



CITY HALL • ONE FRANK H. OGAWA PLAZA, 4TH FLOOR • OAKLAND, CALIFORNIA 94612

Office of the City Auditor
Courtney A. Ruby, CPA, CFE
City Auditor

(510) 238-3378
FAX (510) 238-7640
TDD (510) 238-3254
www.oaklandauditor.com

August 13, 2014

OFFICE OF THE MAYOR
HONORABLE CITY COUNCIL
CITY ADMINISTRATOR
CITIZENS OF OAKLAND
OAKLAND, CALIFORNIA

**RE: RECOMMENDATION FOLLOW-UP REPORT FOR THE COMMUNITY AND
ECONOMIC DEVELOPMENT LOAN RECEIVABLES AUDIT**

Dear Mayor Quan, President Kernighan, Members of the City Council, City Administrator Gardner, and Oakland Citizens:

The Office of the City Auditor (Office) is required to report the status of its audit recommendations to the City Council (Council). In November 2010, the Office released the Community and Economic Development (CEDA) Loan Receivables Performance Audit.

The audit contained 17 recommendations. With the dissolution of CEDA in February 2012 and the merging of its loan functions under Housing & Community Development (HCD), the Office applied the recommendations to a sample of the loans currently managed under HCD. The Administration has closed 11 recommendations and partially closed six recommendations. The Office's follow-up found that policies and procedures for homebuyer and commercial loans need to be further established and implemented. In its attached response, the Administration has agreed to finish addressing all partially closed recommendations by December 15, 2014.

Audits are an objective assessment of whether or not public resources are responsibly and effectively managed to achieve intended results. The impact of an audit's recommendations is achieved when the City Administration ensures prompt and proper implementation, increased accountability, and proper safeguarding of City assets. Therefore, it is critical that the City Administration act upon its responsibility to Oakland residents through timely implementation of audit recommendations.

I want to express our appreciation to the City Administrator, Controller, Director of the Department of Housing & Community Development, and staff for their cooperation and commitment to addressing the concerns highlighted in the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Courtney A. Ruby". The signature is written in black ink and is positioned above the printed name and title.

COURTNEY A. RUBY, CPA, CFE
City Auditor

RECOMMENDATION FOLLOW-UP OF CEDA LOAN RECEIVABLES AUDIT

OVERVIEW

The Office of the City Auditor (Office) follows up on the recommendations of all audits to determine if they have been implemented by the Office of the City Administrator (Administration) or City Council (Council). Recommendation follow-ups increase accountability and ensure recommendations identified by the audits are implemented.

Summary of Process

The purpose of the follow-up process is to assess the implementation status of audit recommendations and when supported, close the recommendations. The Office reviews supporting documentation submitted, conducts interviews, and when applicable, performs on-site visits. The table below shows the status categories for recommendation implementation.

Open	The recommendation has not been addressed or implemented.
Partially Closed	The recommendation has been partially addressed and implemented; however, part of the recommendation remains open. Further work is needed to close the recommendation.
Closed	The recommendation has been fully addressed and implemented.

Audit Overview

In November 2010, the Office released a performance audit of the Administration's management over the Community and Economic Development Agency's (CEDA) Loan Receivables. The audit reviewed development loans funded through the General Purpose Fund 1010 and homebuyer loans funded through the Property Tax Increment Fund, fund 2185. The objective of the audit was to analyze and evaluate loan receivables policies and procedures and to determine if there are adequate internal controls in place to accurately account for outstanding loans, defaulted loans, and loan payments.

The following are key findings from the audit:

- The Finance and Management Agency (FMA) and CEDA Management cannot justify carrying forward on the books approximately \$14 million in loan receivables that should have been written-off.
- FMA and CEDA Management did not accurately record approximately \$220,000 in loan receivables that had been converted to grants by City Council.
- CEDA Management did not maintain any documentation for deeming approximately \$100,000 in loan receivables as uncollectible.
- Subsidiary ledgers used to maintain homebuyer loan information and Oracle (the City's financial management system) are inaccurate, therefore, the process is flawed and errors exceed \$450,000.

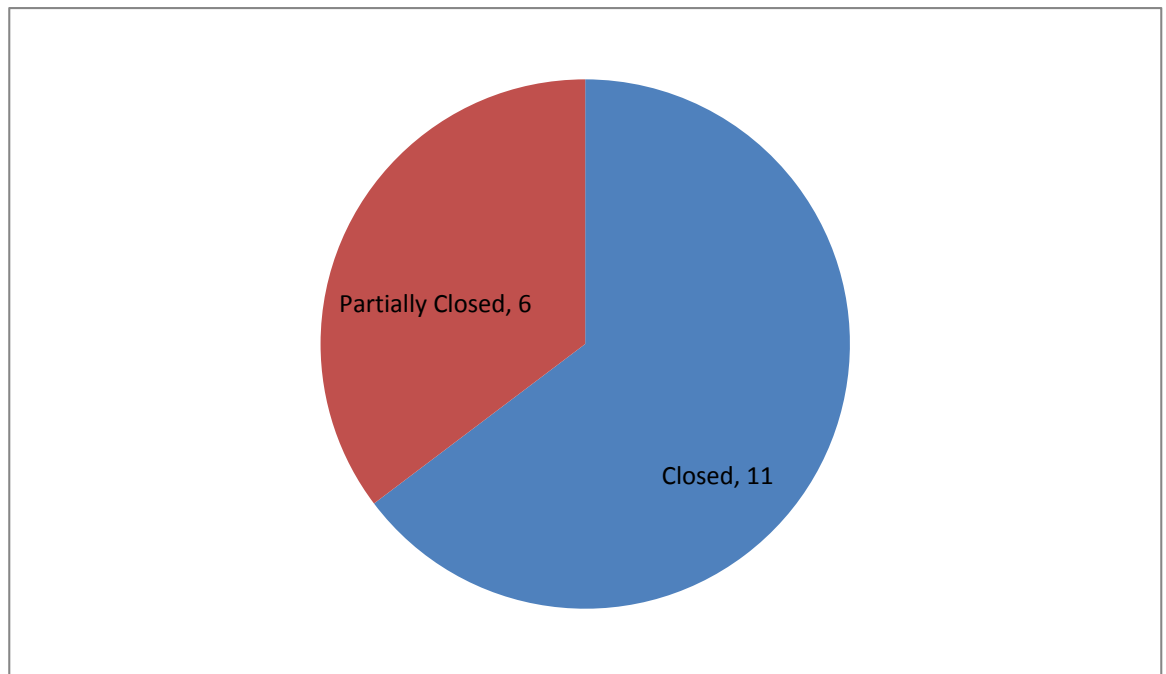
The audit provided 17 recommendations to CEDA and to FMA. However, in February 2012, CEDA was dissolved. As a result, CEDA Housing Services merged into the Department of Housing &

Community Development (HCD) which now administers the City's housing loans. Since the dissolution of CEDA, the City has not funded any new redevelopment loans through its General Purpose Fund. Further, FMA's functions were merged into the Office of the Controller (Controller's Office). Among other responsibilities, the Controller's Office manages the City's centralized billing and receivables system and keeps track of all accounts receivables.

The November 2010 CEDA Loans Receivable Audit reviewed CEDA's policies over homebuyer and development loans and the recommendations were aimed at loan management. Because CEDA was dissolved and loan functions were merged under HCD, the Office applied the recommendations to a sample of the loans currently managed under HCD, which includes homebuyer and commercial loans. The City no longer issues redevelopment loans.

Summary of Results

Out of the 17 recommendations included in the November 2010 CEDA Loans Receivable Audit, the recommendation follow-up process found that the Administration has closed 11 recommendations and six recommendations are partially closed.



The Administration should continue to work with HCD and the Controller's Office to fully implement all partially closed recommendations. The Administration should provide evidence to the Office to support that all partially closed recommendations have been addressed by December 15, 2014.

Implementation Status of Recommendations

The November 2010 CEDA Loans Receivable Audit reviewed CEDA's policies over homebuyer and development loans and the recommendations were aimed at loan management. Because CEDA was dissolved and loan functions were merged under HCD, the Office applied the recommendations to a sample of the loans currently managed under HCD, including homebuyer and commercial loans. The City no longer issues redevelopment loans.

As part of its follow-up process to determine the implementation status of each recommendation, the Office conducted interviews and reviewed all documentation that was provided. A status of "Open" means that there is no evidence to support that the recommendation has been implemented; "Partially Closed" means that there is evidence to support that only part of the recommendation has been implemented, "Closed" means that there is evidence to support that the recommendation has been fully implemented.

The Administration should provide support to the Office that all outstanding recommendations have addressed by December 15, 2014.

#	RECOMMENDATION	STATUS	EXPLANATION OF STATUS
1	<p>Evaluate the design and operation of their internal controls over loan receivables including the establishment of policies and procedures to ensure:</p> <ol style="list-style-type: none"> 1. Accurate loan values, dates, and payment terms are recorded. 2. Loan receivable aging analysis is prepared and reviewed monthly by management and for deferred loans a tracking systems should be established. 3. An allowance for doubtful accounts policy is established that includes preparing periodic estimates of uncollectible loan balances for review and authorization by management. 4. All loan write-offs, grant conversions or forgiveness of delinquent loans have a clear audit trail that documents the justification for writing-off, forgiving or converting the loan including all authorizing signatures and City Council resolutions if applicable. 	Partially Closed	<p>HCD and the Controller's Office have partially addressed this recommendation for homebuyer and commercial loans, but some policies and procedures still need to be established and/or implemented.</p> <ol style="list-style-type: none"> 1. While no policy has been established requiring that loan information is reviewed and reconciled, the Office found that at least annually HCD and the Controller's Office review and reconcile loan sub-ledger records against Oracle and prepare invoice adjustments when needed. However, this reconciliation does not address the accuracy and completeness of HCD's housing and commercial sub-ledgers. For example, during the course of the follow-up, the Office identified a misclassification error in the housing and residential sub-ledger. Due to staffing levels, HCD has one person handling all housing and residential loans, which according to HCD, impacts its ability to review its sub-ledger. <p>In addition, the City has a draft city-wide policy detailing procedures for handling notes and loans receivable, including ensuring that loan information is accurate. This policy was drafted in July 2011 but has not yet been formalized or implemented.</p> <ol style="list-style-type: none"> 2. HCD reviews commercial aging analysis. However, the policies and procedures for its commercial loans unit does not state that this review should occur. Aging analysis does not apply to HCD's housing and residential loans because housing and residential loans are deferred loans. 3. Both HCD's commercial and residential lending loan units have established policies and procedures for an allowance for doubtful accounts HCD's commercial lending unit provided evidence of management review of commercial loans. However, there is no evidence of management review

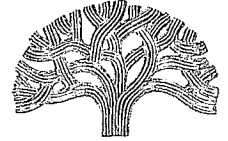
			<p>of doubtful accounts for housing and residential loans.</p> <p>4. All development loans reviewed as part of the original audit have been written-off or converted. However, according to HCD and the Controller's Office, the City does not typically convert or write-off loans. Doubtful housing and residential loans typically are deferred rather than written-off or converted. Doubtful commercial loans are referred to the City Attorney's Office for collection assistance. According to the Controller's Office, it has begun to develop a list of uncollectible loans to consider writing-off. According to HCD, there is not currently an established procedure for loans to be written-off.</p> <p>To close this recommendation, the Administration should formalize and implement its city-wide notes and loans receivable policy, which should include procedures for writing-off, converting, and forgiving loans. The Administration should also work with HCD to update its policies and procedures to include consistent review of aging analysis of commercial loans and include management review and reconciliation of doubtful accounts for housing and residential loans. Updating HCD's housing and residential policies and procedures to include the review steps noted above will help ensure that it is consistently performed. This information should be provided to the Office by December 15, 2014.</p>
2	<p>Conduct an annual review of all loans to ensure that all loan receivable records in the sub-ledger and in Oracle are complete and accurate.</p>	<p>Partially Closed</p>	<p>At least annually, the Controller's Office reviews and reconciles loan sub-ledger records against Oracle and prepares invoice adjustments when needed. However, this reconciliation does not address the accuracy or completeness of all recorded HCD loan information.</p> <p>The Office found that two out of the 16 development loans tested in the original 2010 audit still had discrepancies between HCD's housing sub-ledger and Oracle. One loan was misclassified incorrectly in HCD's sub-ledger and one loan remained in Oracle even though it was approved to be written-off. In response to the Office's finding, the Controller's Office corrected these errors in Oracle.</p> <p>Without secondary review ensuring that HCD's sub-ledgers are complete and accurate, information recorded in Oracle may be inaccurate. According to HCD, in the past, CEDA had a fiscal unit that reviewed all CEDA loan receivables subsidiary systems for accuracy. However, the Loan Servicing Unit within the Residential Lending Services Division of HCD lacks a similar function because it has one staff person responsible for HCD's housing and residential loan sub-ledger.</p> <p>To close this recommendation, the Administration should work with HCD to identify ways to include secondary review of its housing sub-ledgers and it should update its</p>

			housing and residential policies and procedures accordingly. This information should be provided to the Office by December 15, 2014.
3	Find the supporting documentation for the remaining Development loans where the write-off process has not yet been initiated and determine if the loans are still collectible, including interest revenue or if they should be written-off.	Closed	In 2010, the City Council approved writing-off all uncollectible CEDA loans greater than \$1,000, dating back to 1991. All development loans reviewed as part of the original audit have been written-off or converted into a grant.
4	Increase the external auditor's internal control testing of receivables during the next financial statement audit.	Closed	According to the Controller's Office, they shared this recommendation with the external auditors. The external auditors consider the City's controls over financial reporting annually. In FY 2009-10, the external auditors reported a significant deficiency in the evaluation of allowances for doubtful accounts for CEDA's loans receivables. According to the external auditors corrective action was subsequently taken and no similar inaccuracies were detected in FY 2010-11.
5	Establish effective internal controls over loan conversions by developing appropriate procedures to record loans as grants and make the necessary updates to the loans which were approved to be converted to grants.	Partially Closed	<p>According to HCD and the Controller's Office, the City does not typically convert or write-off loans. Review of City Council resolutions confirmed that no CEDA or HCD loans have been converted to grants after 2010.</p> <p>Doubtful housing and residential loans typically are deferred rather than written-off or converted. Doubtful commercial loans are referred to the City Attorney's Office. According to HCD, there is not currently an established procedure for loans to be written-off or converted.</p> <p>To close this recommendation, the Administration should formalize and implement its city-wide notes and loans receivable policy, which should include procedures for writing-off, converting, and forgiving loans as well as annually reviewing all loans listed for write-off, conversion or forgiveness. This information should be provided to the Office by December 15, 2014.</p>
6	Perform an annual review of all loan receivables that would ensure that all loans that have been approved to be accounted for as grants by City Council Resolution are recorded accurately, and create a system of internal controls that tracks, links, and monitors loans to actions taken by City Council.	Closed	Since there have been no conversions of loans to grants since 2010, the Administration has not needed to perform an annual review of such actions.
7	Accurately account for the OPEN and Pro Art loans as grants, and determine if the OCCUR loan is indeed a grant, and if so, accurately account for the conversion, including conducting	Closed	The Pro Art and OCCUR loans were written-off and removed from Oracle and HCD's sub-ledger. The OPEN loan was converted to a grant and removed from Oracle and HCD's sub-ledger.

	the loan write-off process.		
8	Establish a loan receivables policy and procedure for allowance for doubtful accounts, which should detail the criteria for when an account is doubtful and the specific process for accurately establishing an allowance for doubtful accounts.	Closed	Both HCD's housing and residential and commercial lending units established written policies and procedures for an allowance for doubtful accounts. These policies and procedures include criteria for when an account is doubtful and the specific process for establishing an allowance for doubtful accounts. However, as noted in the actions to close recommendation #1, there is no evidence of management review of doubtful accounts.
9	Ensure that all loans that are tracked in the "allowance for doubtful accounts" have the appropriate approvals and supporting documentation stating why the loans may not be collectible.	Partially Closed	<p>Out of a sample of doubtful homebuyer loans reviewed, the Office found that the files for doubtful loans included appropriate supporting documentation, however they were prepared and approved by HCD's single Loan Service Administrator. Approvals typically should be made by management or someone other than the person preparing a file. There is no evidence of management or secondary review or approval of homebuyer doubtful account files.</p> <p>To close this recommendation, the Administration should work with HCD to update HCD's housing and residential policies and procedures to include management/secondary review and approval of doubtful account files. This information should be provided to the Office by December 15, 2014.</p>
10	Update the "Reference" field for each of the remaining Development loans that are not being written-off to reflect the accurate due date and payment terms for the loan. In addition, as part of the annual review in recommendation #2, review the loan due dates and payment terms to ensure accuracy of the recording of the loans.	Closed	All development loans reviewed as part of the original audit have been written-off or converted to a grant and are no longer in Oracle. Further, according to the Administration, Oracle is not meant to record loan details like due dates and payment terms, HCD's sub-ledgers are where loan details should be recorded. As noted in the actions to close recommendation #1, additional review and reconciliation is needed to ensure the accuracy of loan information in HCD's housing and residential sub-ledger.
11	Update the homebuyer loan processing policies and procedures to ensure all key loan receivables processes are documented.	Partially Closed	<p>HCD's current housing and residential policies and procedures cover many key processes; however, as noted in the actions to close recommendation #1, some additional updates should be made to HCD's housing and residential policies and procedures.</p> <p>To close this recommendation the Administration should work with HCD to update HCD's housing and residential policies and procedures to include review of the housing and residential sub-ledger and management review of doubtful accounts.</p>
12	Ensure the revised homebuyer loan receivables policies and procedures are communicated to staff.	Closed	HCD's housing and residential policies and procedures were communicated to the appropriate staff.

13	Include specific guidelines on how to prevent and detect fraud in homebuyer loan receivables process procedures.	Closed	HCD's housing loan application processes requires applicants to meet underwriting credit standards, which typically involve comparison of an applicant's verification of deposit, credit report, and federal tax returns to verify income information and financial standing. Compliance with these requirements help prevent and detect fraud in housing and residential loans.
14	Implement homebuyer loan program fraud training for staff.	Closed	In 2011, three Homeownership Program staff attended housing and residential program fraud training. In 2013, HCD explored new fraud trainings focused on detection strategies for mortgage fraud schemes. In 2014, the Homeownership Program Coordinator attended housing/residential program fraud training.
15	Correct the inaccuracies to the MAP sub-ledger and Notes and Loans Receivables sub-ledger.	Closed	The inaccuracies between the MAP sub-ledger and the Notes and Loans Receivables sub-ledger that were noted in the 2010 audit have been corrected.
16	Improve internal controls over loan receivable subsidiary systems to ensure that there are controls in place that are designed to prevent and detect loan data inaccuracies including appropriate reconciliations. Specifically, ensure that all loans in CEDA's sub-ledgers are reviewed and reconciled to each loan in Oracle as part of the quarterly invoice adjustment process.	Partially Closed	<p>As noted in the explanation for recommendation #2, internal controls over loan information have not prevented or detected inaccuracies.</p> <p>To close this recommendation, the Administration should work with HCD to identify ways to include secondary review of its housing sub-ledgers and it should update its commercial and housing and residential policies and procedures accordingly. This information should be provided to the Office by December 15, 2014.</p>
17	Research and evaluate systems available that would allow for automatic system integration with Oracle.	Closed	According to HCD, it is exploring other options, including integrating a loan management system into Oracle.

CITY OF OAKLAND



CITY HALL • 1 FRANK H. OGAWA PLAZA • OAKLAND, CALIFORNIA 94612

Office of the City Administrator

(510) 238-3301
FAX (510) 238-2223
TDD (510) 238-2007

July 30, 2014

Courtney A. Ruby, City Auditor
City of Oakland, California
1 Frank Ogawa Plaza, 4th Floor
Oakland, CA 94612

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RE: Report of the CEDA Loans Receivables Recommendation follow-up


Dear City Auditor Ruby:

I am pleased to provide you with the Administration's response to the Recommendation Follow-up on the CEDA Loans Receivables Performance Audit. We welcome fair and impartial performance audits conducted cooperatively to improve the effectiveness and transparency of City government operations.

In summary, the Audit provided 17 recommendations for the CEDA Loans Receivable Audit, of which 11 have been fully addressed and implemented (Closed). The remaining six (6) are partially addressed and implemented (partially closed), and further work is needed to close the recommendations.

The Administration will continue to work to fully implement the remaining six (6) recommendations and will provide evidence to the City Auditor's Office to support that all partially closed recommendations have been addressed by December 15, 2014.

Sincerely,


Henry L. Gardner
Interim City Administrator

Cc: Osborn K. Solitei, Director of Finance/Controller