management Information System	56

GLOSSARY

Glossary of Acronyms and Terms	61
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Description of Agency

The Michigan State Housing Development Authority (MSHDA) was established by Act 346, P.A. 1966. During our audit, MSHDA was an autonomous unit within the Department of Energy, Labor & Economic Growth* (DELEG), except for budgeting, procurement, and related functions. Effective May 30, 2010, Executive Order No. 2010-02 transferred MSHDA intact from DELEG to the Department of Treasury.

MSHDA's mission* is to offer financial and technical assistance through public and private partnerships in order to create and preserve decent, affordable housing for low and moderate income Michigan residents. MSHDA acquires its funds through federal government programs (e.g., U.S. Department of Housing and Urban Development), State government programs, and private investors (e.g., through the sale of bonds). MSHDA provides benefits through multifamily development loans, tax credits, single family loans, home improvement loans, administration of the federal government's Section 8 rental assistance programs, and community development grants and technical assistance programs. These benefits are generally offered through other entities, such as developers, banks, landlords, and local communities and development agencies.

As of June 30, 2008 (MSHDA's fiscal year-end), MSHDA reported assets of \$3.6 billion, equity of \$680 million, operating revenues of \$565 million, and net income of \$28 million. As of March 31, 2008, MSHDA had 341 employees, of which 287 were located in its Lansing headquarters and 54 in its Detroit office.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of Family Housing Programs, Michigan State Housing Development Authority (MSHDA), Department of Treasury, had the following objectives:

1. To assess the effectiveness* of MSHDA's efforts in monitoring compliance with program requirements for multifamily housing developments.
2. To assess the effectiveness of MSHDA's administration of the Housing Choice Voucher (HCV) Program.
3. To assess the efficiency of utilizing independent housing voucher agents to oversee the HCV Program.
4. To analyze selected financial information regarding MSHDA and its programs.

Audit Scope

Our audit scope was to examine the program and other records of the Michigan State Housing Development Authority. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances. Our audit procedures, conducted from July 2007 through August 2009, included examination of MSHDA records and activities primarily for the period July 1, 2004 through March 31, 2008.

Audit Methodology

Our methodology included a preliminary review of MSHDA activities and functions. As part of our preliminary review, we interviewed various MSHDA staff and reviewed applicable statutes, policies and procedures, reports, management plans, and other reference materials.

* See glossary at end of report for definition.

To accomplish our first audit objective, we obtained and analyzed selected data regarding MSHDA's multifamily developments. We reviewed MSHDA's process for allocating Low Income Housing Tax Credits and procedures for monitoring multifamily housing program requirements. We also reviewed MSHDA's monitoring of tenant eligibility and related program requirements.

To accomplish our second audit objective, we obtained and analyzed selected data regarding MSHDA's administration of the HCV Program. Also, we examined HCV Program monitoring and administration, including MSHDA's oversight of 55 housing agents who are private contractors paid to monitor the HCV Program on MSHDA's behalf.

To accomplish our third audit objective, we examined the contractual arrangement, including compensation, incentives, and performance standards, between MSHDA and its contracted housing agents. Also, we examined housing agent performance reports. Further, we examined procurement documents including the procurement initiation letter MSHDA sent to the Department of Management and Budget* regarding contracting housing agents. We reviewed the costs and basis outlined in the letter and related procurement documents that supported the decision to procure services from contracted housing agents.

To accomplish our fourth audit objective, we obtained and analyzed selected financial information and reports. We examined MSHDA's financial, accounting, and reporting procedures.

When selecting activities or programs to be audited, 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 review. 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.

* See glossary at end of report for definition.

Agency Responses and Prior Audit Follow-Up

Our report includes 10 findings and 11 corresponding recommendations. MSHDA's preliminary responses indicated that it disagrees with 4 recommendations, partially agrees with 5 recommendations, and agrees with 2 recommendations and has complied or will comply with them.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to 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 the Department of Treasury to develop a plan to address 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 will review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We released our prior performance audit of Multifamily Programs of the Michigan State Housing Development Authority, Department of Consumer and Industry Services (63-201-99), in July 2001. Within the scope of this audit, we followed up 3 of the 9 prior audit recommendations. MSHDA complied with these 3 prior audit recommendations.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

COMPLIANCE MONITORING FOR MULTIFAMILY HOUSING DEVELOPMENTS

COMMENT

Background: The Michigan State Housing Development Authority (MSHDA) issues bonds and notes to the investing public which provide capital to make loans for the development of affordable multifamily housing developments that benefit low and moderate income residents. Also, MSHDA administers the Low Income Housing Tax Credit (LIHTC) Program, which utilizes federal income tax credits under Section 42 of the *Internal Revenue Code* to help finance rental housing for low income tenants.

In addition, the U.S. Department of Housing and Urban Development (HUD) has contracted MSHDA to provide fee-based contract administration* and oversight services for project-based federal housing assistance programs in Michigan. In 2007, HUD paid MSHDA \$8.9 million to oversee performance-based contract administration* at 424 multifamily housing developments and traditionally administered (non-performance-based) contract administration* at 207 multifamily housing developments receiving federal project-based rental assistance* subsidy payments. For 2007, MSHDA subcontracted with two outside contractors to provide approximately \$4.8 million (54%) of its contract administration and oversight responsibilities.

Audit Objective: To assess the effectiveness of MSHDA's efforts in monitoring compliance with program requirements for multifamily housing developments.

Audit Conclusion: **We concluded that MSHDA's efforts in monitoring compliance with program requirements for multifamily housing developments were moderately effective.** Our audit disclosed two material conditions*. MSHDA's process for allocation of federal LIHTCs did not give preference to projects serving the lowest income tenants and projects obligated to serving qualified tenants for the longest period of time (Finding 1). Also, MSHDA had not established and exercised effective criminal history screening practices for housing assistance programs (Finding 2).

Our audit also disclosed two reportable conditions* related to tenant data for housing developments and identification of deceased tenants at federal project-based housing developments (Findings 3 and 4).

* See glossary at end of report for definition.

FINDING

1. Allocation of Federal Low Income Housing Tax Credits (LIHTCs)

MSHDA's process for allocation of federal LIHTCs did not give preference to projects serving the lowest income tenants and projects obligated to serving qualified tenants for the longest period of time. As a result, MSHDA violated both federal and State statutes and disadvantaged some applicants.

The LIHTC Program offers a financial incentive to construct, rehabilitate, and operate rental housing for low income tenants. The federal tax credit is issued by the Internal Revenue Service and allocated by MSHDA to a project's developer over a ten-year period. In allocating the LIHTC, both Section 42(m) of the *Internal Revenue Code* and Section 125.1422b of the *Michigan Compiled Laws* require MSHDA to give preference to projects serving the lowest income tenants and to projects obligated to serve qualified tenants for the longest period.

Instead, MSHDA allocated LIHTCs to developers based on a random lottery, which neither awarded credits to the highest scoring applicants nor granted preference to housing projects serving the lowest income tenants or to projects obligated to serve qualified tenants for the longest period of time.

MSHDA allocated \$63,219,554 in LIHTCs to 140 projects from April 2005 through May 2007. All projects were evaluated and scored based on the following criteria: location (housing needs in the area); public infrastructure (existence of public transportation, walkability, and utilities); community revitalization; local support (tax abatement); federal, state, or local funding; project characteristics (reservation for families with children, the elderly, economic integration, and low income); nonprofit participation; and previous experience.

The random lottery was used to select projects for the allocation and award of credits, after applying an initial threshold review. However, through the random lottery process, all projects meeting a minimum score were afforded an equal chance of being awarded the LIHTC. Consideration or preference was not made for the higher scoring projects or for those serving the lowest income tenants and projects obligated to serve qualified tenants for the longest period of time.

The following chart shows that projects which scored the highest received LIHTCs less often than projects which scored in the middle to low range:

Projects Awarded LIHTCs
2005 through 2007

Score	Number (and Percentage)		Total
	Awarded	Not Awarded	
Top 20%	28 (48%)	30 (52%)	58
Middle 60%	79 (49%)	83 (51%)	162
Bottom 20%	33 (56%)	26 (44%)	59
Total	140	139	279

In addition, utilizing a random lottery to award the LIHTC enticed applicants to submit multiple proposals in order to enhance their odds of selection. However, this disadvantaged those applicants who lacked the resources to develop, fund, and submit multiple proposals in order to enhance their odds of selection under the lottery. The number of multiple applications has more than tripled since the lottery was established in 2005.

RECOMMENDATION

We recommend that MSHDA revise its process for allocating federal LIHTCs to give preference to projects serving the lowest income tenants and projects obligated to serving qualified tenants for the longest period of time.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees in part. MSHDA stated that it is committed to providing safe, decent, and affordable housing to low and moderate income persons residing in Michigan, and that it also believes that all of the programs reviewed by the Office of the Auditor General (OAG) audit are necessary to achieving that result. MSHDA informed us that it no longer utilizes a lottery as a portion of the allocation process under the Qualified Allocation Plan* (QAP). MSHDA also informed us that neither the 2008 QAP, which was under process and consideration for most of 2007, nor the 2009 QAP or 2011 QAP utilized a lottery as a part of the allocation process.

* See glossary at end of report for definition.

However, MSHDA informed us that it believes that the QAP and LIHTC allocation practices at all times were fully consistent with federal and State statutory requirements related to the allocation of the credits. MSHDA also stated that the lottery was only used to select projects for the allocation and award of credits after applying an initial threshold review and analysis process which ensured that projects qualifying for the lottery met MSHDA's goals for the development of safe, affordable, and quality low income housing units in Michigan. Further, MSHDA stated that the QAP scoring criteria contained deep income targeting provisions awarding points to projects that agreed to serve the lowest income persons for the longest period of time. Finally, MSHDA also stated that other states have utilized a lottery as a portion of their LIHTC allocation process.

OFFICE OF AUDITOR GENERAL EPILOGUE

As evidenced in the chart contained within the finding, MSHDA's threshold review, scoring criteria, and deep income targeting provisions did not result in preference to projects serving the lowest income tenants and projects obligated to serve qualified tenants for the longest period of time. To the contrary, the chart shows that the top scoring projects were actually less likely to be awarded LIHTCs than the bottom 20%. After applying the initial threshold review, all projects meeting a minimum score were entered into a random lottery and afforded an equal chance of being awarded LIHTCs. Consideration or preference was not made for the higher scoring projects or those serving the lowest income tenants and projects serving qualified tenants for the longest period of time.

FINDING

2. Criminal History Screening

MSHDA had not established and exercised effective criminal history screening practices for housing assistance programs. As a result, the criminal backgrounds of tenants with recent violent or drug-related convictions, including backgrounds that disqualified them for housing assistance, were not always identified or considered for applicants and tenants.

Our review of criminal history screening for housing assistance programs administered by MSHDA disclosed:

- a. MSHDA had not established criminal history screening standards and procedures for applicants and tenants of MSHDA-financed and tax credit financed housing developments.

Having criminal history screening standards for applicants and tenants with drug-related or violent criminal backgrounds enhances the safety and security of residents and helps to protect MSHDA's investment in housing developments by maintaining desirable living conditions conducive to higher lease and occupancy rates.

As shown in the following chart, we identified the following criminal histories for tenants who, MSHDA's records show, resided in MSHDA-financed and tax credit financed housing developments:

Criminal History	Tenants With Convictions	Tenants With Multiple Convictions
Lifetime registered sex offenders	4 (a)	1
Violent criminal convictions within three years prior to admission to the program (e.g., homicide, criminal sexual conduct, assault with bodily harm less than murder, assaulting a police officer, assault with a dangerous weapon, child abuse, and domestic violence)	135	9
Drug-related convictions within three years prior to admission to the program (e.g., maintaining a drug house, manufacture, delivery/distribution, possession, and use)	82	13
Violent criminal convictions after admission to the program (e.g., criminal sexual conduct, assault with bodily harm less than murder, assault with a dangerous weapon, assaulting/resisting/obstructing a police officer, armed robbery, aggravated domestic violence, and child abuse)	68 (b)	8
Drug-related convictions after admission to the program (e.g., maintaining a drug house, manufacture, delivery/distribution, possession, and use)	53	3

(a) Includes 1 individual still incarcerated at the time of our review.

(b) Includes 2 individuals still incarcerated at the time of our review.

- b. MSHDA's administration of the federal project-based rental assistance programs did not ensure that housing development property owners effectively screened applicants and participants at housing developments that MSHDA oversees.

MSHDA's administrative responsibility for federal project-based rental assistance includes reviewing property owner compliance with federal law and related HUD regulations and requirements, resident eligibility and selection, and safety and security. Tenant criminal history screening is a federally required program eligibility standard that helps protect the safety and security of low income residents who receive project-based rental assistance through the federal government.

Our review of MSHDA's administration of the project-based rental assistance housing developments disclosed:

- (1) MSHDA did not ensure that property managers performed criminal history checks to identify applicants with criminal backgrounds that precluded their eligibility for project-based rental assistance programs.

Owners of federally assisted housing are proscribed under Title 42, sections 13602, 13663, and 1437d of the *United States Code (USC)*, respectively, from housing individuals who are simultaneously incarcerated, lifetime registered sex offenders, or violating a condition of probation or parole imposed under federal or state law.

Our comparison of MSHDA's federal project-based rental assistance tenant records with Michigan Department of State Police and Department of Corrections records disclosed 42 program participants whose criminal

backgrounds precluded their participation in MSHDA-administered programs under the federal requirements at the time of our review:

Conviction Status	Number of Individuals	Federal Requirement
Incarcerated	27 (a)	Federal law 42 <i>USC</i> 13602 requires that tenants occupy their federally assisted housing, which could not occur during incarceration.
Lifetime registered sex offender	10	Federal law 42 <i>USC</i> 13663 and federal regulation 24 <i>CFR</i> 5.856 prohibit admission to federally assisted housing if any household member is subject to a lifetime registration as a sex offender.
Absconder*	5 (b)	Federal law 42 <i>USC</i> 1437d provides cause for immediate termination of tenancy if a tenant is violating a condition of probation or parole imposed under federal or state law.

- (a) Participants had been incarcerated from 15 days to as long as 2,218 days while simultaneously receiving housing assistance.
- (b) Includes 1 sex offender registration absconder, 1 probation absconder (since November 2006), and 3 parole absconders (including one since February 1988).

Sources: Michigan Department of State Police's Internet Criminal History Access Tool* (ICHAT) and Department of Corrections' Offender Tracking Information System (OTIS).

- (2) MSHDA did not ensure that property managers established standards for screening of applicants with other criminal backgrounds prior to their admission to federal project-based rental assistance programs.

Owners of federally assisted housing are required by Title 24, Part 5, Sections 850 through 861 of the *Code of Federal Regulations (CFR)* to establish screening standards to deny admission of individuals with convictions for drug-related and violent criminal activity.

Our comparison of MSHDA's project-based rental assistance housing participant data with the Michigan Department of State Police's ICHAT

* See glossary at end of report for definition.

disclosed the following tenant criminal histories within three years prior to admission to the federal project-based rental assistance program:

Criminal History	Number of Individuals With Convictions	Number of Individuals With Multiple Convictions
Violent criminal convictions within three years prior to admission to the program (e.g., aggravated assault, assault with a dangerous weapon, assaulting/resisting/obstructing a police officer, assault and battery, domestic violence, third degree child abuse, and weapons/firearms discharge in a building)	275	39
Drug-related convictions within three years prior to admission to the program (e.g., possession, use, and delivery/manufacture of controlled substances including cocaine, methamphetamine, ecstasy and marijuana)	127	20

Source: Michigan Department of State Police's ICHAT.

- (3) MSHDA did not ensure that property managers established standards for identifying and evicting participants convicted of crimes after admittance to the project-based rental assistance programs.

Owners of federally assisted housing are required by federal regulations 24 *CFR* 5.850 through 5.861 to establish standards for terminating tenancy for drug-related and violent criminal activity.

Our comparison of MSHDA's project-based rental assistance housing participant data with the Michigan Department of State Police's ICHAT

disclosed the following tenant criminal histories subsequent to admission to the federal project-based rental assistance program:

Criminal History	Number of Individuals With Convictions	Number of Individuals With Multiple Convictions
Violent criminal convictions after admission to the program (e.g., homicide - manslaughter, criminal sexual conduct - fourth degree, assault with bodily harm less than murder, assault with a deadly weapon, assaulting/resisting/obstructing a police officer, aggravated assault, assault and battery, domestic violence [personal protection order, second notice], and second degree child abuse)	563	102
Drug-related convictions after admission to the program (e.g., possession, use, and delivery/manufacture of controlled substances including cocaine, methamphetamine, ecstasy and marijuana)	317	71

Source: Michigan Department of State Police's ICHAT.

- c. MSHDA did not conduct comprehensive criminal history screening for participants in the federal Housing Choice Voucher (HCV) Program. As a result, MSHDA did not consider all criminal histories during its criminal history screening process.

MSHDA is responsible under federal regulation 24 *CFR* 982.553 for establishing standards to deny or terminate participation in the federal HCV Program for lifetime registered sex offenders and screening standards for other illegal criminal behavior. MSHDA has adopted standards that preclude participation in the HCV Program when household members at admission have been convicted of a violent crime or drug-related offense within the previous three years or are currently engaged in illegal drug-related activity, violent criminal activity, or other criminal activity that threatens the health and safety of residents.

MSHDA's process for reviewing HCV Program participants' criminal histories was limited to ICHAT. However, ICHAT does not contain federal offenses, tribal records, or criminal histories from other states. Also, ICHAT does not

contain data on felonies and serious misdemeanors punishable by less than 94 days.

Our review of MSHDA's process for reviewing HCV Program participants' criminal histories disclosed the following weaknesses:

- (1) MSHDA did not utilize federal criminal history sources to identify out-of-State and federal criminal offenses.

Federal regulation 24 *CFR* 5.903 authorizes MSHDA to obtain Federal Bureau of Investigation (FBI) National Crime Information Center criminal history record information for applicant screening, lease enforcement, and eviction actions. The National Crime Information Center contains criminal history data from the FBI; federal, state, local, and foreign criminal justice agencies; and authorized courts.

- (2) MSHDA did not utilize the Department of Corrections' OTIS to help identify individuals with relevant criminal histories not contained within ICHAT. As a result, MSHDA made \$26,481 in rental assistance payments for 4 individuals who were incarcerated and 1 individual who was a probation absconder.

MSHDA's HCV Program Policy and Procedures Manual Chapter XIV, Section E provides that household members incarcerated for over 90 days are considered "permanently absent" and must have rental assistance terminated.

Our comparison of HCV Program participant data provided by MSHDA with OTIS disclosed:

Conviction Status	Number of Individuals	Housing Assistance Paid in Status
Currently incarcerated	4 (a)	\$15,389
Probation absconder	1 (b)	11,092
Total		<u>\$26,481</u>

(a) There were 6 to 10 monthly housing assistance payments paid on each individual's behalf while the individual remained incarcerated.

(b) The individual was a probation absconder since March 26, 2001 and entered the HCV Program on January 1, 2005.

Source: Department of Corrections' OTIS.

- (3) MSHDA was not effective in using ICHAT to identify individuals who were ineligible for the HCV Program.

Our comparison of MSHDA's listing of 56,256 household members (heads of households* and other family members) who participated in the HCV Program as of December 2007 with ICHAT disclosed 254 household

* See glossary at end of report for definition.

members whose criminal backgrounds prior to admission precluded their participation in the HCV Program:

Criminal History	Number of Individuals With Convictions*	Number of Individuals With Multiple Convictions
Violent criminal convictions within three years prior to admission to the program (e.g., children - accosting for immoral purpose, criminal sexual conduct - fourth degree, assaulting/resisting/obstructing a police officer, assault - bodily harm less than murder, assault or assault and battery, assault with a dangerous weapon, domestic violence, and weapons/firearms - possession by felon)	177	33
Drug-related convictions within three years prior to admission to the program (e.g., controlled substance – delivery/manufacture, maintaining a drug house, use - narcotic, cocaine, methamphetamine, and ecstasy, and controlled substance - second or subsequent offense notice)	83	11
Lifetime registered sex offenders	2	0

* Includes 8 individuals having both violent criminal and drug-related convictions.

Source: Michigan Department of State Police's ICHAT.

- (4) MSHDA did not periodically update the criminal histories of HCV Program household members.

Periodic criminal history updates help identify existing participants who are subsequently convicted of relevant criminal offenses and ensure that accurate and complete information is considered when recertifying HCV Program household eligibility at annual renewal.

As shown in the following chart, 551 household members who committed prohibited criminal offenses after admission to the HCV Program were allowed continued participation in the program:

Conviction Type	Number of Individuals With Convictions*	Number of Individuals With Multiple Convictions
Violent criminal convictions subsequent to admission to the program (e.g., homicide - murder - second degree, assault - bodily harm less than murder, armed robbery, assault with attempt to rob while armed, weapons felony firearm, aggravated assault, assault with a dangerous weapon, assault or assault and battery, assaulting/resisting/obstructing a police officer, assault of prison employee, criminal sexual conduct, assault with intent [penetration], criminal sexual conduct - third degree [multiple variables], criminal sexual conduct - third degree [incest], child abuse - third degree and fourth degree, and domestic violence)	352	97
Drug-related convictions subsequent to admission to the program (e.g., controlled substance – delivery/manufacture, possession, use, and maintaining a drug house)	245	50
Lifetime registered sex offenders	5	

* Includes 51 individuals having both violent criminal and drug-related convictions.

Source: Michigan Department of State Police's ICHAT.

RECOMMENDATION

We recommend that MSHDA establish and exercise effective criminal history screening practices for housing assistance programs.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees in part. MSHDA stated that it is committed to providing safe, decent, and affordable housing to low and moderate income persons residing in Michigan, and that it also believes that all of the programs reviewed by the OAG audit are necessary to achieving that result. MSHDA also stated that HUD has established criminal history screening standards and procedures that MSHDA must follow as a public housing agency participating in HUD programs. MSHDA stated that it does not have the statutory or regulatory authority to establish different or alternate standards from those required by HUD. MSHDA believes that it substantially complies with the applicable HUD standards.

MSHDA indicated that it disagreed with part a., asserting that it has no direct legal authority under federal or State law to require project owners to conduct criminal background checks on their existing tenants at MSHDA financed and tax credit financed housing developments. MSHDA also stated that its mission requires service to low and moderate income persons who may also have criminal records, and that the law requires it to prevent current and ongoing criminal activity in a housing development to the best of its ability but does not provide it the authority to exclude persons and families from residing in developments solely on the basis of prior criminal involvement, criminal record, or criminal history.

With regard to part b., MSHDA's administration of federal project-based rental assistance programs, MSHDA indicated that it disagreed because it believes that the primary responsibility for tenant screening, eligibility, and selection rests with the owners of federally-subsidized projects under HUD requirements, primarily as set forth in the 4350.3 Handbook. MSHDA stated that these HUD requirements require owners to include criminal background checks in the screening criteria that are part of their tenant selection process, and to make determinations as to whether an applicant with a criminal history should be denied admission or may be admitted, in accordance with HUD requirements. MSHDA also stated that HUD requirements detail the grounds on which tenants who are determined by the owner to have engaged in criminal activity may be terminated but provide that any termination shall be within the discretion of the owner. MSHDA further stated that termination by the owner is never mandatory and that HUD Handbook 4350.3 grants complete discretion to the owner in deciding whether to evict tenants once they are in residence, even when there are sufficient grounds to do so.

MSHDA also stated that at initial screening, owners only need to follow the standards described in part b.(1) and b.(2) of the finding. MSHDA stated that other standards prohibiting admission are discretionary. MSHDA also stated that an owner may admit a tenant with a criminal history, even a violent criminal history, if the owner employs appropriate standards in making the determination and that, as Contract Administrator, MSHDA's oversight responsibilities were limited to confirming that criminal background checks were performed and that acceptable tenant screening policies were applied consistently in accordance with HUD requirements. MSHDA further stated that it performs annual, on-site tenant file audits for every project in its portfolio and believes that it is doing this effectively.

With regard to part b.(3), eviction for crimes committed after admittance, MSHDA stated that only criminal activity by a participant that threatens the health or safety of other residents, or a failure to comply with the terms of a participant's probation, is grounds for termination of the participants' leases. MSHDA stated that criminal activity that does not threaten the health, safety, or right to peaceful enjoyment of residents or persons residing in the immediate vicinity is not grounds for termination.

MSHDA further stated that if MSHDA were to recommend that owners of project-based housing developments perform criminal background checks on tenants following their admission to subsidized housing, random checks, or checks on selected individuals, are prohibited by HUD, so any owner who adopts a policy of conducting criminal background checks would be required at the time of the annual recertification to perform criminal background checks on all tenants at recertification. MSHDA also stated that if owners performed criminal background checks on all adult tenants as part of the household's annual recertification process, MSHDA believes that the cost would likely approach \$1 million per year. MSHDA believes that this cost would burden the operation of many developments and would have the effect of impairing their ability to meet their operating costs and debt service obligations.

With regard to part c., the HCV Program, MSHDA indicated that it agreed in part. MSHDA stated that its HCV Program fraud coordinator has subsequently been provided access to several databases, including ChoicePoint's AutoTrax and Accurant, and works closely with HUD's Office of Inspector General. MSHDA stated that if a suspicion or complaint or matching database/program reveals a potential criminal problem which could result in an HCV participant's ineligibility for the Program, the fraud coordinator investigates the complaint and takes appropriate action. MSHDA indicated that these actions have included Program termination and/or referral for criminal prosecution.

MSHDA also stated that, in addition to its current utilization of ICHAT screening at admission, MSHDA changed its policy to require ICHAT, OTIS, and/or MSP Sex Offender Registry screening for each new admission, as well as at the time of every "port" and every interim reexamination (when an adult family member is added to the family composition). However, MSHDA stated that, due to the prohibitive cost of running the ICHAT search on 24,000 HCV Program households,

only OTIS and Sex Offender Registry screenings will be performed for the adult members of every HCV household at the time of the annual recertification and any interim change in address.

MSHDA also stated that these changes to its policy on criminal screening were made and distributed to staff and contracted housing agents by April 30, 2008. MSHDA further stated that the additional screening processes were implemented on June 1, 2008 and that further changes to the policy were implemented in 2009. MSHDA also stated that criminal screening training was provided to all HCV staff and contracted housing agents in June 2008 and again in April and May 2009.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

With regard to part a. of MSHDA's response, although MSHDA asserts that it has no direct legal authority under federal and State law, neither is MSHDA prohibited under the law from establishing criminal history screening standards.

MSHDA's enabling legislation, Section 125.1401 of the *Michigan Compiled Laws*, provides that MSHDA be established to increase the availability of safe and sanitary housing for low and moderate income persons and families. In addition, Michigan's federally required five-year Consolidated Plan for Housing and Community Development is prepared by MSHDA to describe the programs and activities that MSHDA will undertake with federal dollars, including LIHTCs. The first stated goal in the Plan is to expand the availability and supply of safe, decent, affordable rental housing for low and extremely low income individuals and families.

The severity of criminal histories described in the finding supports the need for establishing criminal history screening standards.

FINDING

3. Tenant Data for Housing Developments

MSHDA did not maintain complete tenant data for MSHDA-financed and tax credit financed housing developments. As a result, MSHDA was lacking data necessary to effectively oversee housing development programs and criminal history screening.

Accurate housing development and tenant data is highly pertinent to MSHDA's oversight of MSHDA-financed and tax credit financed housing developments. For example, file audits and physical inspections determine whether the owners of housing developments have complied with program requirements such as uniform physical condition standards, tenant income certification, rental rate limits, and tenant eligibility. Similarly, MSHDA's administrative oversight responsibilities of the 631 federal project-based housing developments also require accurate data to ensure that tenant criminal history screening is being properly made by property owners (Finding 2) and that tenant subsidy payments are properly made on behalf of tenants (Finding 4).

During our review of MSHDA's oversight and criminal screening for multifamily housing programs, we requested and received from MSHDA detailed housing development and tenant data. Our review of that data disclosed that MSHDA's tenant data was incomplete.

MSHDA requires development owners to report tenant names, social security numbers, and dates of birth. For the 998 MSHDA-financed and tax credit financed housing developments that MSHDA provided for our review, there was critical identifying information omitted for 30,029 (52%) of the 57,982 tenants, including a complete name for 1,767 (3%) tenants, a social security number or equivalent for 1,337 (2%) tenants, or a date of birth for 29,104 (50%) tenants.

MSHDA also had incomplete tenant detail (tenant identities) for 1 of its 5 submissions of federal project-based housing development data.

RECOMMENDATION

We recommend that MSHDA maintain complete tenant data for MSHDA-financed and tax credit financed housing developments.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees. MSHDA stated that, although at the time of the audit no federal or State law or regulation required MSHDA to collect tenant data in any format for developments in the Compliance Monitoring portfolio, for a number of reasons MSHDA decided it would be prudent to begin collecting this data. MSHDA also stated that the database was developed for different uses and purposes related to MSHDA's compliance monitoring tasks and mission.

MSHDA further stated that during the audit period its database was developed and maintained by the MSHDA Compliance Monitoring section in the Office of Legal Affairs. MSHDA also stated that its tenant data collection project was an enormous undertaking for the Compliance Monitoring section and, at the time data was initially examined by the OAG, the project was approximately at the halfway point and that many development owners had not yet been asked to provide tenant data through the on-line system.

In addition, MSHDA stated that in July 2008, Congress passed the Housing and Economic Recovery Act, which directed MSHDA and all state housing finance agencies to begin to collect and submit to HUD certain demographic and economic information on tenants residing in LIHTC-financed properties. MSHDA stated that the statute also directed HUD to define the standards for this information collection which, according to MSHDA, HUD has only recently completed. MSHDA stated that it is currently in the process of implementing HUD's data requirements, with a deadline for the first data submission of November 30, 2010.

FINDING

4. Identification of Deceased Tenants at Federal Project-Based Housing Developments

MSHDA had not identified and updated on a timely basis its records of deceased tenants at federal project-based housing developments. Also, MSHDA had not recovered on a timely basis subsidy overpayments made on behalf of deceased tenants. As a result, \$153,638 in housing assistance subsidy payments continued to be made on behalf of tenants after their death and \$114,637 of these subsidy overpayments were not recovered.

HUD's project-based rental assistance programs provide rental subsidies that are paid to private owners of multifamily housing on behalf of tenants to help make such housing affordable for lower income households. MSHDA administers project-based rental assistance programs on behalf of the federal government, including the subsidy payments.

Our comparison of MSHDA's records of existing federal project-based housing development tenants with Department of Community Health death certificate records disclosed that 2,805 (3%) of the 83,389 tenants had been deceased for a period of time ranging from 5 days to as long as 563 days.

MSHDA informed us that it would take from 30 to 90 days before tenant subsidy payments could be stopped because tenant data is reported a month in advance of payment. However, our review of records for 148 of the 2,805 deceased tenants disclosed that 19 (13%) of the 148 reviewed had been dead for over 30 days, including 6 (4%) who had been dead for over 90 days.

In addition, we determined that subsidy payments totaling \$153,638 continued to be made on behalf of 53 of the 148 deceased tenants reviewed, which included the 19 deceased tenants described in the preceding paragraph. However, MSHDA had not completely recovered the overpayments of subsidies paid to housing owners on behalf of the 53 deceased tenants. Of the \$153,638 in subsidy payments made on behalf of deceased tenants, MSHDA had recovered only \$39,001 (25%).

RECOMMENDATIONS

We recommend that MSHDA identify and update on a timely basis its records of deceased tenants at federal project-based housing developments.

We also recommend that MSHDA recover on a timely basis subsidy overpayments made on behalf of deceased tenants.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees in part. MSHDA stated that, subsequent to the audit, owners are now required to run regular data checks through the Enterprise Income Verification (EIV) system on tenants receiving project-based subsidies. MSHDA stated that those checks should and do flag deceased tenant files. MSHDA also stated that, in July 2010, HUD began to require owners to run periodic cross checks of tenants receiving project-based subsidy using the EIV system. MSHDA stated that the EIV system is fully updated on a quarterly basis using the records of the federal Social Security Administration. MSHDA stated that it believes the EIV system is more accurate than the database maintained by the Michigan Department of Community Health. In addition, MSHDA stated that it performs tenant file audits for this portfolio according to very specific Management and Occupancy Review standards developed by HUD to verify that owners are complying with HUD requirements. MSHDA also stated that the fact that a tenant participating in the program is deceased does not disqualify the remaining family members from receiving

assistance so long as the remaining household members comply with program requirements.

However, MSHDA stated that the only reasonably available method for MSHDA to recover the subsidy overpayments cited in the finding that were owed by Section 8 tenants or landlords was referral of the claim and debt to the Collection Division, Michigan Department of Treasury. According to MSHDA, a tenant or landlord who receives an overpayment of subsidy is informed of that overpayment by MSHDA staff and repayment is requested within 30 to 45 days. If either payment is not received or the tenant or landlord in question fails to request an informal hearing related to the validity of the debt, MSHDA stated that the matter is turned over to the Collection Division, Department of Treasury, for follow-up and collection.

ADMINISTRATION OF THE HOUSING CHOICE VOUCHER (HCV) PROGRAM

COMMENT

Background: The HCV Program provides tenant-based rental assistance* subsidies for very low income people who find their own housing in private homes and apartment buildings. MSHDA receives funding from HUD to administer the Program and pays subsidies directly to landlords on behalf of participating families and individuals. The families and individuals pay the difference between the actual rent charged by their landlord and the amount subsidized by the Program. MSHDA administers approximately 24,000 HCVs.

Because demand for HCV assistance exceeds the resources available, long waiting periods are common. MSHDA closes its waiting lists when it has more families on the list than can be assisted in the near future. As of February 2008, MSHDA's waiting list totaled 54,241 applicants. Once an opening becomes available, an application is drawn from the waiting list and reviewed for eligibility, including income, citizenship status, and criminal history.

* See glossary at end of report for definition.

Audit Objective: To assess the effectiveness of MSHDA's administration of the HCV Program.

Audit Conclusion: We concluded that MSHDA was effective in its administration of the HCV Program. However, our assessment disclosed one material condition related to criminal history screening for the federal HCV Program, which is reported in Finding 2 under our first audit objective.

HOUSING VOUCHER AGENT OVERSIGHT OF THE HCV PROGRAM

COMMENT

Background: MSHDA administers the federally funded HCV Program pursuant to Section 8 of the United States Housing Act of 1937, as amended. The federal government pays MSHDA to administer the Program, including wait list maintenance, eligibility determination, criminal history screening, admissions selection, housing assistance payment amount calculation, housing quality standards compliance, and annual reexaminations.

MSHDA hired independent contractors (housing voucher agents) to assist MSHDA in performing several of MSHDA's administrative responsibilities, including the items mentioned in the preceding paragraph. MSHDA reported that it received approximately \$44 per voucher from the federal government to administer the Program and paid its housing voucher agents between \$19 and \$24 per voucher, depending on incentives, to administer HCVs on MSHDA's behalf.

Audit Objective: To assess the efficiency of utilizing independent housing voucher agents to oversee the HCV Program.

Audit Conclusion: We concluded that it was efficient to utilize independent housing voucher agents to oversee the HCV Program. Our audit report does not include any reportable conditions related to this objective.

FINANCIAL INFORMATION REGARDING MSHDA AND ITS PROGRAMS

COMMENT

Background: MSHDA provided \$39.9 million in funding to create the Great Lakes Capital Fund (GLCF), a private nonprofit entity that functions independently of MSHDA and without MSHDA representation on its governing board.

GLCF was originally known as the Michigan Capital Fund For Housing when MSHDA funded its creation in 1993. According to MSHDA's records, GLCF was a nonprofit housing corporation created by MSHDA to facilitate private sector investment in rental housing projects in Michigan. Taking advantage of the federal Low Income Housing Tax Credit (LIHTC) Program, GLCF uses limited partnerships to raise equity from for-profit investors and then uses those funds to invest in affordable rental housing developments. A March 2003 report from a former member of MSHDA's senior management depicted GLCF's role as primarily "an equity investor in multifamily rental properties, which is a function that MSHDA cannot perform." MSHDA's records also indicated that GLCF provided technical assistance to nonprofit housing providers and had a lending program with the United Methodist Church.

In initially establishing GLCF, MSHDA reported making several Housing Development Fund repayable grants* available to GLCF in the following amounts:

Housing Development Fund Grant Number	Date	Amount	Interest Rate
03	November 1991	\$.5 million	0%
15	September 1994	7.0 million	5%
21	February 1996	7.3 million	6%
26	July 1996	10.5 million	6.3%
36	November 2000	13.1 million	7%
58	August 2002	1.5 million	0%
Total		<u><u>\$ 39.9 million</u></u>	

Note: MSHDA reported that all repayable grants had been repaid by GLCF.

* See glossary at end of report for definition.

According to MSHDA records of the grants, the first grant (Number 03) was used to provide initial operating capital for GLCF. The next four grants (Numbers 15, 21, 26, and 36) were used by GLCF to provide bridge loans to developers who had been awarded LIHTCs and were waiting for equity payments from GLCF. Once equity payments started to flow, the bridge loans were repaid. The sixth grant (Number 58) was to provide start-up funds for a new GLCF subsidiary, Capital Fund Services, Inc. (CFS). CFS was to provide services to affordable housing providers and promote community and economic development activities.

Since its creation by MSHDA in 1993, GLCF has reported significant growth. GLCF reported that it established the Indiana Capital Fund for Housing in 2002 and 2003 and then merged the Indiana Capital Fund for Housing and Michigan Capital Fund for Housing in June 2003 to create GLCF. In addition to Michigan, GLCF reported establishing offices and making investments in Indiana, Wisconsin, and Illinois. In 2008, GLCF reported having 16 separate investment funds valued at \$1.2 billion in cumulative investment. For 2006, GLCF reported revenues of \$12.3 million and assets of \$29.9 million.

In addition, GLCF was involved in the founding and operation of the Michigan Magnet Fund (MMF) (described in Finding 5), and functioned as both a lender as well as a contractor to MMF. GLCF's president and chief executive officer served as an officer of MMF's governing board, while MMF's 2007 federal New Markets Tax Credit application disclosed that GLCF serves as MMF's "fund manager and compliance agent," assigning five professional staff members to work on MMF matters and charging MMF fees that are paid out of MMF's loan origination and asset management fees. According to a February 5, 2008 correspondence from GLCF to MMF, GLCF had a service agreement with MMF that amounted to \$1.7 million over a nine-year compliance period. In addition, MMF's 2007 federal New Markets Tax Credit application reported that the fee GLCF charges MMF covers only 70% of GLCF's actual costs, leaving 30% as an in-kind contribution. Regarding lending to MMF, MMF reported for the 2006 tax year that it owed GLCF \$253,200 at year-end. Further, GLCF subsidiary CFS reported that MMF had repaid CFS \$150,000 as of the end of the 2006 tax year.

GLCF also formed several other subsidiaries, including nonprofit as well as for-profit ventures. GLCF for-profit enterprises include a title insurance services agency, an investment company providing housing and commercial financing, a company that

invests in affordable housing developments, and plans for an enterprise to channel the tax credits awarded to MMF by the federal government.

Audit Objective: To analyze selected financial information regarding MSHDA and its programs.

Audit Conclusion: **We analyzed selected financial information regarding MSHDA and its programs.** Our analyses disclosed two material conditions. Former members of MSHDA's senior management, while employees of MSHDA, acted as officers and directors of MMF and represented MSHDA's interests in MMF activities without the knowledge and consent of the MSHDA Board (Finding 5). Also, MSHDA was not effective in precluding conflicts of interest or restricting postemployment activities of its employees (Finding 6).

Our analyses also disclosed four reportable conditions related to Housing Development Fund repayable grants to GLCF, use of a Homeless Initiatives Grant to procure a personal services contract, controls over grants activities, and procurement of an integrated accounting and management information system (Findings 7 through 10).

FINDING

5. Michigan Magnet Fund (MMF)

Former members of MSHDA's senior management, while employees of MSHDA, acted as officers and directors of MMF and represented MSHDA's interests in MMF activities without the knowledge and consent of the MSHDA Board. As a result, the MSHDA Board was unaware and unable to exercise governance of MSHDA's activities involving MMF.

Section 125.1421 of the *Michigan Compiled Laws* provides that MSHDA's powers are vested in the MSHDA Board members, not management. Further, a quorum of the MSHDA Board is necessary for exercising the powers of MSHDA, unless delegated to MSHDA employees previously by the Board.

MMF is an independent nonprofit organization established to compete for federal tax credits under the federal New Markets Tax Credit program. MMF designated MSHDA as the "controlling entity" of MMF in applications to secure federal tax credit allocations, resulting in the federal government's organizational profile

describing MMF as "a subsidiary of the Michigan State Housing Development Authority" and potentially subjecting MSHDA to MMF's obligations and liabilities.

Our review disclosed that former members of MSHDA's senior management, while employees of MSHDA, were involved in the following actions regarding MMF without the knowledge and consent of the MSHDA Board:

- a. One former member of MSHDA's senior management and one current member of MSHDA's senior management, while employed at MSHDA, were elected and participated as officers and/or directors of MMF and represented MSHDA's interests regarding MMF by acting to nominate and/or approve MMF Board members on MSHDA's behalf.

The former member of MSHDA's senior management also served as MMF's "authorized representative" for the federal New Markets Tax Credit program. In addition, this former senior manager, while an employee of MSHDA, acted as MSHDA's representative to authorize an agreement between MMF and the federal government for MMF to receive an allocation of \$60 million in federal New Markets Tax Credits; the approval of various commercial development projects awarded tax credits by MMF from its \$60 million federal New Markets Tax Credits allocation; the award of MMF service contracts and fees; and the borrowing of money from MSHDA grantee GLCF.

- b. Former members of MSHDA's senior management allowed MMF to designate MSHDA as MMF's controlling entity in MMF's applications for federal tax credit allocations and acted to demonstrate MSHDA's control by approving the election of MMF Board members on behalf of MSHDA.

To represent MSHDA as MMF's controlling entity under the federal New Markets Tax Credit program requirements, Article VIII of MMF's Third Restated Articles of Incorporation provides that all directors elected to the MMF Board must have MSHDA's written approval.

Because MSHDA's powers are vested in the MSHDA Board and were not delegated to MSHDA's management with regard to MMF, only the MSHDA Board was empowered to designate MSHDA as MMF's controlling entity and to demonstrate that control through written approval of all MMF directors.

However, there was no record that the MSHDA Board authorized or was informed of MSHDA's designation as MMF's controlling entity, including what MSHDA's duties and responsibilities as MMF's controlling entity were, that the federal government's organizational profile for MMF described MMF as "a subsidiary of the Michigan State Housing Development Authority," or the occurrences necessary for MSHDA to have controlled or accepted MMF as a subsidiary under the federal New Markets Tax Credit program.

Nevertheless, MMF's applications for federal New Markets Tax Credits described MMF as a "Government-Controlled entity" and included MSHDA's total assets of nearly \$3 billion and cited as MMF's record of prior performance MSHDA's \$2.7 billion in bond mortgage community investment, MSHDA's \$318 million in LIHTC allocations, MSHDA's \$50 million in loans to the Michigan Broadband Development Authority, MSHDA's 40 years of experience providing loans and financing to disadvantaged communities; and MSHDA's experience administering various HUD programs. Also, MMF's applications cited MSHDA's \$2.5 billion in aggregate principal of bonds outstanding as well as MSHDA's AA bond rating as a track record for raising capital.

- c. MMF amended its Articles of Incorporation in an attempt to avoid application of Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, regarding inclusion of the financial activities of MMF in the financial statements of MSHDA.

GASB Statement No. 14, as amended, defines the criteria for determining whether certain organizations should be discretely presented as component units of a financial reporting entity based on the nature and significance of their relationship with a primary government. Under Statement No. 14, a primary government is financially accountable for the organizations that make up its legal entity, as well as legally separate organizations if its officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government.

MSHDA's management did not disclose or obtain authorization from the MSHDA Board to support the actions taken as MSHDA's MMF representative regarding exclusion of the financial activities of MMF from the financial statements of MSHDA.

RECOMMENDATION

We recommend that MSHDA's senior management keep the MSHDA Board informed of matters related to MSHDA activities involving MMF.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees that MSHDA's senior management should keep the MSHDA Board informed of matters related to MSHDA activities. MSHDA stated that its Board authorized MSHDA's participation in the 2009 New Markets Tax Credit application by MMF and MSHDA's participation in MMF as of the May 2009 MSHDA Board meeting. Also, MSHDA stated that, at this meeting, the MSHDA Board adopted a resolution authorizing MSHDA activities related to MMF. MSHDA stated that MMF received two actual awards of New Markets Tax Credits: \$60 million in 2005 and \$60 million in 2009.

However, MSHDA stated that it disagreed that MSHDA Board members are and were unaware of MMF and MSHDA's participation prior to our audit. MSHDA stated that the MSHDA Board was first informed of MSHDA's intention to participate in MMF activities in a memorandum to the Board members dated September 29, 2004. MSHDA also stated that MSHDA Board members have been briefed by staff with regard to MMF and issues related to MMF on an ongoing and regular basis since the date of this 2004 memorandum.

MSHDA cited the following examples as evidence of MSHDA staff's briefing of the MSHDA Board:

- The November 2005 and February 2006 *Building Blocks* - MSHDA's on-line newsletter that is routinely provided to MSHDA Board members - both featured articles regarding MSHDA's involvement in MMF.
- On March 2, 2006, the Michigan Economic Development Corporation, MSHDA, and the Great Lakes Capital Fund issued a joint press release regarding a series of projects funded by MMF.

- On August 23, 2006, the MSHDA Board adopted a resolution of appreciation that specifically recognized a MSHDA staff member's representation of MSHDA on the MMF Board.

MSHDA also stated that it believes that MMF's activities related to the development of projects supported by New Markets Tax Credits are fully consistent with MSHDA's housing, community development, and economic development activities. Further, MSHDA stated that, as of April 22, 2010, MSHDA is no longer the controlling entity of MMF.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

Our review of the September 29, 2004 memorandum described in MSHDA's response disclosed that the memorandum was unsigned and lacked any significant details pertaining to MSHDA's activities regarding MMF that are described in the finding. Also, the memorandum did not appear on the agenda for the September 29, 2004 MSHDA Board meeting nor did it appear in the Board minutes of the meeting. Therefore, we could not substantiate that the September 29, 2004 memorandum had been disseminated or presented to the MSHDA Board or that the MSHDA Board had taken any action to acknowledge or approve of any of the activities described in the memorandum. Further, a comprehensive review of MSHDA Board minutes and agenda items for other meetings was undertaken by both MSHDA and OAG staff, which revealed no documentation to substantiate that the MSHDA Board was ever informed or took action to authorize MMF activities at a MSHDA Board meeting until May 2009.

FINDING

6. Conflicts of Interest and Postemployment Activities of MSHDA Employees

MSHDA was not effective in precluding conflicts of interest or restricting postemployment activities of its employees. As a result, some former MSHDA employees engaged in activities that may have conflicted with their official duties while employed at MSHDA and/or subsequent to their employment with MSHDA.

Section 125.1422 of the *Michigan Compiled Laws* empowers MSHDA to adopt a code of ethics for its employees that discloses financial interests, precludes conflicts of interest, and restricts postemployment activities for up to one year after an employee terminates employment. MSHDA adopted its Code of Ethics effective

September 25, 2002. In addition, Act 196, P.A. 1973, as amended, commonly referred to as the State Ethics Act, prescribes the standards of conduct for public officers and employees.

Our review disclosed:

- a. Three former members of MSHDA's senior management, while still employed by MSHDA, served as officers and/or directors of outside organizations, which were positions that conflicted with their duties at MSHDA.

The State Ethics Act prohibits public officers and executive branch employees from rendering services to a private or public interest when that service is either incompatible or in conflict with the discharge of the officers'/employees' official duties or when that employment may tend to impair their independence of judgment or action in the performance of official duties.

In 2002, two former members of MSHDA's senior management began serving as vice president and director, respectively, for CFS while simultaneously employed by MSHDA. CFS was a subsidiary of GLCF, a nonprofit housing corporation to which MSHDA provided \$38.4 million in repayable grants between November 1991 and April 2005.

Similarly, as described in Finding 5, a third former member of MSHDA's senior management served as both an officer and a director of MMF while simultaneously employed by MSHDA.

As senior-level executives, these MSHDA employees could not have independently represented either CFS or MMF as an officer or a director, while simultaneously being employed by MSHDA, without being in conflict. MSHDA's administration of the LIHTC Program, the employees' specific approval of grant awards, and MMF's reliance on MSHDA in its applications for the allocation of federal tax credit awards all constitute examples of conflicts of interest that are incompatible, are in conflict, and/or may impair the independence in judgment or action of these employees when serving as officers or directors of these MSHDA-affiliated outside organizations.

- b. MSHDA had not enforced existing postemployment restrictions regarding all three senior executives described in part a., who continued to serve as officers and/or directors in CFS and MMF after resigning from MSHDA. MSHDA also had not enforced existing postemployment restrictions regarding the two former members of MSHDA's senior management who served as vice president and director, respectively, of CFS while employed by MSHDA, and then became employed by CFS's parent organization and MSHDA grantee, GLCF, upon their resignation from MSHDA.

MSHDA's Code of Ethics restricts employees who terminate employment as follows:

[E]mployees who terminate employment with the Authority shall not be involved in any manner with any development or program for which the employee, while employed by the Authority, was responsible for any decision making or had a direct involvement. This restriction is applicable for a period of six months after the employee leaves the Authority unless a longer period of time is required pursuant to state or federal statute.

To the extent MSHDA employees were expected to represent MSHDA's interests as officers and directors of CFS and MMF, once these employees resigned from MSHDA, presumably current MSHDA employees would have filled these positions, but they did not. Furthermore, pursuant to MSHDA's Code of Ethics, the former employees would also have had to resign as officers and directors of CFS and MMF and not be involved with these entities for a period of at least six months, but they did not resign.

Also, these two former members of MSHDA senior management had both approved a repayable grant to GLCF's subsidiary, CFS, while still MSHDA employees. Upon resigning from MSHDA in September 2003 and April 2006, respectively, both of these individuals were immediately employed by GLCF, without waiting the requisite six months.

- c. MSHDA did not establish postemployment restrictions regarding the disclosure and use of confidential information in its Code of Ethics.

MSHDA's Code of Ethics restricts current employees from using their official position, authority, or confidential information gained under that position or

authority for personal or financial gain, while a MSHDA employee. However, there was no postemployment restriction that similarly proscribed former MSHDA employees from doing so subsequent to their MSHDA employment.

Similarly, MSHDA's Code of Ethics restricts former employees' involvement in a development or a program for a period of six months. However, this did not address the broader implications of the disclosure and use of confidential information subsequent to employment for the period beyond six months. For example, the employee may be privy to information that is subject to the attorney-client privilege.

RECOMMENDATION

We recommend that MSHDA improve its effectiveness in precluding conflicts of interest and restricting postemployment activities of its employees.

AGENCY PRELIMINARY RESPONSE

MSHDA disagrees. MSHDA stated that it believes that MSHDA's Code of Ethics adequately addresses activities both during employment and postemployment and that there is insufficient evidence to support the contention that any violations of MSHDA's Code of Ethics occurred. According to MSHDA, its Code of Ethics is violated if the employee engages in activity while employed or postemployment activity related to a development or program for which the employee had decision-making responsibility and/or direct involvement in while employed by MSHDA. MSHDA stated that the audit did not identify any specific development or program in which a former employee engaged in activities that violated the MSHDA's Code of Ethics.

With regard to postemployment activities, MSHDA stated that the fact that certain persons were once MSHDA employees and were subsequently involved in the operations and management of GLCF or MMF does not constitute sufficient factual basis to find that MSHDA's Code of Ethics was violated. MSHDA further stated that, for example, both GLCF and MMF engage in activities that do not necessarily involve MSHDA financing or support. MSHDA stated that GLCF engages in activities in other Great Lakes states while MSHDA's activities are all located in Michigan. MSHDA also stated that MMF's financing activities are typically separate from MSHDA's financings and do not directly utilize MSHDA financing or other MSHDA programs. MSHDA further stated that MSHDA's Code of Ethics restricts

former employees' activities related to MSHDA for a period of six months after their MSHDA employment. MSHDA stated that its Code of Ethics provisions are in addition to the requirements of State statute dealing with similar issues, specifically the State statutes dealing with conflict of interest and standards of conduct of State employees. MSHDA stated that it disagreed because it did not appear to MSHDA that any of the events described in the finding violated either MSHDA's Code of Ethics or the applicable State laws.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

MSHDA's belief that there is insufficient evidence to support that its Code of Ethics was violated does not negate a need for MSHDA to improve its effectiveness in precluding conflicts of interest and restricting postemployment activities of its employees.

As described in the finding, former members of MSHDA's senior management held positions that conflicted with their duties at MSHDA and engaged in postemployment activities that violated MSHDA's Code of Ethics.

The former senior executives described in the finding included three of the four highest ranking positions within MSHDA's management. While employed by MSHDA, each of these former employees authorized, approved, or were otherwise involved with or participated in MSHDA's activities regarding GLCF, MMF, and/or CFS.

MSHDA employees possessing this level of authority and involvement on MSHDA's behalf in the funding and operation of GLCF, MMF, and CFS either presented or should have presented a sufficient basis for MSHDA to restrict their postemployment activities under MSHDA's Code of Ethics. These reasons support a need for MSHDA to improve its effectiveness in precluding conflicts and in adopting and enforcing postemployment restrictions.

FINDING

7. Housing Development Fund Repayable Grants to the Great Lakes Capital Fund (GLCF)

MSHDA needs to seek an Attorney General Opinion regarding MSHDA's authority to use Housing Development Fund repayable grants to create and support GLCF.

Although GLCF's investment-related activities may have generally supported MSHDA's objectives related to the LIHTC Program, providing grants to create and operate GLCF may not have constituted permissible uses of MSHDA's Housing Development Fund resources.

As further described in the background section, MSHDA provided \$39.9 million in both interest-bearing and non-interest-bearing repayable grants to create, fund, and support the operations of an independent, nonprofit organization known as the Great Lakes Capital Fund (GLCF). According to MSHDA, GLCF uses LIHTCs to raise equity from for-profit investors, such as Michigan corporations and financial institutions, as well as national investors, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Through the use of limited partnerships, MSHDA reported that GLCF uses the equity raised to invest in affordable housing development.

We reviewed MSHDA's use of six Housing Development Fund repayable grants to fund and support the creation of GLCF. Our review raised the following questions that MSHDA should consider asking the Attorney General:

- a. Was MSHDA authorized to create and fund a private nonprofit organization designed to exercise functions that MSHDA itself was not empowered to do?

Section 125.1424 of the *Michigan Compiled Laws* authorizes MSHDA to use Housing Development Fund money to make interest-bearing or non-interest-bearing advances to nonprofit housing corporations, as well as to make grants to private nonprofit organizations. However, neither provision specifically addresses creating a private nonprofit housing corporation. Instead, the statutory language reflects that grants will be made to organizations that currently exist.

MSHDA reported that GLCF was created to perform functions that MSHDA was not authorized to do. According to MSHDA's records, its repayable grants

were used by GLCF to fund such things as initial operating capital; bridge loans to developers waiting for initial equity payments from GLCF; and start-up funds for legal fees, business plans, and application costs to the Internal Revenue Service (IRS) associated with nonprofit entity formation for GLCF, as well as its CFS subsidiary.

- b. Did MSHDA's use of Housing Development Fund money provided to GLCF constitute a grant authorized by law?

Section 125.1424 of the *Michigan Compiled Laws* authorizes MSHDA to use money held in the Housing Development Fund to make grants to private nonprofit organizations. However, MSHDA reported that each of the six Housing Development Fund repayable grants was repaid by GLCF, including some with interest. We also learned of a promissory note to MSHDA from GLCF's subsidiary, CFS, for the most recent grant.

A grant is usually recognized as a form of aid that does not need to be repaid. If MSHDA's funding did not constitute a grant under the statute, but rather a repayable loan, then MSHDA may not have been authorized under this section of law to use Housing Development Fund money for this purpose.

- c. Did MSHDA's use of Housing Development Fund money provided to GLCF constitute an advance authorized by law?

Section 125.1424 of the *Michigan Compiled Laws* also authorizes MSHDA to make interest-bearing or non-interest-bearing advances to nonprofit housing corporations. However, the statute provides that these advances are only to defray the development costs of the proposed housing projects themselves. It does not provide for start-up costs or equity fund payments associated with limited partnerships that may invest in those housing projects.

- d. If the Housing Development Fund money was used to provide grants, as opposed to advances, were the grants used for a permitted statutory purpose?

Section 125.1424 of the *Michigan Compiled Laws* provides that if MSHDA uses Housing Development Fund money for grants, the grants shall be made to support the net costs incurred in planning or implementing housing

assistance or community or housing development. According to the statute, examples of permissible community or housing development included land and building acquisition; housing rehabilitation, capital improvements, or modifications; and the provision of necessary supportive services. However, MSHDA's records do not show how GLCF used the grants to acquire land, rehabilitate housing, or make capital improvements. Rather, MSHDA's records show that grants were used for start-up costs and initial operating capital to create GLCF and its CFS subsidiary.

- e. If the Housing Development Fund money was used to provide advances, as opposed to grants, were the advances used for a permitted statutory purpose?

Section 125.1424 of the *Michigan Compiled Laws* provides that advances may not be made unless it is anticipated that a federally-aided or MSHDA-aided mortgage may be obtained by the nonprofit housing corporation. Section 125.1424 also provides that the proceeds of an advance must be repaid in full concurrent with receipt of permanent financing of a housing project pursuant to Section 125.1444 of the *Michigan Compiled Laws*.

MSHDA's records do not show that GLCF's repayable grants were used in anticipation of GLCF obtaining a mortgage or that repayment was concurrent with the permanent financing of a housing project by GLCF pursuant to Section 125.1444 of the *Michigan Compiled Laws*.

An Attorney General Opinion would establish whether funding the costs incurred in the creation and operation of GLCF constituted a permitted use of Housing Development Fund money and would advise MSHDA of its responsibilities going forward.

RECOMMENDATION

We recommend that MSHDA seek an Attorney General Opinion regarding MSHDA's authority to use Housing Development Fund repayable grants to create and support GLCF.

AGENCY PRELIMINARY RESPONSE

MSHDA disagrees. MSHDA stated that it disagrees because the grant activities have all been completed, and all of the funds subject to repayment have been

repaid. Therefore, MSHDA stated that it sees no benefit in requesting an Attorney General Opinion or in asking the Department of Attorney General to spend scarce resources investigating activities which occurred in the past and are no longer current.

MSHDA also asserted that it believes that the funding of the grants to GLCF was within MSHDA's legal and statutory authority. MSHDA stated that its enabling act, Act 346, P.A. 1966, contains various provisions with regard to legislative determinations and findings and provides for certain powers necessary to accomplish MSHDA's mission. According to MSHDA, these powers broadly empower it to engage in all activities necessary or convenient to carrying out MSHDA's purposes related to housing and community development activities. MSHDA believes that there can be little doubt that the support of the GLCF activities is consistent with both the legislative determination and findings and the powers enumerated above because MSHDA believes that the LIHTC equity provided by the sale of the LIHTCs is a key and necessary component to the accomplishment of MSHDA's mission.

MSHDA also stated that it disagrees because MSHDA believes that a key portion of its providing safe, decent, and affordable housing to low and moderate income persons residing in Michigan is accomplished through the administration, allocation, and subsequent sale (by the sponsor of the development awarded the credits) of the LIHTCs. According to MSHDA, LIHTC equity is the largest single form of subsidy utilized by MSHDA to accomplish its mission and goals. MSHDA also stated that since LIHTC equity has been a major source of funds necessary to the development of low and moderate income housing developments since the LIHTC Program was created in 1986 - many of which MSHDA stated are also supported by its direct lending and other programs - MSHDA believes that there is no doubt that the creation of GLCF has generally benefited MSHDA and the citizens of the State.

MSHDA stated that it engaged in the award of grants to GLCF from November 1991 to August 2002. According to MSHDA, the grants provided support for the marketing and sale of LIHTCs, the proceeds of which were then invested in low and moderate income housing developments in Michigan. According to MSHDA, the term of the grants was from November 1991 to November 2004. MSHDA also stated that grant funds subject to repayment were repaid as of November 3, 2004,

and there were no currently open grants or grant making activities between MSHDA and GLCF related to these activities. MSHDA also stated that it believes that all of the grants and activities were consistent with the terms and conditions associated with the applicable Housing Development Fund grant.

MSHDA stated that it also engaged its external financial auditor in activities related to testing and evaluating MSHDA's internal controls procedures and policies, specifically related to the management and disbursement of grant funds. According to MSHDA, these reviews have consistently found that MSHDA's internal controls are appropriately designed and implemented and include a proper distribution of authorities and sign-offs/controls related to grant disbursement and management procedures.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

Attorney General Opinions are binding on State agencies and are necessary in this instance to ensure that MSHDA is utilizing its own scarce resources in accordance with its enabling legislation and related statutes. Whether the grant activities were consistent with the grant terms and conditions is not pertinent to the finding. The relevant inquiry is whether the grant itself is found to have been an appropriate use of MSHDA grant funds. Similarly, whether the funds have already been repaid is not pertinent to the finding because, absent an Attorney General Opinion, there will be nothing to prevent MSHDA from making similar grants to GLCF or others again in the future. Therefore, an Attorney General Opinion will advise MSHDA whether such grants are appropriate and ensure that MSHDA is appropriately administering its grants programs in the future.

Regardless of MSHDA's assertion that such grants provided a key or necessary component to MSHDA's mission, MSHDA's enabling legislation does not empower it to act singularly on the basis of what MSHDA believes is in its own interest. MSHDA must also act consistent with the applicable law, including limitations placed upon it by statute.

An example of this limitation is illustrated in Attorney General Opinion No. 5658 (dated February 27, 1980). The Attorney General opined that, under MSHDA's enabling legislation, MSHDA may only finance commercial facilities that serve and improve a residential area in which a MSHDA residential project is located or planned, provided that the MSHDA project supported a basic domestic residential

need and was within walking distance of a MSHDA planned residential facility. The Opinion further emphasized that the basic function of MSHDA was to provide housing, not commercial development, and that commercial use must be incidental to MSHDA's primary purpose: housing.

Such an Attorney General Opinion established a framework for the limits of MSHDA's authority and, by example, illustrates why such an Opinion would also be useful in this instance, which is to provide MSHDA direction regarding its use of MSHDA grant funds.

FINDING

8. Use of a Homeless Initiatives Grant to Procure a Personal Services Contract

MSHDA's management circumvented *Michigan Civil Service Commission Rules* and the MSHDA Board's authorization by using a Homeless Initiatives Grant to procure a personal services contract from an employee of a grantee.

Adherence to *Michigan Civil Service Commission Rules* and the MSHDA Board's authorization helps to maintain accountability through established oversight processes as well as promoting responsible management.

Section 7-5 of the *Michigan Civil Service Commission Rules* prohibits disbursements to independent contractors unless the disbursement is approved or preauthorized by the Civil Service Commission consistent with the Standards for Disbursement of Personal Services provided for in Section 7-3 of the *Michigan Civil Service Commission Rules*. Those standards provide that the services must be temporary, intermittent, or irregular; the services are so specialized, technical, or unique that they are not recognized within the classified service or qualified candidates could not be recruited; the services involve the use of unavailable equipment, materials, or facilities; or the services would be obtained at "substantial savings" (as defined under the rule).

MSHDA Board Resolution dated September 27, 2006 authorized a \$1.4 million grant to the Corporation for Supportive Housing (CSH) to fund "The Partnership to End Homelessness."

On June 22, 2007, without authorization from the MSHDA Board, MSHDA management amended the CSH grant agreement by increasing the award by \$92,000 and expanding the scope in order to provide funding to fill a vacant director position at MSHDA, utilizing a CSH employee. The CSH employee was publicly referred to by MSHDA as a MSHDA division director, in both correspondence and on MSHDA's Web site, and functioned in that capacity. However, the individual remained employed by CSH, with MSHDA agreeing to reimburse CSH through the grant agreement for the Holland, Michigan-based employee's salary, fringe benefits, mileage, parking, food, and lodging. MSHDA also agreed to reimburse CSH through the grant agreement for costs associated with CSH hiring a temporary employee and consultant to replace its employee while assigned to MSHDA.

MSHDA did not seek Michigan Civil Service Commission approval for disbursement to the independent contractor or document whether it met Standards for Disbursements for Personal Services under Section 7-3 of the *Michigan Civil Service Commission Rules*.

RECOMMENDATION

We recommend that MSHDA's management comply with *Michigan Civil Service Commission Rules* and the MSHDA Board's authorization and refrain from using Homeless Initiatives Grants to procure personal services from an employee of a grantee unless specifically approved and authorized as required.

AGENCY PRELIMINARY RESPONSE

MSHDA disagrees. MSHDA does not believe that this contractual arrangement/grant was intended to or did constitute a violation of Civil Service Commission rules and requirements. MSHDA believes the engagement with CSH was not a personal service contract and therefore was not treated as such. MSHDA also stated that it believes that neither the Civil Service Commission nor Department of Management and Budget (DMB) approval was required in this instance.

MSHDA stated that the grant in question was made to CSH to allow CSH to fund the Partnership to End Homelessness, which MSHDA described as an unprecedented collaboration of nine national foundations, financial institutions, and nonprofit organizations that joined together to end homelessness in Michigan over

10 years. MSHDA stated that, as a result of this grant, CSH tasked an employee to work with MSHDA to improve and expand MSHDA's activities related to the integration of multifamily rental development activities and supportive housing activities. MSHDA stated that it received significant and valuable services as a result of this activity.

MSHDA also stated that it regularly engages in the contracting process related to personal services contracts with the Civil Service Commission and DMB, obtaining all necessary Civil Service Commission and DMB approvals as applicable.

FINDING

9. Controls Over Grants Activities

MSHDA had not established and exercised effective controls over its grants activities.

Effective controls over grants are necessary to ensure that MSHDA funds are used for appropriate purposes, that MSHDA makes the best use of its resources, and that MSHDA awards and distributes its grants equitably to the most deserving recipients.

MSHDA administers a variety of grant programs that are provided to an array of grantees. Federally funded grants, such as Community Development Block Grants and Emergency Shelter Grants, are administered pursuant to applicable federal requirements. In addition, MSHDA has established its own internally funded grants, such as Housing Development Fund Grants and Homeless Initiatives Grants. These grants are funded by MSHDA through its various income sources, such as lending and fee-based housing activities, and fees earned for administering various federal programs on behalf of HUD.

During our audit period, MSHDA reported awarding 1,195 individual grants to 469 different recipients, totaling \$142.4 million in grant awards. Of this amount, \$54.7 million (38%) was funded internally from MSHDA's income. The remainder of MSHDA's grants, \$87.7 million (62%), were funded by federal programs.

Our review of MSHDA's grants activities disclosed the following internal control weaknesses:

- a. MSHDA did not always obtain MSHDA Board approval for internally funded (non-federal) grants of \$250,000 or more.

Michigan Administrative Code R 125.152 - 125.153 provides that MSHDA grant awards of \$250,000 or more must be presented to the MSHDA Board for approval by resolution.

Our review of 14 of MSHDA's 751 internally funded grants of \$250,000 or more disclosed 12 (80%) grants that were signed and executed without MSHDA Board approval, including 11 grants that were never presented to the MSHDA Board for approval. Also, we noted one grant that was signed and executed 57 days prior to obtaining MSHDA Board approval. The 14 grants reviewed ranged from \$250,000 to \$2.0 million and totaled \$9.7 million.

- b. MSHDA staff members did not always obtain proper executive director authorization for internally funded (non-federal) grants of less than \$250,000.

Michigan Administrative Code R 125.152 authorizes MSHDA's executive director (not MSHDA staff members) to issue, on behalf of MSHDA, a commitment for a grant to an applicant in an amount of less than \$250,000 if the executive director determines the following requirements are met:

- (1) The grant applicant is authorized to receive a grant.
- (2) The grant applicant will use the grant funds for permissible activities.
- (3) The grant applicant is expected to successfully implement the terms of the grant agreement.
- (4) The grant application satisfies the award factors and criteria adopted by MSHDA.

Our review of a sample of 13 MSHDA grants of less than \$250,000 disclosed that 11 (85%) of the grants reviewed, valued at \$1.6 million, did not have the

signed authorization of the executive director. In addition, 12 (92%) of the 13 grant agreements we examined, valued at \$1.8 million, did not have documentation of a determination from the executive director regarding whether the grant had met the four requirements necessary to award a grant on behalf of MSHDA.

- c. MSHDA had not required its Finance Division to exercise sufficient oversight of grant payments prior to disbursing MSHDA funds.

MSHDA's Finance Division is responsible for disbursing MSHDA funds and must verify that payment requests are proper prior to disbursement. However, the Finance Division only verified that grant payment requests had the approval of the grant administrator in the division from which the disbursement request originated. The Finance Division did not establish whether original authorization existed by resolution of the MSHDA Board or from the executive director.

Grants disbursement oversight by the Finance Division is a necessary internal control practice that minimizes the risk of unauthorized acquisition, use, or disposition of MSHDA assets by helping to ensure that grant payments are made in accordance with applicable law, authorized under the respective grant agreements, and recorded accurately in MSHDA's accounting records.

RECOMMENDATION

We recommend that MSHDA establish and exercise effective controls over its grants activities.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees in part. MSHDA agrees that more internal controls over its grants activities would ensure proper approval and authority are obtained prior to awarding or disbursing grants. MSHDA stated that increased internal control procedures have been implemented.

However, with regard to part a. of the finding, indicating that MSHDA did not always obtain MSHDA Board approval for internally funded (non-federal) grants of \$250,000 or more, MSHDA stated that it disagrees. MSHDA stated that MSHDA staff conducted a review of the eleven grants the finding cited in this regard.

MSHDA stated that documentation was obtained that demonstrates MSHDA Board approval was received on 9 of the 11 grants.

MSHDA stated that Board approval for 9 of the grants was demonstrated by the approval of various resolutions related to MSHDA programs or activities. MSHDA stated that these resolutions approved an overall program expenditure for the total program or activity, and delegated authority to the executive director to make sub-awards to specific projects and programs with follow-up reporting to the Board after the sub-awards had been executed. The resolutions specifically gave authorization to the executive director to approve grants, "...without further approval of the Authority." The executed grants were then reported to the Board, as required by the terms and conditions of the program resolutions, at a later date through a periodic delegated actions report.

MSHDA stated that the Board delegated authority provided under *Michigan Administrative Code R 125.153* to the executive director through the adoption of the program and activity resolutions and that, thereby, 9 of the 11 grants received Board approval.

MSHDA also stated that an example of MSHDA's disagreement with part a. is as follows:

MSHDA stated that it disagrees that MSHDA staff signed and executed a \$449,500 grant agreement prior to obtaining MSHDA Board approval. MSHDA stated that, during the grant award process, authorized signatories signed the grant staff report that was included in the Board docket as early as July 8, 2004. MSHDA stated that the staff report represents a recommendation by MSHDA staff to the MSHDA Board, and that no action can be taken on the recommendation prior to the Board's concurrence in the recommendation and approval of the action. MSHDA stated that MSHDA Board approval for this grant was obtained on July 28, 2004, and then the grant award notification letter was issued August 20, 2004. MSHDA stated that the fact that signatures were obtained on a staff report prior to MSHDA authorization may have caused the disagreement with the finding; however, MSHDA stated that the award notification was delivered after MSHDA Board approval.

With regard to part b. of the finding, MSHDA agreed that proper executive director authorization for 11 of the internally funded (non-federal) grants of less than \$250,000 was not obtained. MSHDA stated that its current policy incorporates procedures ensuring proper authorization is obtained before executing a grant award. MSHDA also stated that in an effort to improve internal control procedures, MSHDA has begun to require a cover sheet in each grant file that shows a number of items have been reviewed prior to the grant award (e.g., source of funding, required authorization, etc.).

MSHDA also stated that, although the executive director's authorization was not obtained prior to the grant award, each grant was presented to the executive director and the MSHDA Board in a subsequent "Delegated Action Report" that was included in the official Board dockets.

With regard to part c. of the finding, MSHDA stated that it sees no benefit in enabling the Finance Division to have more oversight when grant compliance is conducted in another division. MSHDA stated that prior to disbursing MSHDA funds, the Finance Division ensures proper signatures are obtained from the grant administrator; this signifies grant terms and conditions have been adhered to and payment is warranted.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

Regarding MSHDA's disagreement with part a. of the finding, MSHDA's administrative rules did not provide for the delegation of authority for grants of \$250,000 or more or for avoiding MSHDA Board approval by resolution of each individual grant of \$250,000 or more. An administrative rule is an agency's written regulation, statement, standard, policy, ruling, or instruction that has the effect of law. *Michigan Administrative Code R 125.152* requires that "all applications for development fund grants in the amount of \$250,000 or more shall be presented to the authority for approval, along with authority staff analysis of the application and the executive director's recommendation" *Michigan Administrative Code R 125.153* requires that the MSHDA Board must review the staff analysis and recommendation presented for each grant in the amount of \$250,000 or more. In addition, R 125.153 requires the MSHDA Board to authorize, by resolution, each grant to applicants in the amount of \$250,000 or more, after the MSHDA Board has reviewed the individual application and found that it meets the requirements of the MSHDA Act and MSHDA administrative rules.

The \$449,500 grant was made to the Michigan Council for Arts and Cultural Affairs (MCACA), Michigan Department of History, Arts and Libraries, to fund economic development projects under the State's "Cool Cities" program, including storefront and arts center renovations; streetscape and parking lot improvements; an art incubator; retail gallery, studio, office, and theater construction; moving costs for a metalworking school, gallery, and sculpture garden; renovation of commercial space; creation of public art; and development of 35 loft apartments.

The first sentence of the grant agreement with MCACA reads as follows: "THIS GRANT AGREEMENT made and entered into as of June 1, 2004, by and between the Michigan Council for Arts and Cultural Affairs, an agency of the State of Michigan, . . . (the 'Grantee'), and the Michigan State Housing Development Authority . . . ('the Authority')." The end of the grant agreement reads as follows: "IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year shown above," followed by the signature of the director of MCACA, on behalf of the "Grantee," and the signature of MSHDA's director of legal affairs, on behalf of MSHDA. The resolution authorizing this grant was approved by the MSHDA Board during its July 28, 2004 meeting, 57 days after the "day and year shown above" on which the grant agreement indicated the grant had been entered into and executed.

FINDING

10. Procurement of an Integrated Accounting and Management Information System

MSHDA had not established an effective control environment over the procurement of its integrated accounting and management information system. As a result, MSHDA could not ensure that the related contract was managed in a fiscally responsible manner and provided assurance that vendors met contractual obligations and user needs.

Section 125.1421 of the *Michigan Compiled Laws* provides that MSHDA shall be within the Department of Energy, Labor & Economic Growth (DELEG) and that MSHDA's budgeting, procurement, and related functions shall be performed under the direction and supervision of the DELEG director. DMB Administrative Guide procedure 0610.01 requires that executive branch departments and subunits shall manage their contracts in a fiscally responsible manner and ensure that vendors meet contractual obligations.

In February 2003, MSHDA invited vendors to submit proposals for an information system for financial (general ledger, accounts payable, mortgage servicing, and investments), multifamily lending, compliance monitoring, and asset management operations. In February 2004, MSHDA executed a three-year contract, with two optional one-year extension periods, for its current accounting and management information system.

MSHDA paid \$3.1 million to an information technology vendor, plus an undetermined amount to an outside consultant, to acquire and implement an integrated accounting and management information system in 2004. However, in 2007, MSHDA began the process to rebid the contract, just three years after purchasing the system.

Our review of the procurement and operation of MSHDA's accounting and management information system disclosed:

- a. MSHDA negotiated a contract that did not allow it to continue to use its accounting and management information system five years after first procuring it, unless MSHDA negotiated an extension of the contract.

As a result, based on MSHDA's interpretation of the existing contract language, unless MSHDA awarded the new contract to the existing vendor, it would again undergo the costs of development, training, and conversion of its data to another new system after only five years.

MSHDA stated that under Executive Directive No. 2005-03, it was required to competitively re-bid its 2004 information system contract when the contract expired in 2009. However, MSHDA also stated that after February 2009, its 2004 contract did not allow MSHDA to continue to access the system's source code, which was necessary for MSHDA to continue to utilize the system that it paid for under its 2004 contract.

- b. MSHDA had not utilized the investment management system purchased under its 2004 information system procurement. As a result, MSHDA continued to enter its investment transactions manually, despite having paid for an investments management component. MSHDA reported that it was again

attempting to procure an investment management system in its 2007 information system procurement.

In an effort to modernize and integrate its investment management activities, MSHDA's 2004 contract requirements with its vendor specified that the information system provide MSHDA the ability to account for and monitor its investments, interface with the general ledger and other internal and external systems, produce journal vouchers and reports, and download information in a user friendly format.

However, MSHDA informed us that the accounting and management information system it procured in 2004 did not provide an investment management system that it could use to manage and account for its investments. MSHDA continues to monitor and account for its investments on an electronic spreadsheet and manually enters its investments transactions by journal voucher into its accounting system.

- c. MSHDA could not generate a complete chart of accounts from its accounting and management information system. Without a complete chart of accounts from its information system, MSHDA could not readily obtain and produce a basic level of detail of how its financial activity is coded, aggregated, and ultimately presented in its financial statements.

RECOMMENDATION

We recommend that MSHDA establish an effective control environment over the procurement of its integrated accounting and management information system.

AGENCY PRELIMINARY RESPONSE

MSHDA agrees. Regarding part a., MSHDA agrees but stated that the contract in question was negotiated on MSHDA's behalf by the Department of Information Technology (DIT) according to DIT's contracting processes and procedures. MSHDA stated that it has subsequently completed a DMB and DIT managed request for proposal process for a new accounting system and that the new accounting system is in the process of being implemented. However, MSHDA stated that the procurement referenced in the finding was conducted in accordance with State policy and primarily through a collaboration with DMB and DIT, and

therefore, MSHDA had little control over setting the terms and conditions for procuring the accounting and management information system.

MSHDA also stated that it engages in contracting processes and procedures mirroring those mandated by DMB and administers a competitive contract request for proposals and contract selection process. MSHDA further stated that it also requests and receives CS-138 approvals from the Civil Service Commission before it engages in the contracting process.

In addition, MSHDA stated that it has received legal opinion guidance from the Department of Attorney General and other guidance from State officials with regard to exceptions from certain State administrative procedures, given what MSHDA describes as its status as an independent public body corporate and politic, and the nature of the vast majority of funds being non-State funds.

MSHDA agreed with part b. and stated that MSHDA will be using the new system to track investments.

MSHDA also agreed with part c. and stated that its new accounting system will include the capability to produce a complete chart of accounts.

GLOSSARY

Glossary of Acronyms and Terms

absconder	A parolee or probationer who has eluded supervision by failing to report in a reasonably timely manner.
CFS	Capital Fund Services, Inc.
CSH	Corporation for Supportive Housing.
Department of Energy, Labor & Economic Growth (DELEG)	Formerly the Department of Labor and Economic Growth.
Department of Labor and Economic Growth	Renamed Department of Energy, Labor & Economic Growth effective December 28, 2008 pursuant to Executive Order No. 2008-20.
Department of Management and Budget (DMB)	Renamed Department of Technology, Management & Budget effective March 21, 2010 pursuant to Executive Order No. 2009-55.
effectiveness	Success in achieving mission and goals.
EIV	Enterprise Income Verification.
FBI	Federal Bureau of Investigation.
fee-based contract administration	A method of project-based contract administration in which MSHDA is responsible for conducting on-site management reviews of assisted properties; adjusting contract rents; reviewing, processing, and paying monthly vouchers submitted by owners; renewing contracts with property owners; and responding to health and safety issues at the properties.
GASB	Governmental Accounting Standards Board.

GLCF	Great Lakes Capital Fund.
HCV	Housing Choice Voucher.
head of household	The adult member of a household designated by the family as head on the Household, Income, Asset, and Expense Declaration and who wholly or partly has responsibility for paying the rent, with the legal capacity to enter into a lease under State and/or local law.
HUD	U.S. Department of Housing and Urban Development.
Internet Criminal History Access Tool (ICHAT)	A criminal history database offered to the public by the Michigan Department of State Police, limited to felonies and serious misdemeanors punishable by over 93 days that are required to be reported to the State repository by law enforcement agencies, prosecutors, and courts in all 83 Michigan counties. ICHAT does not include federal offenses, tribal records, or criminal histories from other states.
LIHTC	Low Income Housing Tax Credit.
material condition	A reportable condition that 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.
MCACA	Michigan Council for Arts and Cultural Affairs.
mission	The main purpose of a program or an agency or the reason that the program or the agency was established.
MMF	Michigan Magnet Fund.
MSHDA	Michigan State Housing Development Authority.

OAG	Office of the Auditor General.
OTIS	Offender Tracking Information System.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
performance-based contract administration	A method of fee-based contract administration in which MSHDA submits and receives voucher payment amounts directly from HUD each month, based on the monthly amounts MSHDA verified and paid to property owners.
probation absconder	An offender who has eluded probation supervision by failing to report in a reasonably timely manner and is considered to pose a direct threat to the health, safety, and welfare of any person, household, or community.
project-based rental assistance	A federal housing program that provides rental subsidies to privately owned multifamily developments so that they are affordable to low income households.
Qualified Allocation Plan (QAP)	A plan prepared by MSHDA, submitted to the Legislature, and approved by the Governor after notice to the public and public hearing that sets forth the selection criteria used to allocate LIHTC.
repayable grant	A form of MSHDA's financial assistance whereby the recipient agrees to reimburse MSHDA for the full amount of the assistance provided (to the extent disbursed) at the end of the term of the agreement, except the recipient's repayment obligation shall be limited or forgiven in whole or in part if desired outcomes are not achieved.

reportable condition A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

tenant-based rental assistance A federal housing program that provides rental subsidies to low income tenants who find their own housing in private rental units that agree to rent under the program and meet minimum health and safety standards.

traditionally administered contract administration A method of fee-based contract administration in which MSHDA and HUD establish a yearly budget, and HUD pays MSHDA set monthly payments. At the end of the year, HUD and MSHDA reconcile the payments HUD made to MSHDA with the monthly amounts MSHDA verified and paid to property owners throughout the year, exchanging payment as necessary to settle any difference.

USC *United States Code.*

