




OFFICE OF THE CITY MANAGER

March 30, 2009

TO: CITY COUNCIL

FROM: MICHAEL BECK 
CITY MANAGER

SUBJECT: HOUSING DEPARTMENT INTERNAL AUDIT

At the Finance Committee on March 23rd, staff presented the results of a recent audit of the Housing Department. At the request of the Finance Committee Chair, this report is now being presented to the City Council for their information and review. The audit was performed by RSM McGladrey who will be available Monday evening, along with city staff, to present the findings of the audit. I have attached a copy of the report that was presented to the Finance Committee.

Generally the audit findings are positive. The audit does identify a few areas that require some attention by staff which is underway. This exemplifies the value of conducting such audits.

03/30/2009

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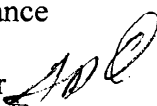
MEMORANDUM - City of Pasadena

Department of Finance

March 23, 2009

TO: Finance/Audit Committees

THROUGH: Andrew Green, Director of Finance

FROM: George Owens, Internal Auditor 

SUBJECT: Housing Department Internal Audit

Attached is a recent audit performed by RSM McGladrey. A summary of the recommendations are included in the attached report.

External auditors who conducted the audit will be at the Finance Committee.

City of Pasadena

Housing Department Internal Audit
January 2009

RSM! McGladrey

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an affiliation of separate and independent legal entities.

RSM McGladrey

December 11, 2008

Mr. Steven B. Mermell
Director of Finance
100 N. Garfield Ave, Room S353
Pasadena, CA 91109-7215

Dear Mr. Mermell,

Thank you for allowing RSM McGladrey, Inc. (RSM McGladrey) to provide professional internal audit services for the Department of Housing and Community Development (Housing Department) of the City of Pasadena (the City). Consistent with the approved engagement plan, RSM McGladrey conducted an internal audit of select operational functions of the Housing Department, beginning on October 27 and concluding on October 31, 2008.

The purpose of the internal audit was to independently evaluate adherence with internal policies and procedures, best practices and industry-accepted standards. Our staff relied on existing policies and procedures, internal control descriptions, industry standards, and rules and regulations as the basis for testing and reviewing the control environment.

Based on our transactional testing, review of the policies and procedures, and our understanding of existing processes, the City's Housing Department are functioning at a satisfactory level. Overall, our transactional testing identified one high-risk exception on loan boarding and documentation. The other findings were moderate-to low-risk in nature and can be addressed in the normal course of business. Based on our experience, a satisfactory control environment does not mean exceptions will not occur. Rather, it means there are no major breakdowns in the primary systems of controls that are designed to prevent and detect problems. (See Appendix B for a description of the rating system applied to the internal audit process.)

We conducted an exit meeting on October 31, 2008 to discuss our preliminary findings and recommendations with Senior Project Manager James Wong and Project Manager Aldra Allison. Management was receptive to our findings and agreed to consider our recommendations for implementation.

We would like to express our thanks to the staff of the City's Housing Department, who were extremely helpful and candid throughout the process. We hope this report provides your staff with meaningful feedback on the status of the City's Housing programs.

Please contact Andrew Chen at (949) 255-6634 if you have any questions regarding the content of this report or if members of your staff would like any additional guidance related to our recommendations. You may also contact me directly at (626) 405-4287.

Sincerely,

RSM McGladrey, Inc.



Dan Shumovich, Managing Director
Risk Management Group

Overall Recommendations

We recommend the Housing Department consider the following actions to address the observations contained in this report and to further strengthen the internal controls and practices in the Department.

- Develop and enhance policies and procedures to address the following areas:
 - Funding Risks
 - Past Due and Delinquent payment Issues
 - Underwriting – with focus on financial strength analysis
- Establish an early contact system with borrowers, participating in the deferred payment program, for arranging payments and detecting potential payment issues.
- Enhance the developer selection process by reviewing developer/owner's financial strength and expand the construction management process.
- Address the loan documentation deficiencies identified during the audit.
- Establish a tracking system for outstanding documents.
- Ensure billing statements are generated and mailed for all borrowers whose loan payments are due.
- Ensure reconveyances are sent for recording within the timeframe stated in the California Civil Code Section 2941.
- For paid off loans, ensure the Promissory Notes are stamped paid along with the date paid.

Scope and Audit Coverage

The scope of our internal audit testing included audit coverage in the following areas:

- Prior audit follow-up
- Policies and procedures
- Lending authority
- Underwriting Process and compliance
- Loan boarding and funding
- Loan file documentation
- Loan payment processing and monitoring
- Past due payment resolution
- Collateral control and release
- Payoffs and Reconveyances
- Loan system set up and tickler management
- Security and Segregation of duties
- Reconciliation and suspense accounts

Introduction

The Department of Housing and Community Development has developed a number of programs intended to assist lower income residents to either purchase or rent residential properties at affordable prices. These programs have been under the supervision of Pasadena Community Development Commission.

The City's housing programs include several major categories: Homebuyer Assistance programs, Housing Rehabilitation Programs, and Rental Housing Assistance programs and several other related services and programs. A majority of the housing programs received funding support from federal and state government under various housing programs. As a result, these funding authorities would periodically conduct on-site reviews of respective programs for initial and continued qualification and eligibility. U.S. Department of Housing and Urban Development (HUD) conducted an on-site review in July 2008 and made several recommendations based on their findings. This resulted in several revisions and new additions to the City's Community Development Block Grant (CDBG) and Home Investment Partnership (Home) programs that HUD supports.

Major Funding Programs Reviewed

Home Ownership Opportunities Program (HOP)

The HOP program has been the City of Pasadena's primary program intended to assist in securing home ownership for residents below certain income level thresholds. Other resources include programs under California Housing Finance Agency (CalHFA), a state agency that provide below-market interest rate financing for the development of affordable housing, and programs under HUD.

Rental Housing & Supportive Services Programs

The Pasadena Community Development Commission administers the Section 8 Rental Assistance Program, a federally- funded program which assists very low-income households obtain affordable housing within Pasadena.

Housing Rehabilitation Program

The City also works with developers to build affordable apartments or fund the rehabilitation of existing apartments for affordable rental or purchase. One of the major programs the City participates in is the Home Investment Partnership (Home) program. Home is a formula-based program that allocates federal grants to support affordable housing for low- and moderate-income families.

Specific Observations and Recommendations

Prior Regulatory Audit

Timely and effective corrective action in response to audit findings is a routine part of doing business in a governmental agency. Well-prepared and implemented corrective action plans produce a healthy environment for strengthening the system of internal controls. A lack of appropriate follow-up can expose the Department and City to undue risk and operating inefficiency.

We reviewed the City Manager's response to the U.S. Department of Housing and Urban Development (HUD) fiscal year 2008 on-site monitoring. Our review indicated the Department has satisfactorily addressed the on-site monitoring findings and made corrective action plans.

Housing Department Policy

The purpose of reviewing the Department's policies is to evaluate the adequacy of written policies and guidance, as well as general management of the department. A well-written and formally approved funding policy is a critical mechanism to provide oversight to the approval of loans under various programs. In addition, the management of funding, construction, loan monitoring and repayment schedules is equally important and critical.

Observation 1 - Low Risk

The Department has developed various policies for the execution and maintenance of HOP programs, rehabilitation programs, and rental housing programs. New programs were introduced in 2008. Our review of the Department's policies and procedures noted the Department does not currently have an updated comprehensive written policy and procedure manual that includes all programs under its supervision and written guidelines are not available for managing the entire loan portfolio. Comprehensive policies and guidelines would address critical areas of funding risks, including how various loans under supervision are being monitored, construction costs are being effectively managed, and past due issues are being resolved.

Recommendation

We recommend management review, update, and develop policies and procedures to ensure a comprehensive policy manual that addresses all areas of the City's funding programs including risk-based management of loans after funding.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Develop a comprehensive policy and procedures manual that addresses all areas of the funding programs including risk-based management of loans after funding. Management is reviewing the policies and procedures manuals of the Los Angeles Community Development Commission programs as models.

Underwriting / Credit and Project Analysis / Program Acceptance

Sound underwriting / credit analysis provides support for each credit decision made by the Housing Department in order to support each funding decision. Sufficient due diligence must be conducted and documented, including analysis of the purpose of the credit request and sources of repayment. This applies to individual borrowers, commercial developers and contractors, and rental building owners having subsidized rental units.

The purpose of reviewing the underwriting and compliance is to evaluate the adequacy of credit analysis, underwriting processes, and program acceptance guidelines. Underwriting procedures serve as an extension of the general policy of the Housing Department and the City Manager in carrying out their oversight responsibilities. Underwriting procedures also provide a basis for defining roles and responsibilities of staff and as well as a training mechanism for educating staff on expectations with regard to a particular function.

Observation 2—Low Risk

The Housing Department has developed a number of underwriting guidelines, flowcharts, and procedures for their HOP loans, housing development loans and rehabilitation loans. We tested five loans in conjunction with reviewing underwriting guidelines for HOP and administrative plans for "Home" loans and Residential Rehabilitation loans.

Our review of the various underwriting procedures and administrative plans found that some of the written procedures needed to be expanded and/or enhanced to reflect current operating practices. We noted that existing underwriting guidelines / procedures do not establish a systematic review standard for analyzing the financial health of the contractor or developer / rental-housing owner; i.e., Net operating income and debt service coverage. Most lending organizations use such information to evaluate the financial health of the project or the developer.

Our discussions with management indicated that in practice they do consider the financial condition of the developer/owner and contractors, even though the Department has not developed a specific methodology for the financial analysis. Our transactional testing noted certain development loans (e.g., King Village), which contained construction costs along with net operating income and debt service coverage information on the project.

Furthermore, our review of the sampled loans noted that additional costs were assessed during or after the construction / renovation (e.g., Beacon Housing Inc.). The Department accrued late charges for this developer/owner. While this process was discussed and the additional funds were approved, it was not treated as an exception. In addition, related to construction projects (e.g., King's Village), we noted that significant value difference between lower appraised value (\$24.7 million) and project cost (\$37.6 million) was noted but not highlighted or discussed.

Recommendation

We recommend management document the credit analysis and financial requirement for contractors and developer/owners who participate in Construction, Housing Development, and Rehabilitation loans. We further recommend management treat significant changes, cost overruns, delays, or value difference as underwriting and funding approval exceptions.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Include in the project underwriting procedure documentation of the credit analysis and financial requirements for developers who receive agency loan assistance.
- ✓ Document significant changes in the project or financing (e.g., cost overruns, delays, value differences) as underwriting and funding approval exceptions.
- ✓ Develop a financing term sheet of underwriting guidelines and parameters.
- ✓ Engage the Finance Dept. in review of developer financial statements.

Payment and Delinquency Resolutions

A large number of HOP loans are on a deferred payment system. First payment is not due until five or more years after the loan closes. The Department tracks payment dates and payment receipts through the Interlinq loan system. Department management maintains payment histories through the Interlinq system and other mechanisms.

Observation 3 - Moderate Risk

Our review noted that the delinquent payments issue had not been systematically addressed until September 2007, when the Housing Department hired a temporary worker to collect all delinquent information and to organize the delinquent loans into categories as High Priority, Low Priority, Repayment Plan, and Do Not Contact. The temporary worker also started to contact borrowers regarding their payment plans. Even though some past due loans have been paying under a new payment plan, we noted that some borrowers were over 30 payments (more than two and a half years) in arrears. We were informed that the project has been inactive since March 2008 due to the departure of the temporary worker.

Once a loan has been approved and structured according to the borrower's financial ability, and funded, the borrower has the obligation to repay the loan when due. Some restructure of the payment plans may be necessary for repayment due to unforeseen circumstances; by far the majority of the loans need to be paid on time, especially if the borrower continues to make payments to the first lien holder.

Recommendation

We recommend management review and enhance policy guidelines and procedures for resolving delinquent payment issues. A re-evaluation of staffing duties may be warranted to keep payment programs on track and minimize losses.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Review and enhance policy guidelines and procedures for resolving delinquent loan payment issues.
- ✓ Consider re-evaluation of staffing duties to keep payment programs on track and minimize losses. Currently, one staff person is responsible for loan production and loan servicing/collections (in addition to other work program areas non-related to homebuyer assistance lending). Hire temporary assistance as needed.
- ✓ Enhance the department's asset management and compliance monitoring capacity by adding one (1) FTE with skills in these areas. The position could be funded by implementing a Compliance Monitoring Fee to offset costs.
- ✓ Consider establishment of a loan review committee.

Observation 4 - Moderate Risk

Our review of the Department's usage of the Interinq system and the system's capabilities noted the System has not been utilized as an effective tool in reporting updated payment information and to provide warning systems for delayed payments; including complete up to date stratification data on past due 1-29 days, 30-59 days, 60-90 days, and 90 days or more past due. Currently, the system does not automatically generate tracing letters or default notices. The system also does not generate payment reminders to borrowers a few weeks or months before the first payment due date, since many loans are on a deferred payment plan.

Recommendation

We recommend management enhance the use of the Department's loan information system to provide up to date payment and delinquency information on all borrowers. In addition, we recommend management establish an early contact system with borrowers, in the deferred payment program, for payment arrangements, and to detect and monitor potential repayment problems at an early point in delinquency.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Contract with Interlinq (vendor) to provide on-site training and technical assistance in order to enhance the use of the loan system, particularly with respect to up-to-date payment and delinquency information.
- ✓ Incorporate into new HOP Operations Manual: Send payment reminder letter to borrowers 90 days prior to their initial payment date.

Observation 5 - Low Risk

Historically, the Department has not always been notified when the first lien holder, normally a bank, sells their loans. The lack of notification could become in the event the borrower default on payments; the Department would not know which institution owned the first lien.

Recommendation

We recommend management incorporate notification conditions to first lien holders regarding the sale of the loans and subsequent buyers' consent to communicate with the Department regarding significant payment information.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation by incorporating the following measures into the new HOP Operations Manual:

- ✓ Request first lien holder to provide agency with written notification if their loan is sold.
- ✓ Require borrower to provide written authorization to agency to communicate with, request, and receive financial information from other lien holders.

Documentation / Covenants / Tickler Tracking

A loan tickler system is used to track expiration dates for outstanding items for all loan types, including tracking for such items as insurance documents, documents out for recording, and title policies. The Housing Department is responsible for obtaining these items. A tickler system should be available to allow for tracking and to ensure all required documents are received.

Observation 6 - Moderate Risk

We noted there is no tracking tickler available through the Interlinq Loan System and the Department has not established a manual tracking system. Despite that eventually most of these documents are received, it would be advantageous for the Department to have an effective tracking system using prescribed time-lines to track required documents and expected due dates.

Recommendation

We recommend management implement a system of tracking outstanding items necessary to complete a loan. Without an effective tracking system important documents may not be properly identified as pending or missing.
Loan Management Information System / Software Implementation

Effective management information systems should provide department management with relevant and accurate information from which to evaluate the status of the loan portfolio and the Department programs.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Incorporate into new HOP Operations Manual: A loan close-out checklist for tracking agency receipt of specific documents (from escrow, title, County Recorder, insurance company) and expected due dates. Checklist will be monitored by program staff assistant on a weekly basis.

Observation 7- Moderate Risk

The Department uses the Interling system as a major system tool for loan entry and funding information management. We noted that a number of key data such as loan boarding, collateral, rates, payment tickler, data stratification, first lien lender status, history of loan restructures / amendments, construction progress and status, and program information has not been populated in the loan accounting system.

Recommendation

We recommend the Department enhance the use of the loan system by incorporating the data noted above into the Interling and other loan information systems.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ Review Interling loan records for non-populated data fields, assess which missing data would be useful to have in the system, and update the loan records accordingly.

Program Monitoring

The Department hired an outside consultant company, Urban Futures, to monitor the on-going housing programs. Urban Futures provides the covenant compliance monitoring service for the Department and issues a Certificate of Continuing Program on an annual basis. Their service includes among other tasks:

- Project conditions
- Rental situations including collecting rent rolls
- Eligibility monitoring

Observation 8 - Low Risk

We noted that the service report for both 2006 and 2007 fiscal year were submitted in August 2008. They do not appear to be submitted in a timely manner.

Recommendation

We recommend the Department ensure the service provider submits the annual service reports within the contracted due dates.

Management Response

Management concurs with audit observation. The reports were delayed because the service contract between the City and compliance monitoring firm was not in place. Management will proceed with implementing the recommendation as follows:

- ✓ Ensure that service contracts are processed in a timely manner.
- ✓ Transmit "reminder" letter to the service provider 30 days prior to due date of required reports.

Documentation and Loan Boarding Callback

Callback and verification of promissory note information (comparing loan terms and conditions with the loan accounting system) is designed to ensure customer information is properly recorded on the Housing Department's loan accounting system and the correct interest rate, calculation methods, terms and product types are entered accurately. Callback procedures ensure loan information is accurate and the accounting for each loan is properly administered.

Observation 9 – High Risk

We selected a sample of ten (10) loans boarded from August 1, 2007 through September 30, 2008. We reviewed each loan for proper approval, loan documentation and accurate boarding to test the integrity of loan accounting data and compliance with approved loan terms and conditions. Our review of the 10 loans identified the following:

1. Elise Brunnick \$139,500 - A loan number has not been assigned to this loan funded May 15, 2008 and has not been boarded in the Interliq Loan System. In addition, we noted the following:
 - We did not initially locate a Settlement Statement. The Settlement Statement was later obtained during the audit.
 - The payment date and maturity date have been left blank in the Promissory Note. Also, the borrower's initials are missing under the Repayment of Default section.
 - The Notice of Restrictions and Right of First Refusal to Purchase Property form has the manually written statement inserted "See exhibit B attached". Exhibit B is the Request for Notice of Default and Sale which has been labeled as Exhibit B. This was not done by the Housing Department, probably by the escrow officer. Although recorded, the Request for Notice is embedded in the other document and may be missed should the first lien default.
 - The Notice of Restrictions and Right of First Refusal to Purchase Property is missing the date of the first deed of trust.
 - The Deed of Trust with Assignment of Rents is missing the date of the first deed of trust.
2. Nancy Chase Baca \$200,000 - A loan number has not been assigned to this loan funded July 24, 2008 and has not been boarded on the Interliq Loan System. We also noted the payment due date on the Promissory Note is set up for a date other than the first of the month.
3. Nica Hernandez, Loan No. 100000220 - The Affordable Housing Loan Agreement is missing the date of the Agreement and the signature of Jane Rodriguez, Secretary. In addition, we noted the following:
 - The Purchaser Affordability Agreement is missing the date of the Affordable Housing Loan Agreement.
 - We also did not locate the appraisal. The appraisal was later obtained during the audit.
4. Anneliese Gomez, Loan No. 100000214 - The Promissory Note is not dated and the payment date and maturity date are blank. In addition, we noted the following:

- The Promissory Note and original recorded documents are in the loan file. They were recorded September 26, 2007 and should have been transferred to City Hall for safekeeping per policy.
 - The Notice of Restrictions and Right of First Refusal to Purchase Property is missing the date of the first deed of trust.
 - The Deed of Trust with Assignment of Rents is not dated and is missing the date of the first deed of trust.
 - The Affordable Housing Loan Agreement is missing the date of the Agreement and the signature of Jane Rodriguez, Secretary.
5. Karl Hallie, Jr., Loan No. 1000000223 - The Promissory Note is not dated and the payment date and maturity date are blank. We also noted the amount of the Fidelity National Title Company insurance is \$84,000, which does not match the note amount of \$137,020. Additionally, the title policy shows the amount of the deed of trust recorded is \$137,820,000, which does not match the deed of trust's amount of \$137,020.
6. Rachael Nehdar, Loan No. 1000000221 - The payment due date on the Promissory Note is set up for a date other than the first of the month. In addition, we noted the following:
- The Deed of Trust with Assignment of Rents is missing the date of the first deed of trust.
 - The Affordable Housing Loan Agreement is missing the date of the Agreement.
7. Kevin Chung, Loan No. 1000000225 - The payment date and maturity have been left blank on the Promissory Note. We also noted the following:
- The Notice of Restrictions and Right of First Refusal to Purchase Property is missing the date of the first deed of trust.
 - The Deed of Trust with Assignment of Rents is missing the date of the first deed of trust.
8. Elizabeth Guerra, Loan No. 1000000219 - The Promissory Note is not dated and the payment date and maturity date are blank. In addition, we noted the following:
- The Notice of Restrictions and Right of First Refusal to Purchase Property is missing the date of the first deed of trust.
 - The Deed of Trust with Assignment of Rents is missing the date of the first deed of trust.
 - The Affordable Housing Loan Agreement is missing the date of the Agreement and the signature of Jane Rodriguez, Secretary.
9. Leticia Gutierrez, Loan No. 1000000226 - The Promissory Note was not located during the audit. In addition, we noted the following:
- We did not locate a Settlement Statement. The Settlement Statement was later obtained during the audit.
 - The Notice of Restrictions and Right of First Refusal to Purchase Property were missing the date of the first deed of trust.
 - The Affordable Housing Loan Agreement is missing the date of the Agreement and the signature of Jane Rodriguez, Secretary.
 - The Application Checklist was not located.

Eight of the loans reviewed have been entered on the Interlinq Loan System, but are pending active status. The eight loans were funded from inclusionary funds and this particular category has not been set up in Interlinq. The oldest funding date is from September 26, 2007. When loans are not boarded promptly, the system totals in Interlinq will not balance to those in the general ledger.

We were informed a callback is performed when loans are input into the Interlink Loan System, but we were unable to find evidence of the review.

Recommendation

We recommend management review the above-noted documentation discrepancies and correct them as necessary. We also recommend the Interlink Loan System is set up as soon as possible to allow loans funded from the inclusionary source to be boarded on the date of funding. We also advise the person performing a callback of new loans boarded on the Interlink Loan System to provide evidence of a callback with their initials and date of callback.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation as follows:

- ✓ All ten loan files are currently under review to correct noted documentation discrepancies as may be necessary.
- ✓ All Inclusionary-funded loans identified as "pending" in the Interlink system are in the process of being set to "active".
- ✓ Incorporate into new HOP Operations Manual: The person performing a callback of new loans boarded on the Interlink system will provide evidence of the callback with his/her initials and date on the loan set-up form.

Processing of Monetary Transactions

Processing of monetary transactions such as payments, disbursements and payoffs are performed in different departments. The Housing Department does not do any actual monetary processing. The Department prepares requests for loan funding checks or wires and sends them to the appropriate area for processing. Payments and payoff checks are processed in the Accounts Receivable area.

We reviewed the Accounts Payable process for issuing checks for loan funding, as well as documents required and authorized signatures required before checks are issued. The controls in place are appropriate for ensuring loan funds are properly released.

The Accounts Receivable area receives a Loan Trial Balance – Loan ID Sequence report, which is automatically printed and sent to them. The department does not use the 24 page report, so we suggest removing them from the recipient list.

Observation 10 – Moderate Risk

The staff processing payments is also responsible for mailing billing statements to borrowers. We were informed 59 billings were recently sent out. Our review of the Loan Trial Balance shows there are 81 loans that should have monthly billing statements. This is a difference of 22 statements.

Recommendation

We recommend management in the Housing Department review the discrepancy as soon as possible. If 22 borrowers are not receiving a billing statement, the City of Pasadena is not receiving the payments it should for those loans.

Management Response

As recommended, the observed discrepancies relating to 22 borrowers have been reviewed with the following conclusions:

- 11 of the discrepancies relate to homeowner rehabilitation loans for which payment is deferred until the earlier of refinancing, property resale, or maturity date. The Interlink system does not generate monthly billing statements for these loans.
- 3 of the discrepancies relate to borrowers who have actually repaid their loans in full.
- 1 of the discrepancies relate to a borrower whose property was foreclosed on.
- 7 of the discrepancies relate to homebuyer loans for which the billing dates have been corrected in the Interlink system, thereby enabling billing statements to be generated and mailed to the borrowers.

Reconveyances

Proper reconveyance procedures are intended to return title to owners in a timely manner once a real estate secured loan has been paid in full. Failure to transfer title in a timely and accurate manner can result in poor customer service and other problems for borrowers. In the case of real estate, California Civil Code Section 2941 governs reconveyance procedures for loans secured by a deed of trust on any type of real property.

Observation 11 – Moderate Risk

When a loan secured by real estate is paid, California Civil code Section 2941 requires the lien release to be sent for recording within 30 days of being paid. We selected ten paid real estate secured loans, with a sample of three from 2005, one from 2006, four from 2007 and two from 2008. We noted the following:

- One loan paid off on March 25, 2005, but was not reconveyed until October 22, 2007.
- One loan paid off on November 2005, but was not reconveyed until October 17, 2007.
- One loan paid off on September 18, 2006, but was not reconveyed until May 27, 2007.
- One loan paid off on May 17, 2007, but was not reconveyed until November 2, 2007.
- Six loans had no records in the files to show they had been sent for reconveyance and they do not show on the Reconveyance Documents log as having been sent.

Our review of the Reconveyance Documents Log noted that the latest date entry was October 5, 2007 giving the appearance that a reconveyance has not been processed since then.

Recommendation

We recommend management ensure all lien releases are sent for recording as required. After a loan is paid, there are signatures required on the reconveyance forms from people who are not on site. This can also add to the time delay in processing a reconveyance. We suggest management consider simplifying the signing requirements for reconveyances, since at that point the loan has been paid in full there is no further risk assuming secondary checks have been performed to validate full repayment. We also suggest after a loan is paid that a loan history is printed and placed in the file.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation by incorporating the following measures into the new HOP Operations Manual:

- ✓ Monthly review of Reconveyance Documents log will be performed by Project Manager to ensure that all lien releases are sent for recording.
- ✓ After a loan is paid off, print out the loan history and place it in the file.

Paid Loans

Returning the paid Promissory Note and Deed of Trust in a timely manner is an important part of customer service. This also provides the customer final acknowledgement of their loan being paid.

Observation 12 – Low Risk

When a loan is paid off, the Department mails the Promissory Note and Deed of Trust to the borrower; however, the documents are not stamped paid.

Recommendation

We recommend the Department stamp the Promissory Note paid and apply a date stamp as evidence of the payoff date prior to delivery to the borrower.

Management Response

Management concurs with audit observation and will proceed with implementing the recommendation by incorporating the following measure into the new HOP Operations Manual:

- ✓ Date-stamp the Promissory Note as "PAID" to evidence the payoff date prior to delivery of the document to the borrower.

Security

Concerns regarding security of customer information have grown in recent years. As such, the City has an obligation to protect information by ensuring it cannot be accessed by unauthorized individuals. In addition, it is important to protect the City by securing within the area all items that could potentially be misused.

Entrance to the Housing Department requires an individual to be "buzzed" in through a locked door, which is only done when a borrower arrives to sign loan documents. The conference room used is close to the entrance and does not allow the borrower access to any other customer information. We have no reportable exceptions.

Segregation of Duties

Segregation of duties is a basic, key internal control and one of the most difficult to achieve. It is used to ensure errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Segregation of duties provides two benefits: (1) a deliberate fraud is more difficult because it requires collusion of two or more persons, and (2) it is much more likely innocent errors will be found. At the most basic level, it means no single individual should have control over two or more phases of a transaction or operation. Management should assign responsibilities to ensure a cross-check of duties.

Based on the work we reviewed, segregation of duties appears to be appropriate. We found no reportable issues.