



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report-Issued December 2, 2014

Community Economic Development Assistance Corporation

For the period July 1, 2011 through December 31, 2013





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Mr. Roger Herzog, Executive Director
Community Economic Development Assistance Corporation
One Center Plaza, Suite 350
Boston, MA 02108

Dear Mr. Herzog:

I am pleased to provide this performance audit of the Community Economic Development Assistance Corporation. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2011 through December 31, 2013. My audit staff discussed the contents of this report with management of the agency, and their comments are reflected in this report.

I would also like to express my appreciation to the Community Economic Development Assistance Corporation for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMBump".

Suzanne M. Bump
Auditor of the Commonwealth

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EXECUTIVE SUMMARY

The Community Economic Development Assistance Corporation (CEDAC) was formed as a quasi-public agency in 1978 under Chapter 40H of the Massachusetts General Laws to assist nonprofit organizations engaged in community economic development. CEDAC is the primary lender of funding for predevelopment costs, including site-acquisition costs, to nonprofit agencies involved in the development of affordable housing in Massachusetts. CEDAC also provides nonprofit agencies with technical support in the areas of housing finance and development and strategic project management.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of CEDAC for the period July 1, 2011 through December 31, 2013.

The objective of our audit was to review certain aspects of CEDAC's administration of its lending process to determine whether it had established adequate controls over this process to ensure that (1) loans were being provided in accordance with established guidelines, (2) its loan portfolio was being effectively monitored for performance and desired outcomes, (3) state funds were being properly safeguarded, and (4) the rate of loan defaults and the return on investment for loans were adequate to support CEDAC's continued operations and accomplishment of its mission.

Summary of Findings

- CEDAC did not file an annual plan with the Office of Performance Management and Oversight (OPMO) that identified its annual goals and performance measurements and the extent to which it had achieved the goals it had established during the prior year. Because CEDAC did not file this annual plan, it did not provide the Commonwealth or the public with the transparency necessary to determine how effectively it was meeting its organizational goals and objectives.
- CEDAC did not perform a risk assessment. Its lack of a department-wide risk assessment, with cross-references of risks to controls established to mitigate them, may hinder or prevent it from fulfilling its responsibilities, achieving its goals and objectives, and ensuring the integrity and effectiveness of its internal control system.

Recommendations

- CEDAC should take the measures necessary to ensure that it continues to file its annual plan in accordance with Chapter 6A, Section 16G, of the General Laws.

- CEDAC should perform an agency-wide risk assessment that identifies the most significant areas (risks) that could prevent it from attaining its mission, goals, and objectives and then cross-reference those risks to documented internal controls that will be used to mitigate them.

Post-Audit Action

CEDAC met with representatives of OPMO, and both parties agreed that CEDAC would begin filing its annual plan, starting in 2014 for plan year 2015. CEDAC officially filed its fiscal year 2015 annual plan with OPMO on June 9, 2014.

OVERVIEW OF AUDITED AGENCY

Background

The Community Economic Development Assistance Corporation (CEDAC) is a quasi-public agency¹ established in 1978 under Chapter 40H of the Massachusetts General Laws. CEDAC is governed by a nine-member board of directors. Eight members are public- and private-sector housing-development professionals appointed by the Governor. The state's Secretary of Housing and Economic Development is the board chair.

CEDAC supports the community-development needs of community-based nonprofit organizations by offering flexible capital financing for the development of affordable housing (its largest program) and assisting in the revitalization of economically distressed areas. It is the primary lender of predevelopment funding, including site-acquisition costs, to nonprofit agencies involved in the development of affordable housing in Massachusetts. CEDAC also provides nonprofit developers with technical support in the areas of housing finance and development and strategic project management.

In addition to its lending program, CEDAC is also the underwriter of the Housing Innovations Fund (HIF), the Facilities Consolidation Fund (FCF), and the Community-Based Housing (CBH) Program, three loan programs administered by the Commonwealth's Department of Housing and Community Development. CEDAC's financial statements describe HIF, FCF, and CBH loans as "deferred payment permanent loans that fund affordable housing development." HIF loans support affordable housing projects such as limited equity cooperatives,² single-room-occupancy housing, and housing for special-needs residents. FCF loans provide capital to develop housing for consumers receiving service from the Massachusetts Department of Developmental Services and the Massachusetts Department of Mental Health. CBH loans support the development of housing for people with physical disabilities.

¹ The website for the Massachusetts Executive Office for Administration and Finance defines authorities and quasi-public agencies as "state agencies and boards created by statute, that are funded to some extent with state tax dollars, and that are not directly accountable to a single elected official."

² A limited equity cooperative is a residential housing development owned by a limited equity cooperative housing corporation, which is "a corporation organized and operated primarily for the benefit of low-and moderate-income persons" according to 760 Code of Massachusetts Regulations 23.02.

During the fiscal years ended June 30, 2013 and June 30, 2012, CEDAC's financial position, revenue, and expenses included the following selected data:

	Fiscal Year Ended	
	June 30, 2013	June 30, 2012
Total Assets*	\$55,902,048	\$59,336,148
Total Liabilities	\$44,595,272	\$47,739,692

* Total assets include loans receivable as of the end of each fiscal year less allowances for uncollectible amounts.

Operating revenue and expenses during the fiscal years ended June 30, 2013 and June 30, 2012 were as follows:

	Fiscal Year Ended	
	June 30, 2013	June 30, 2012
Operating Revenue	\$3,495,431	\$3,625,594
Operating Expenses	\$3,785,111	\$3,684,951

During our audit period, July 1, 2011 through December 31, 2013, CEDAC had approximately 20 full-time employees.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Community Economic Development Assistance Corporation (CEDAC) for the period July 1, 2011 through December 31, 2013.

The objective of our audit was to review certain aspects of CEDAC's administration of its lending process to determine whether it had established adequate controls over this process to ensure that (1) loans were being provided in accordance with established guidelines, (2) its loan portfolio was being effectively monitored for performance and desired outcomes, (3) state funds were being properly safeguarded, and (4) the rate of loan defaults and the return on investment for loans were adequate to support CEDAC's continued operations and accomplishment of its mission.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To accomplish our audit objectives, we performed the following procedures:

- We gained an understanding of CEDAC's operations and the composition of its board of directors, identified the key executives and key project managers, and conducted interviews with various CEDAC staff members.
- We identified and reviewed applicable laws, rules, and regulations that were pertinent to our audit objectives, including Chapter 40H of the General Laws, regulations promulgated by the Office of Performance Management and Oversight (OPMO), and CEDAC's own internal policies and procedures.
- We reviewed the meeting minutes of CEDAC's board of directors from our audit period.
- We obtained and reviewed independent auditors' reports regarding CEDAC.
- We reviewed CEDAC's Internal Control Procedures Manual, including its loan granting and monitoring process.
- We reviewed CEDAC's loan default rate, comparing historical rates to current activity, and reviewed the consistency of its methodology for determining loan loss reserves. Because of the

low loan default rate over CEDAC's history, we performed a limited review (examining two out of a total of seven loans that were defaulted on during our 30-month audit period) for appropriate documentation and approvals.

- We reviewed CEDAC's interest and fee-related income to determine its adequacy to support CEDAC's continued operations and accomplishment of its mission.
- We reviewed loan documentation data from selected files, including checklists, environmental reports, appraisals, and signed agreements.
- We obtained a list of loans from CEDAC's electronic loan database and selected loans and related source documents to trace them to the financial records. We determined that the database was sufficiently reliable for the purposes of our audit.
- We selected for examination a sample of files representing CEDAC's largest loan programs, including predevelopment, acquisition, and permanent deferred payment loans issued by CEDAC during our audit period. We selected these files using a non-statistical judgmental sampling methodology; therefore, our results cannot be projected to the population. We reviewed them to determine whether the loans were adequately documented, properly authorized, monitored by CEDAC staff, and in agreement with CEDAC's enabling legislation. The total population of predevelopment, acquisition, and permanent deferred payment loans committed to during our 30-month audit period was 187; from this population, we selected a sample of 25 loans for review.

Based on our audit, we have concluded that, except as discussed in the Detailed Audit Results and Findings section of this report, during the audit period, CEDAC was issuing loans in accordance with established guidelines, effectively monitoring its loan portfolio for desired outcomes, and adequately safeguarding state funds; its rate of loan defaults was reasonable; and its return on investment for loans was adequate to support CEDAC's continued operations and accomplishment of its mission. However, we found that CEDAC did not file an annual plan with OPMO as required by law. Further, its internal control documentation did not include a detailed assessment by management of the risks inherent in its operations. These issues are discussed in the Detailed Audit Results and Findings section of this report.

DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE'S RESPONSE

1. The Community Economic Development Assistance Corporation had never filed an annual plan with the Office of Performance Management and Oversight as required by law.

Contrary to the requirements of Chapter 6A, Section 16G, of the Massachusetts General Laws, the Community Economic Development Assistance Corporation (CEDAC) did not file an annual plan with the Office of Performance Management and Oversight (OPMO)³ that identified its annual goals and performance measurements and the extent to which it had achieved the goals it had established during the prior year. Because CEDAC did not file this annual plan, it did not provide the Commonwealth or the public with the transparency necessary to determine how effectively it was meeting its organizational goals and objectives.

Legal Requirements

Under Chapter 6A, Section 16G, of the General Laws, CEDAC is required to file an annual report with OPMO that details its operations and accomplishments; its performance with regard to the goals and programs or initiatives outlined in its approved plan; its receipts and expenditures during the fiscal year; its assets and liabilities at the end of the fiscal year; its audited financial reports; the number, nature, and amounts of investments it has made and grants it has awarded; and the number, nature, and amounts of real-estate-related loans, working capital loans, and guarantees it has approved.

Reason for Noncompliance with Annual Plan Filing Requirement with OPMO

CEDAC officials told us that OPMO had never notified them of the filing requirement. The Office of the State Auditor (OSA) contacted officials at OPMO, who told us that they had not realized that CEDAC was subject to the filing requirements and had not contacted CEDAC to request a filing.

Recommendation

During our audit, OSA brought this matter to CEDAC's attention, and the agency subsequently contacted OPMO. As a result, both parties agreed that CEDAC would begin filing its annual plan, starting in 2014 for plan year 2015. OSA subsequently confirmed that CEDAC filed its fiscal year

³ OPMO is a department within the Executive Office of Housing and Economic Development that oversees the effectiveness, accountability, and transparency of public and quasi-public entities engaged in economic development. Certain agencies are required to submit an annual report including an annual plan and accomplishments related to prior plans.

2015 annual plan with OPMO on June 9, 2014. In the future, CEDAC should take the measures necessary to ensure that it continues to file its annual plan in accordance with Chapter 6A, Section 16G of the General Laws.

Auditee's Response

The law was enacted in mid-2010 as part of a reorganization of state economic development agencies, and the new law's reporting requirements to OPMO began in FY13. CEDAC has no objection to this finding, and wants to clarify the very short history of this new law. Once it was brought to CEDAC's attention that it was subject to OPMO requirements, we have worked closely with OPMO to rectify this matter. Pursuant to OPMO's request, we have filed our FY14 plan and annual report and our FY15 annual plan.

2. CEDAC's internal control documentation did not include a risk assessment.

During our review of CEDAC's internal control plan, we noted that CEDAC did not perform a risk assessment. A risk assessment is an integral part of an entity's internal control process because it identifies and analyzes risks and assists management in prioritizing the activities where controls are most needed to mitigate risk. CEDAC's lack of a department-wide risk assessment, with cross-references of risks to controls established to mitigate them, may hinder or prevent it from fulfilling its responsibilities, achieving its goals and objectives, and ensuring the integrity and effectiveness of its internal control system.

Authoritative Guidance

Policies and procedures incorporating adequate internal controls are fundamental to all business enterprises. The most widely used framework for internal controls in the United States was developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May 2013, COSO released its updated *Internal Control—Integrated Framework*, which incorporates the concept of enterprise risk management. A key element of enterprise risk management is management's identification and assessment of the risks inherent in its operations that could prevent the accomplishment of its mission and goals.

Further, in its Internal Control Guide, the Office of the State Comptroller defines an internal control plan as "a high level department-wide summarization of the department's risks and the controls used to mitigate those risks."

Reasons for Absence of Risk Assessment

CEDAC has extensive policies and procedures that document its internal controls, and CEDAC officials believe that these controls adequately address all risks to its operations. However, OSA believes that without conducting a risk assessment, CEDAC cannot be certain that it has effectively identified all risks to its achieving its goals and objectives and developed appropriate controls to mitigate those risks.

Recommendation

CEDAC should perform an agency-wide risk assessment that identifies the most significant areas (risks) that could prevent it from attaining its mission, goals, and objectives and then cross-reference those risks to documented internal controls that will be used to mitigate them.

Auditee's Response

CEDAC does have an internal control policies and procedures manual outlining key controls and processes, which address the risks to operations. While that manual does not explicitly refer to a formal risk assessment document, the policies and procedures manual could not have been drafted without having conducted such a risk assessment. We understand that the risk assessment document is more in the form of a recommendation and not a deficiency finding. Typically we seek to adopt these kinds of recommendations as are appropriate to our scale and scope of operations. In addition, we recognize that it would provide helpful guidance to external readers how the policies relate to our assessment, and to have that agency-wide assessment reported in one more concise document.

To that end, we will prepare an enterprise risk assessment document that summarizes the risk assessment performed, which led to the creation of our internal control manual and our lending policies and procedures manual.

APPENDIX

Community Economic Development Assistance Corporation (CEDAC) Program Descriptions⁴

CEDAC Housing Programs

CEDAC continues to experience a steady volume of lending activity for its high risk pre-development lending program and a high volume of activity for subordinate permanent financing offered through the three state supported housing finance programs administered by CEDAC: the Housing Innovations Fund, Facilities Consolidation Fund, and Community-Based Housing programs. CEDAC's pre-development lending program utilizes a short-term loan product that allows nonprofit borrowers to access capital resources to help fund a project's pre-development cycle, usually a three to five year timeframe. In a constrained economic environment, CEDAC's pre-development capital is most critical because the capital is able to be patient and remain in these projects until the longer term financing is committed to fund project costs. . . .

Housing Preservation

During 2009, CEDAC was awarded a grant of \$1 million from the John D. and Catherine T. MacArthur Foundation (MacFound) to support a Massachusetts Housing Preservation Initiative. Massachusetts was one of twelve states awarded funding from MacFound through a highly competitive process. . . . With this funding, CEDAC, collaborating with other state and quasi-public agencies, monitors and identifies affordable housing properties at risk of loss of affordability at the expiration of a legally mandated affordability period and works with the owners to help maintain affordability. . . . CEDAC also provides technical assistance and training to developers, owners, tenants, and state and local officials regarding Federal housing preservation programs and the state's new law, Chapter 40T, which regulates publicly-assisted multifamily rental housing. . . .

Permanent Deferred Payment Lending

CEDAC continued to serve as underwriter for the Department of Housing and Community Development (DHCD) for Housing Innovations Fund (HIF) loans, Facilities Consolidation Fund (FCF) loans, and Community-Based Housing (CBH) loans. HIF, FCF, and CBH loans are deferred payment permanent loans that fund affordable housing development. . . . FCF in particular has experienced enormous demand as Department of Development Services (DDS) service providers respond to recent Federal and state litigation and the closing of state institutions aimed at expediting the move of DDS clients into community-based residences. The Department of Mental Health (DMH) has increased its goal for the production of community residential programs as well. . . . CEDAC is responsible for managing the funds between the time that they are received from DHCD and disbursed to borrowers. . . .

Economic Development

CEDAC's Commonwealth Workforce Coalition (CWC) is a statewide capacity building program providing professional development training and networking opportunities for staff engaged in workforce development, education, training, and employment for adults and youth. Topics for

⁴ Text in this appendix is quoted from CEDAC's combined general purpose financial statements for the fiscal years ended June 30, 2013 and June 30, 2012.

trainings and regional network meetings include best practices on employer engagement and improving program participants' soft skills.