



BOARD OF SUPERVISORS  
AGENDA LETTER

Agenda Number:

Clerk of the Board of Supervisors  
105 E. Anapamu Street, Suite 407  
Santa Barbara, CA 93101  
(805) 568-2240

Department Name: Auditor-Controller  
Department No.: 061  
For Agenda Of: 2/6/2007  
Placement: Set Hearing  
Estimate Time:  
Continued Item: YES  
If Yes, date from:  
Vote Required: Majority

---

TO: Board of Supervisors  
FROM: Department Director(s) Robert W. Geis, C.P.A.  
Contact Info: Betsy Schaffer, Audit Manager 568-2456

**SUBJECT: Housing & Community Development Audit**

---

**County Counsel Concurrence:**

As to form:  Yes  No  N/A

**Auditor-Controller Concurrence:**

As to form:  Yes  No  N/A

**Other Concurrence:** N/A

As to form:  Yes  No  N/A

**Recommended Action(s):**

Set Hearing for February 13, 2007 to receive and file reports and take under consideration the findings, recommendations and management comments regarding the Housing and Community Development Department Audit. (Set hearing for 45 minutes)

**Summary:**

At the request of the Board of Supervisors the Auditor-Controller conducted an audit of the Housing and Community Development Department. We are issuing two audit reports that cover programs in the Housing Development Division and programs in the Housing Finance Division. We began our work in February 2006 and issued a preliminary report on findings related to the Development Division dated March 15, 2006. Due to significant internal control weaknesses in that Division we increased the scope of our field work to determine compliance with program policies and restrictive covenants for 21 developments, consisting of 416 affordable units and issued a final report dated October 9, 2006. In September 2006 we began work on the Finance Division and issued a final report dated November 22, 2006.

In August, 2006 the Director of HCD resigned and the Assistant CEO and CEO staff assumed management of the department. Immediately they began to lead a project improvement task force to address the weaknesses in the Programs and to create improved processes. Effective January 16, 2007 John Torell was hired as the new Director of HCD. We are hopeful management and the task force will continue to lead the effort to focus on determining the overarching goals of the Program which will drive the design of the internal control framework and the associated processes necessary to reach the goals. We also sincerely appreciate the efforts by HCD staff and management in assisting in our examination. CEO and HCD management have responded to the findings and recommendations positively and taken initiative to implement improvements; their responses should be considered part of the final report.

### **Audit Scope Limitations**

While the scope of our audit was broad, because of the number of control weaknesses in the department in the areas we examined, it could be reasonably expected that not all weaknesses have been discovered. For instance we did not examine the Development Division controls over rental activities. We also did not have resources to thoroughly examine the controls related to the Finance Division five year implementation plan. However, our examinations have included sufficient inquiries, observations, and tests of transactions to provide a basis for our conclusions and to enable us, where appropriate, to recommend changes to procedures to assist management in achieving its objectives.

### **Background:**

## **Housing Development Division Audit**

### **Purpose and Scope**

The purpose of our audit was to determine whether an adequate and effective system of control had been provided over key activities of the Program. Our examination focused exclusively on the affordable ownership activities of the Program. We did not review the system of controls over the affordable rental activities administered by the Program. We were concerned specifically with the following processes of the affordable ownership activities:

- Lottery and eligibility process
- Inventory control and unit tracking
- Restrictive covenant compliance monitoring and enforcement
- Refinancing and home equity monitoring
- General administrative functions

### **Conclusion**

The Housing and Community Development Department, through its Housing Development Division, is responsible for oversight of the Program. The Program works to increase and maintain the inventory of affordable homes within the unincorporated areas of the County.

In our opinion, the system of control provided over the affordable ownership activities of the Program is inadequate. Significant weaknesses exist in every key control point. We noted a consistent lack of management oversight, poor practices in selecting and determining eligibility for participation in the Program, ineffective restrictive covenants and related legal actions to secure County rights on the properties, ineffective monitoring and enforcement of participant compliance with Program restrictions, and poor administrative support functions.

The lack of strong internal controls has led to inconsistencies in Program administration, inequalities in benefits, and undetected violations of guidelines by Program participants. Management has not developed specific Program goals; therefore, adequate policies and procedures guiding operations do not exist.

## **Finance Division Audit**

### **Purpose and Scope**

The Finance Division (also referred to as "Housing Finance" in this report) itself is primarily an administrative conduit that receives program funding, and then awards or distributes it in accordance with funding guidelines and restrictions to achieve program objectives. Recipients of the funding can include individuals, other governmental agencies, and community-based organizations providing housing programs. In this audit report, we present and

## Housing & Community Development Audit

2/6/2007

Page 3 of 5

group our findings and recommendations by each funding source, i.e. program. Overarching findings with respect to the Division as a whole are included as "General Program" findings.

Our audit of the Finance Division of HCD was limited in scope. For ease of reference, the Finance Division's functions can be broken down into three primary areas:

- 1) securing and awarding of available funds,
- 2) accounting for funds and compliance with specific funding guidelines, and
- 3) monitoring program distributions and ultimate program success with identified plans.

Due to time and other resource limitations, we did not audit the award process or confirm the success of the program with funding allocations (areas 1 and 3 above). Our audit focused on area 2 – accounting for funds and compliance with specific funding guidelines. With this limited scope in perspective, the purpose of our audit was to identify the types of funding and their respective sources administered by the Finance Division of HCD, and determine whether an adequate and effective system of controls has been developed over the accounting function related to these funds.

Our audit examined transactions recorded in the County's financial system and amounts or balances available for housing programs for the fiscal years ended 6/30/05 and 6/30/06. For this 2-year period, our audit examined over \$13 million. Additionally, although we touched on the shared equity component of the Inclusionary Housing program during our audit of Housing Finance, an in-depth examination of this program was conducted independent of this audit and the results have been addressed in a separate report.

### Conclusion

Management lacks effective and focused oversight of the finance activities within Housing and Community Development. A nonexistent overall strategy to achieve delineated housing objectives is causing millions of dollars that have been earned or otherwise gained for the purpose of funding affordable housing programs to needlessly accumulate. Financial transactions and assets that the Housing Finance Division is responsible for managing are minimally protected due to weak and ineffective internal controls.

Several programs and grant compliance requirements, such as County matches, were found only through the audit process. Additionally, at least \$350,000 of in-lieu fees owed to Housing Finance were found through the audit's discovery of inadequate control processes surrounding in-lieu fees. An attempt at creative financing through a "Portfolio Recapitalization Loan" produced a funding vehicle that cost the County money without being utilized for any project.

We found programs that are dormant and revenue sources that have been lost due to management not performing their role effectively. We found programs that are disproportionately incurring administration fees due to management not performing their role responsibly. We found that documentation of important decisions that were made against policy, and lack of documentation in general, were common themes and resulted due to management not taking their role critically.

Suffering the lowest priority by Housing Finance management, who nurtured a hands-off approach to understanding the County's financial accounting and monitoring tools, was the technical accounting function. This coupled with management's inability to simplify the program jargon to the lay person causes unnecessary confusion when trying to better understand program requirements. All of these elements appear to have created an environment lacking key controls necessary to mitigate the risk of error and fraud, such as segregation of duties, account reconciliation, and management review.

### Management's General Comments:

HCD recognizes the need for a thorough management review of all aspects of HCD internal operations and finances. In this regard, we especially appreciate the efforts of the Auditor-Controller and the preparation by his office of two audit reports that will serve as invaluable guidelines in the re-vitalization and effectiveness of HCD's internal operations. Although several of the problems identified have plagued this County for decades, significant

## Housing & Community Development Audit

2/6/2007

Page 4 of 5

efforts have already been expended to address deficiencies identified in the audit report in a timely manner, including:

- Simplified lottery application process
- Residential property management database
- Annual survey for all "for sale" affordable unit households
- Utilization of property search tools to verify income and assets
- Implementation of additional internal controls in the income certification process
- Establishment of Violations Committee for review of possible covenant violations and referrals to the District Attorney's Office
- Adoption of an owner occupancy ordinance to facilitate enforcement actions

Management also recognizes that improving HCD's internal processes, while essential, will not, in itself, serve to create the solutions necessary to ensure the availability of affordable and workforce housing programs in the County's unincorporated areas. We believe that a clear re-articulation of the County's housing needs within the context of maintaining the economic, social, and environmental health of our communities is needed.

The solution to the County's housing issues, to be successful, must ultimately be based upon and consistent with the underlying values of our community. A Stakeholders Advisory Group has been established by the Board of Supervisors as a first step in this process. The department will also focus on the development of a strategic plan that will include a statement of departmental goals and objectives based on the identified needs of the local communities in which the department provides service. In conjunction with the audit findings, the department's strategic plan will include an evaluation of current programs and business operations to identify additional process improvement opportunities in all areas of the department's operations.

Management comments addressing specific audit findings in the Housing Development Division audit report were included by the auditor as an attachment to that report. Management comments addressing findings in the Housing Finance Division audit report have been included within the body of that audit report by the Auditor.

### **Performance Measures:**

Achieve management's acceptance of at least 80% of all audit recommendations for the improvement of business processes and controls per management responses to audit reports.

### **Fiscal and Facilities Impacts:**

Budgeted:  Yes  No

### **Fiscal Analysis:**

Narrative:

#### **Revenue Recovery**

One of the most significant findings of the finance division audit is the potential to recover In-lieu fee revenues of approximately \$350,000 not paid by two developers. In addition, future collections could have been lost due to internal control weaknesses surrounding the collection of In-lieu fees.

#### **HCD Departmental Costs**

The second significant fiscal impact is the loss of affordable housing stock to the community. These community assets are intended to provide and maintain affordable housing stock to the unincorporated areas of the County. The fiscal impact of lost units due to foreclosure or improper use has not been quantified.

The cost related to the lack of good internal controls and efficient and effective processes to maintain this program have not been quantified as part of the audit process. Management will need to continue the evaluation of this program in order to determine the right mix of resources to carry-out the goals and objectives of this

**Housing & Community Development Audit**

2/6/2007

Page 5 of 5

program. Management's current assessment is that more resources are required to carry out program policies implemented since the late 1980's.

**Internal Audit Cost Summary**

Cost Summary  
1/1/05 - 11/30/06

	Inclusionary Housing		Housing Finance		Total	
	Hours	Amount	Hours	Amount	Hours	Amount
Staff	2,548	\$ 119,190	735	\$ 43,643	3,282	\$ 162,832
Supplies		5,292		132		5,424
		<u>\$ 124,482</u>		<u>\$ 43,774</u>		<u>\$ 168,256</u>

Almost fifteen different staff members including Auditors and Audit Management working as a team completed various components of the audit of these programs. The cost of staff time of HCD is not included in these recorded hours. Most of the costs are labor intensive. We have compiled over 25 binders of information. Sent numerous mailings, conducted in depth asset searches (Accurant) and spent time in the filing and delivery of notices, knocking on doors and interviewing owners of affordable units. As can be seen from the above hours audits are tedious work but the process results in detailed findings and recommendations that management can use to make improvements within a departmental program. The Auditor could claim the audit paid for itself twice over with the recovery of \$350,000 in uncollected developer fees; however it is the identification of internal control weaknesses in the program that should be most beneficial to management. The CEO management team is focused on making the necessary process improvements in order to fix the operations of this department.

**Staffing Impact(s):**

**Legal Positions:**

Undetermined

**FTEs:**

N/A

**Special Instructions:**

None

**Attachments:**

***Report on Internal Controls over Activities of the Inclusionary Housing Program***

***Report on Internal Controls over Activities for the Housing Finance Program***

**Authored by:**

County Internal Audit Division

**cc:**

HCD

CEO

County Counsel