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New Jersey Housing and Mortgage Finance Agency

July 1, 2004 to August 31, 2006

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State Auditor
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Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Joseph J. Roberts, Jr.  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
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Enclosed is our report on the audit of the New Jersey Housing and Mortgage Finance Agency for the period of July 1, 2004 to August 31, 2006. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor  
January 10, 2007
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New Jersey Housing and Mortgage Finance Agency

Scope

We have completed an audit of the New Jersey Housing and Mortgage Finance Agency for the period July 1, 2004 to August 31, 2006. Our audit included financial activities accounted for in the agency’s Single Family Mortgage Component, Multi-Family Housing Component, and General Fund.

The New Jersey Housing and Mortgage Finance Agency (NJHMFA) is established in, but not of, the Department of Community Affairs. This public authority was created by the New Jersey Housing and Mortgage Finance Agency Law of 1983. The prime responsibility of the agency is to provide funding for affordable home ownership for New Jersey residents. Annual expenditures and revenue for those programs included in our scope were $30 million and $23 million, respectively. The major components of revenue were administrative fees from government agencies and fees charged to borrowers.

Objectives

The objectives of our audit were to determine whether financial transactions were related to NJHMFA’s programs, were reasonable, and were recorded properly in the accounting system. We also determined whether the oversight provided by the agency’s board of directors was adequate and whether the agency had complied with the executive orders applicable to the operations of independent authorities.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.
In preparation for our testing, we studied legislation, administrative code, executive orders, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also reviewed financial trends and the agency’s website, and interviewed agency personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

**Conclusions**

We found that the financial transactions included in our testing were related to NJHMFA’s programs, were reasonable, and were recorded properly in the accounting system. We determined that the oversight provided by the agency’s board of directors was adequate; however, the agency was not timely with its submission of required certifications as mandated by 2 executive orders. In making these determinations, we noted certain internal control weaknesses meriting management’s attention.
SINGLE FAMILY LOANS – DOCUMENTATION

Documentation to verify client eligibility for NJHMFA loan programs should be maintained.

NJHMFA administers a variety of single family mortgage loan programs for income-qualified homebuyers throughout the state and for homebuyers living in target areas. Most of these loans are processed by participating lenders, such as banks and mortgage companies. NJHMFA personnel review the loan packages to determine whether the applicant satisfies the eligibility criteria for the applicable program and submitted all required documents. The reviews by the agency underwriters are recorded on an Underwriting Worksheet. NJHMFA then purchases the loans and sends them to firms who service the loans.

During calendar year 2005, NJHMFA approved 1472 loans. We reviewed a sample of 50 loan packages for eligibility, required documentation, proper loan amounts, and allowable debt ratios; some of these tests were not applicable to all of the sample items. Our review revealed numerous cases of inadequate documentation, as follows:

- Fifteen of 29 files did not include all the documents that are required to be submitted by the agency.

- Agency personnel decided to waive program criteria, such as allowable debt ratios and income limits, in 11 cases. These decisions were not documented and management approval to waive these criteria was not obtained.

- There were four loans where income could not be traced directly from the worksheets to the loan files and instead had to be determined through a series of calculations. In all four cases, the calculation of income by the
underwriter was not documented in the files.

- Monthly income figures on the agency’s Underwriting Worksheets were not supported by documentation in the loan files for 2 of 17 loans tested.

NJHMFA does not maintain the loan application files beyond 30 days; it is the responsibility of the servicing firms to maintain complete files. The files that we reviewed were submitted to us by the servicing firms and as such we could not determine whether the agency’s underwriters had verified that the required documents were submitted. Agency personnel are not required to record the source of the monthly income figures that they develop or their justifications for decisions that are not consistent with program guidelines. Because complete loan application packages were not available and agency decisions to waive program criteria were not documented, it is possible that ineligible applicants were approved. It is also possible that some of the applicants with high debt ratios who were approved for loans will not be able to maintain monthly payments.

**Recommendation**

We recommend that agency personnel document the source of the monthly income figures on the Underwriting Worksheets. They should also document the justification to waive program criteria and obtain management approval to do so. In addition, NJHMFA should remind its servicing agents that they are responsible to maintain all loan file documentation.

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**NJHMFA EMPLOYEES AT DCA**

As of December 31, 2005, there were 12
Cost allocation analysis should be performed.

Employees on the NJHMFA payroll who worked at the Department of Community Affairs (DCA). DCA provided reimbursement to NJHMFA for the salaries and fringe benefits of three of these employees. The nine NJHMFA employees working at DCA whose salaries were not reimbursed earned approximately $520,000 during 2005. In addition, there are numerous employees at DCA who perform work related to the housing mission of NJHMFA. There is no written agreement between NJHMFA and DCA which documents the working arrangement between the two agencies.

Neither NJHMFA nor DCA has undertaken an analysis of the amount of work performed byNJHMFA employees for DCA and by DCA employees for NJHMFA and compared the time worked to the salaries paid by each agency. Officials from both agencies have explained that the operations of the two agencies are seamless and it is very difficult to determine the amount of time that these employees devote to each agency. However, without such an analysis, it is impossible to know whether NJHMFA is overpaying or underpaying for salaries.

Recommendation

We recommend that both NJHMFA and DCA perform an analysis to determine the salary costs each agency is incurring on behalf of the other agency and determine whether one of the agencies should reimburse the other for salary expenses. A memorandum of understanding should also be developed which identifies the working arrangements and manner of determining future cost recoveries or payments.

COMPLIANCE WITH EXECUTIVE ORDERS

There are a number of executive orders that have been issued recently which establish guidelines for the operations of the state’s independent
NJHMFA should submit annual certifications required by Executive Order 41.

authorities, which include the New Jersey Housing and Mortgage Finance Agency. We found that NJHMFA has not complied with the terms of several of these orders.

Executive Order Number 41, which was issued in 2005, requires that the executive director of each authority shall annually, as of January 1, certify in writing to the Director of the Governor's Authorities Unit that the authority has met the requirements of:

1) Executive Order Number 122 regarding the creation of an audit committee to assist in the oversight of its financial reporting and audit processes; and

2) Executive Order Number 134 regarding the adoption of procedures to limit or ban campaign contributions from vendors with whom they are doing business.

We found that NJHMFA had not submitted the required certifications to the Governor’s Authorities Unit that were due on January 1, 2006. Although agency officials were aware of the need to comply with the terms of these two executive orders and have taken appropriate action to do so, they were not aware of the need to submit annual certifications regarding their compliance.

Recommendation

We recommend that the agency immediately submit certifications to the Governor’s Authorities Unit regarding their compliance in 2006 with Executive Orders 122 and 134 and ensure that annual certifications are submitted from now on.

Executive Order 122, which was issued in 2004, requires that authorities create an audit committee and sets forth the terms of membership and the responsibilities of the committee. The executive order establishes a number of criteria regarding
the independence of committee members. We could not verify that the independence requirements for members of the NJHMFA audit committee have been satisfied, because agency officials had not obtained independence certifications from its committee members.

Recommendation

We recommend that the agency request that its Audit Committee members complete certifications attesting to the fact that they are in compliance with the restrictions of Executive Order 122.

REVENUE

We tested NJHMFA’s revenue collection procedures by sampling transactions from the eight largest revenue accounts in fiscal year 2005, which totaled $17.7 million. Much of the agency’s revenue is received via electronic transfer. However, we found that receipts for the Police and Fire Loan Administrative Fees account and the Real Estate Owned (REO) and Foreclosure Receipts account were not deposited timely. Total Police and Fire Loan Administrative Fees revenue in fiscal year 2006 was $1 million; we tested all receipts deposited in February 2006 and March 2006 and found that 102 of 156 receipts, totaling $33,150 of $50,700 tested, were deposited from 3 to 29 days after the date of receipt. Total REO and Foreclosure Receipts revenue in fiscal year 2006 was $3.3 million; we tested all receipts for the months of April and May 2006 and found that six of the nine receipts, totaling $205,083 of $278,234 tested, were deposited from 6 to 15 days after they had been received. There is no centralized mail log at the agency to identify incoming receipts and checks are not restrictively endorsed until they are prepared for deposit by the Finance office.

There is no agency policy regarding timing of deposits and the need for restrictive
endorsements. In the absence of such a policy, we allowed two days for receipts to be deposited. Some units collecting revenue do not prepare daily transmittals for delivery to the Finance office. The presence of undeposited checks, sometimes in non-secured locations, increases the possibility of lost or misappropriated funds.

**Recommendation**

We recommend that:

- The agency should develop a policy regarding the handling of checks and the timely depositing of the checks;

- All units which collect revenue should prepare deposit transmittals on the day of receipt;

- All checks be restrictively endorsed at the initial point of receipt and;

- Checks should be kept in secure locations overnight.
SINGLE FAMILY LOANS – DOCUMENTATION:

1. Fifteen of 29 files did not include all the documents that are required to be submitted by the Agency.

HMFA Response:

When HMFA reviews single family loan files, they are complete. Those files are sent to contracted sub-servicers for servicing and storage. The files that were reviewed by the Auditor were retrieved from the contracted sub-servicers and were missing information. The sub-servicer (from Chicago, Illinois) whose files were deficient has been placed on notice and advised that they must maintain complete files.

HMFA will now require the sub-servicer to acknowledge receipt of the complete set of documents. HMFA’s internal audit staff will additionally include a check of the complete file as part of its annual audit of the sub-servicers. Failure to comply with maintaining complete files will be viewed as a violation of the current contract and the sub-servicer will be deemed an unqualified bidder in future contracts for this service.

2. Agency personnel decided to waive program criteria, such as allowable debt ratios and income limits, in 11 cases. These decisions were not documented and management approval to waive these criteria was not obtained.

HMFA Response:

HMFA underwriters did not waive program criteria, which are set by the IRS regarding the use of Tax Exempt Mortgage Revenue Bonds. HMFA single family underwriters do have discretion to allow debt ratios that exceed program guidelines if there are compensating factors, e.g., large down payments, solid savings history, rental payment history that exceeds the anticipated debt service payment, etc. Such cases are presented to the Assistant Director or Director of the Single Family Division for approval.

HMFA will adopt an internal documentation procedure to ensure that calculations, discretionary determinations and appropriate management approval are clearly noted on the underwriting worksheet. Implementation: January 2007.
3. There were four loans where income could not be traced directly from the worksheets to the loan files and instead had to be determined through a series of calculations. In all four cases, the calculation of income by the underwriter was not documented in the files.

HMFA Response:
HMFA notes that calculations were correct but Single Family will adopt an internal documentation procedure to ensure that the underwriters write such calculations on the underwriting worksheet. Implementation: January 2007.

4. Monthly income figures on the Agency’s Underwriting Worksheets were not supported by documentation in the loan files for two of the 17 loans tested.

HMFA Response:
HMFA calculates monthly income, however those notes are not always apparent on the underwriting worksheet. HMFA will adopt an internal documentation procedure to ensure that the underwriters worksheets contain the relevant documentation to support the calculations and conclusions made when determining income. Implementation: January 2007.

NJHMFA EMPLOYEES AT DCA:
We recommend that both NJ HMFA and DCA perform an analysis to determine the salary costs each agency is incurring on behalf of the other agency and determine whether one of the agencies should reimburse the other for salary expenses. A memorandum of understanding should also be developed which identifies the working arrangements and manner of determining future cost recoveries or payments.

HMFA Response:
In view of the fact that HMFA is "in but not of" the Department of Community Affairs, the operations of the two agencies are seamless: Staff of the two entities work jointly on most projects and policy development. Examples include the Governor's Plan for 100,000 units of affordable housing, execution of the State's Balanced Housing program, COAH, the Governor's Conference on Housing and Community Development and the State's Special Needs Trust Fund. Housing development projects are reviewed in staff meetings involving DCA and HMFA employees with the work responsibilities shifting depending on the project. Many central office functions - management, communications, marketing, legislative support and training - are shared in order to eliminate duplicative efforts. It must also be emphasized that the work done by DCA and HMFA employees is within their respective statutory authorizations; thus they are not, as the audit report suggests, acting outside the scope of that authority – therefore there is no need to reimburse or document the individual work that is done by each entity.

COMPLIANCE WITH EXECUTIVE ORDERS:
We recommend that the agency immediately submit certifications to the Governor’s Authority’s Unit regarding their compliance in 2006, with EO 122 and 134 and ensure that annual certifications are submitted from now on.
HMFA Response:

1) **Executive Order No. 41**: The HMFA complied with the substantive requirements of the Order and did submit required certifications to the Governor's Authority's unit for 2006 on August 28, 2006. HMFA will take all necessary steps to insure that future certifications are filed when due.

2) **Executive Order No. 122**: In the past, the HMFA relied on the professional responsibility of the individual members with regard to satisfying their independence requirements. In the future, the HMFA will verify their independence and will document it accordingly.

**REVENUE:**
The agency should develop a policy regarding the handling of checks and the timely depositing of the checks; All units which collect revenue should prepare deposit transmittals on the day of receipt; All checks be restrictively endorsed at the initial point of receipt and; checks should be kept in secure locations overnight.

**HMFA Response:**
HMFA’s Finance Division has a policy already in place to address the handling and timely depositing of checks. This policy will be expanded to the entire Agency to insure that deposits and transmittal of revenues and checks are made in a timely fashion.