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Development Loans (Loan C) Review

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To: Jeremy Hanson-Willis, Community Planning & Economic Development (CPED)

Re: Development Loans (Loan C) Review

The Internal Audit Department (IA) conducted a review of Development Loans (Loan C) within the CPED Department of the City of Minneapolis (City). This review was included in the 2012 Internal Audit Plan and was completed in September 2012.

Background

CPED offers a wide range of loans and Grants in a variety of programs offered through public agencies and community organizations around the Greater Minneapolis area. When a new loan is approved and finalized, a decision is made as to where the loan should reside for ongoing management and oversight. Some City loan assets are serviced externally¹ while Loan C is CPED's internal loan servicing system. Loans being serviced in Loan C will normally fall under business development and preservation loans or loans made for single family or multifamily affordable housing development. The following criteria typically apply to internally serviced Loan C type loans:

- Loans that have unusual repayment terms or cash flow participation;
- Loans that are forgivable based upon the term of occupancy;
- If the loan has a probability that the terms may require deferral, restructuring, or higher than normal possibility of later default; and
- Loans that will require securing periodic financial statements, insurance binders, occupancy/affordability data, or other similar information.

As of December 31, 2011 the gross balance of Loan C type loans provided to recipients was approximately \$241.7 million and the collectible amount of these loans was approximately \$29.5 million. In 2011, CPED provided approximately 63 new loans with an approximate amount of \$8.6 million. The funding of these loans comes from a variety of sources including federal, State, Metropolitan Council, foundations, the Federal Home Loan Bank, and the City of Minneapolis. Each of these sources has their own obligations and requirements that must be met to fulfill or satisfy the loan.

Objectives

The review was performed to ensure processes and controls are in place to adequately grant, record and continually monitor outstanding loan balances due to the City.

Scope

This review included gaining an understanding of internal controls, including current policies and procedures, through observation, inquiry, and limited testing related to the overall management of granting, recording and monitoring processes with focus on a sample of development loans within Loan C. IA also performed, on a sample basis, testing of processes and transactions for the period from January 1, 2011 through September 30, 2012.

¹ Loans that are not a part of Loan C and are monitored by a third party contracted by the City.

Summary of Findings and Management Responses:

1. Loan Files and Documents

The organization of the loan files made it difficult to identify key documents. Loan files sampled were missing documents; however, these documents were located and placed into the proper file. In addition, two loan files were not located. There were documents related to multiple loans for the same borrower within the same file. The loan files are stored within unlocked file cabinets that are not fireproof and the keys are kept in one employee's desk.

Management Response

Files have been and are being reviewed by staff on an ongoing basis to assure they are in compliance with the current policy for management of Loan C. Management will not be altering the current file organizing system beyond placing each loan in a separate file folder. File cabinets will be locked once CPED completes its relocation to the sixth floor. CPED is in the process of purchasing fireproof cabinets for storage of all loan files and will be transferring Loan C files to those cabinets. CPED has provided a separate set of keys to an employee involved in Loan C management.

2. Monitoring

Although CPED management monitors loans, there is no documentation available to demonstrate that monitoring is occurring. Furthermore, budgetary staff reductions have resulted in duties not being segregated appropriately. Additionally, there is no formal process for designating and authorizing user access to MINS. Also, a review of MINS access privileges does not occur on a regular basis. In addition, it was noted that City Grants provided to projects recorded in MINS are not easily distinguished from loans.

Management Response

CPED management will ensure that evidence of management review will be documented and retained. In addition to hiring an additional staff person, all Loan C servicing is being relocated to the same floor and additional staff time will be devoted to support these services which will better enable a segregation of duties. CPED management will establish a formal process to monitor system access and develop a process to ensure a review of access privileges will be performed periodically. Going forward loans will be clearly distinguished within MINS from Grants using a specific naming convention.

3. Processes, Guidelines and Procedures

Current written procedures are not detailed enough to guide CPED personnel.

Management Response

The current Business Process for Loan Administration policy document will be updated to include additional procedural information.

4. Record Retrieval & Return to Storage

Several of the loan files selected for testing were sent to records retention and had to be retrieved. There are no formal forms for retrieving boxes. Also, it was noted that there is no check-in/check-out functionality in the current database to monitor and trigger follow-up actions for the boxes that have been checked out too long.

Management Response

The Clerk's Office will be recruiting for a new City Records Manager in the near future, as the result of the departure of the current incumbent of that position. Consequently, the Clerk's Office prefers to delay any changes or adjustments until the new Records Manager is in place; We anticipate having a new City Records Manager hired and in place by early February 2013.

Conclusion

Based on our review, we believe there are opportunities for improvements to address risk areas identified in this report. CPED, Finance & Property Services (Finance) and the City Clerk's Office management worked collaboratively with IA to develop action plans.

IA would like to extend our appreciation to CPED, Finance and City Clerk's Office personnel who assisted and cooperated with us during this review.

Cc: Paul Aasen, City Coordinator's Office
Mark Anderson, CPED
Wesley Butler, CPED
Casey Carl, City Clerk's Office
Kevin Carpenter, Finance
Sandra Christensen, Finance
Connie Griffith, Finance
Chuck Lutz, CPED
Jeffrey Streder, Finance
Thomas Streitz, CPED
Mike Sunderman, Finance

Development Loans (Loan C) Review

Audit Findings and Action Plans

1. Loan Files and Documents

Missing Files and Documents

Auditors selected a sample of 10 loans to perform various testing for documentation completeness. Four of the 10 loan files sampled were missing documents; however, these documents were located and placed in the proper file. In an additional sample of five satisfied loans² selected, two loan files were not located. Having the proper documents included within the loan files enhances the completeness of loan information and creates efficiencies in time spent locating the information at a later date. Additionally, the misplacement of recently satisfied loan files violates the records retention policy.

File Appearance & Organization

The condition of the loan files made it difficult to identify key documents. Additionally, in several of the files reviewed, there were documents related to multiple loans for the same borrower within the same file. As each loan has a different loan number assigned and a different agreement, it would be beneficial to separate loans regardless of a common borrower to increase organizational efficiencies. Organized files can make it easier to ensure all necessary documents are maintained and may increase efficiencies in time spent locating necessary information.

Physical Security over Loan Files

While the file cabinets that house the loan files are located in a restricted access office area that only a limited number of employees have access to, Auditors noted the loan files are stored within unlocked file cabinets that are not fireproof and the keys are kept in one employee's desk. The office can only be entered with a code and visitors can only gain access if one of the employees allows access; however, building maintenance, cleaning and security personnel have access to this area. Furthermore, while there is a practice of placing an "out" sign for loan files that are being checked out, the sign is left blank and there is no log to indicate who checked out the file and when it was returned.

Recommendation

IA recommends CPED management:

1. Evaluate and make necessary improvements to the Loan C filing system to ensure all files and documents are well organized, can be easily located and loans are filed individually; furthermore, implement a logging system that lists the employee's name, date & time the loan file was checked out/in, and any additional information needed by management; and
2. Examine options to obtain fireproof cabinets, keep the cabinets locked after normal business hours and ensure another set of file cabinet keys be kept and maintained for emergencies by another party or in a bank safety deposit box.

Management Response

1. CPED currently has a file process in place. The files mentioned in the finding as missing documents were established before the current filing process was implemented. Files have been and are being reviewed by staff on an ongoing basis to assure they are in compliance with the current policy for management of Loan C. Since the policy was approved in 2005, all loan documents are submitted at the time the loan is set up in Loan C. Every loan will be made to have its own separate file folder. Management will not be altering the current file organizing system beyond placing each loan in a separate file folder.
2. File cabinets will be locked once CPED completes its relocation to the sixth floor. CPED is in the process of purchasing fireproof cabinets for storage of all loan files and will be transferring Loan C

² Satisfied Loans are loans where the terms and requirements have been met by the loan recipient and satisfaction of payment, loan forgiveness and/or loan settlement has been officially issued by the City.

files to those cabinets. CPED has provided a separate set of keys to an employee involved in Loan C management.

Responsible Party

Senior Contract Management Coordinator

Expected Completion Date

December 31, 2013 and ongoing for reconstructing older files

Projected Cost of Implementation

The projected cost of the file cabinets could be as much as \$15,000. We estimate that there will be as much as \$32,000 of staff time diverted to organizing and transferring records.

2. Monitoring

Loan Monitoring

CPED management monitors loans in hard copy generated through the MINS³ system in various ways depending upon the terms of the contract. CPED management reviews a report generated from MINS which identifies loans that are matured or past due and follow-up actions are taken as necessary; however, there is no documentation available to demonstrate that monitoring is occurring. Effective monitoring is a key control that allows management to be aware of and address items needing timely attention.

Segregation of Duties

Based on the work performed, budgetary staff reductions have resulted in one employee performing the following activities:

- Request and receive payments, as payments are expected from some loans;
- Authorized to approve the satisfaction/forgiveness of Loan C type loans;
- Allowed to authorize loan subordination;
- Monitor Loan C type loans; and
- Update Loan C type loan information within MINS.

To ensure effective internal controls are in place, duties should be segregated appropriately. If this is not possible, mitigating controls (i.e. additional management oversight) should be in place.

MINS System Access & Functionality

For an employee to gain access to MINS, Supervisor permission is required; however, there is no formal process for designating and authorizing users, including superusers⁴. MINS is capable of generating a user access list to ensure users have appropriate access privileges; however, a review of MINS access privileges does not occur on a regular basis. This could potentially lead to users having access that is no longer required.

In addition, it was noted that City Grants provided to projects recorded in MINS are not easily distinguished from loans, which may create discrepancies in MINS reporting when reports related to Loan C type loans are needed. Due to this circumstance, it is unclear if the true population of Loan C files from MINS is accurate.

Recommendation

IA recommends CPED management:

1. To document the monitoring process to ensure Loan C type loans are effectively monitored by CPED management;

³ MINS is the software system used by CPED to track and monitor loans and is also used as a subsidiary ledger for Loan C.

⁴ The *superuser* is a special user account used for system administration.

2. Properly segregate the duties listed above to ensure effective internal controls are in place. If this is not possible, other mitigating controls should be in place;
3. Examine options to enhance the MINS system to enable management monitoring of loans effectively and to ensure that Loan C type loans and CPED Grants are tracked separately; and
4. Develop a formal process for requesting/revoking access including superusers to MINS and periodically review user access to MINS.

Management Response

1. CPED management does monitor the loans in Loan C. Management will ensure that evidence of management review will be documented and retained.
2. CPED has hired an additional staff person whose duties include assisting with the management of Loan C activities. All Loan C servicing is being relocated to the same floor and additional staff time will be devoted to support these services which will better enable a segregation of duties.
3. The population in Loan C is accurate and there is no evidence to the contrary and this is because of the management and oversight of the loans at the time they are put into the Loan C servicing system. Going forward loans will be clearly distinguished within MINS from Grants using a specific naming convention.
4. CPED management will establish a formal process to monitor system access within MINS and develop a process to ensure a review of MINS access privileges will be performed periodically.

Responsible Party

Senior Contract Management Coordinator

Expected Completion Date

July 1, 2013

Projected Cost of Implementation

We do not anticipate there being a capital expenditure associated with this activity. We anticipate that there will be a minimum of \$10,000 of staff time diverted to this activity.

3. Processes, Guidelines and Procedures

Current written procedures are not detailed enough to adequately guide CPED personnel in the following areas:

- Monitoring & Collection Process;
- Procedures for Delinquent Loans;
- Loan Forgiveness Process; and
- Loan Satisfaction Process

Enhancing these procedures will help management to better monitor, collect, forgive and/or satisfy loan C type loans and will further provide CPED staff with clear guidelines in performing their job duties.

Recommendation

IA recommends CPED management update the "Business Process for Loan Administration" policy document to appropriately guide staff as they perform their Loan C management duties. CPED management should periodically review the "Business Process for Loan Administration" policy document to ensure it remains current.

Management Response

The current Business Process for Loan Administration policy document will be updated to include additional procedural information.

Responsible Party

Senior Contract Management Coordinator

Expected Completion Date

July 1, 2013

Projected Cost of Implementation

We do not anticipate there being a capital expenditure associated with this activity. We anticipate that there will be a minimum of \$4,000 of staff time diverted to this activity.

4. Record Retrieval & Return to Storage

Loan files are sent to City Clerk's office for storage in standard 10 pound boxes. The City Clerk's office manages the stored boxes and has a database for boxes maintained related to Loan C. The database includes a box number and location. For a City employee to request a box containing the loan files, the employee contacts (via e-mail or phone) the City Clerk's office with the requested box information and storage location. Several of the loan files selected for testing were sent to records retention and had to be retrieved. There are no formal forms for retrieving boxes. Also, it was noted that there is no check-in/check-out functionality in the current database to monitor and trigger follow-up actions for the boxes that have been checked out too long. Not monitoring this process could potentially lead to difficulty in locating the checked out boxes.

Recommendation

IA recommends City Clerk's Office management:

1. Develop a formal process to track retrieved boxes that have been checked in/out for an extended period to ensure boxes are handled appropriately; and
2. Examine options for acquiring software that allows for efficient and effective monitoring of City records to include retrieving boxes from records retention that are checked in/out from appropriate Departments.

Management Response

The Clerk's Office will be recruiting for a new City Records Manager in the near future, as the result of the departure of the current incumbent of that position. Consequently, the Clerk's Office prefers to delay any changes or adjustments until the new Records Manager is in place and sufficiently briefed on these and other related issues to evaluate options to strengthen controls. We anticipate having a new City Records Manager hired and in place by early February 2013.

Responsible Party

Casey Carl, City Clerk

Expected Completion Date

March 31, 2013

Projected Cost of Implementation

To be determined after deciding on the best option.

Projected Cost of Implementation (contents provided by CPED)		
Audit Finding		Total Estimated Cost
1	Loan files and documents <ul style="list-style-type: none"> • File Cabinets • Staff Time 	\$ 15,000 \$ 32,000
2	Monitoring	\$ 10,000
3	Processes, guidelines & procedures	\$ 4,000
4	Record Retrieval & Return to Storage	TBD
Totals		\$ TBD

Abbreviations Used Throughout the Report	
City	The City of Minneapolis
CPED	The Department of Community Planning & Economic Development
Finance	Finance and Property Services Department
IA	Internal Audit Department
Loan C	Internally serviced Development Loans managed by CPED
MINS	Software system used to track and monitor loans
TBD	To Be Determined