



ARLINGTON
VIRGINIA

Internal Audit Report – Affordable Housing Investment Fund (AHIF): Loan Administration

Report Date: March 3, 2021

TABLE OF CONTENTS

Transmittal Letter	1
Executive Summary	
Background	2
Objective and Scope	2
Overall Summary / Highlights	2
Background, Objectives and Approach	
Background	3
Objectives and Approach.....	5

TRANSMITTAL LETTER

March 3, 2021

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Pursuant to the contract and related statement of work for Arlington County, Virginia (“the County”), we hereby present the internal audit of the County’s Affordable Housing Investment Fund (“AHIF”) loan administration process. Our report is organized in the following sections:

Executive Summary	This section includes a background summary of the function, the objectives and approach, and a detailed description of the observation(s) noted during this internal audit. Identified with each observation is the recommended action(s), and management’s corrective action plan, including the responsible party and estimated completion date.
Background	This section provides an overview of the function within the process and pertinent operational control points and related compliance requirements.
Objectives and Approach	The AHIF internal audit objectives and focus are expanded upon in this section as well as a review of the various phases of our approach.

As described in our objectives and procedures outlined on pages 5 - 6 of this report, the observations noted are based on our analysis of the processes, documents, records and information provided to us by the County. This internal audit focused on evaluating the soundness of internal control policies to safeguard assets and on reviewing compliance with County policies. We offer no assurances that schemes or fraudulent activities have not been, or are not currently being perpetrated by any person within the areas reviewed.

We would like to thank the staff and all those involved in assisting RSM US LLP with this internal audit.

Respectfully submitted,

RSM US LLP



Executive Summary

Background

The County's Affordable Housing Investment Fund ("AHIF") is one of the main financing programs for affordable housing development. Since its creation in 1988, AHIF, along with federal loan funds have helped to create the majority of the County's more than 8,000 approved affordable rental units that benefit low- and moderate-income households. Since the inception of the AHIF program, the County has originated more than \$400 million in loans for affordable rental units. Between fiscal year ("FY") 2010 and FY 2021, AHIF received an average of \$11.1 million in local funding annually.

As of June 30, 2020, AHIF includes over 100 active projects and approximately \$325 million in active principal balances. The program provides a revolving loan fund that provides gap financing to developers that preserve or build Committed Affordable Units ("CAFs") in the County.

Although certain aspects of the County's affordable housing loan administration function are centralized within the Housing Division within the Community Planning, Housing and Development Department ("CPHD"), some of the functions such as, disbursement approval and general ledger administration are facilitated by the Treasurer's Office and the County's Department of Management and Finance ("DMF").

Previously effective as of December 2016 and updated May 1, 2020, the County implemented the *Arlington County Multifamily Program – Loan Portfolio Management Procedures and Guidelines*. The purpose was to define and implement a standard policy and process for the administration of loans and define roles and responsibilities for County personnel that monitor and manage key control procedures. Specifically, the policy establishes Housing Division Supervisor and Staff responsibilities, and defines internal controls surrounding loan set-up, annual reviews and payment processing. The document also outlines best practices for County compliance, quality assurance and recordkeeping, and outlines all applicable regulations to which the AHIF Administrator(s) must adhere.

Properties that receive an AHIF loan, regardless of whether they pay off their loan, are committed to keeping their property affordable by committing a certain amount of rental units as affordable for an average 60 year period. Due to this commitment, AHIF Administrators perform Tenant File Compliance Reviews on all CAFs. During this review, CPHD staff verify that properties have income restrictions on a certain number of rental units. Household income sizes are reviewed to confirm they meet AHIF affordability requirements.

Fieldwork was performed from October 2020 through January 2021.

We would like to thank all Arlington County team members who assisted us throughout this internal audit.

Objective and Scope

The primary objective of this internal audit was to assess whether the system of internal controls surrounding the AHIF's loan administration process are operating effectively, as well as, to assess compliance with specific requirements for a sample of loans.

The internal audit covered the period of July 1, 2019 to June 30, 2020. A sample of loans, and payments were selected for testing based on initial walkthroughs. Additionally, we reviewed actions taken related to two improvement opportunities identified within a previous AHIF audit, which was completed by a third party in 2017.

Our control testing focused on the following areas: payment processing, loan closing, loan setup, and loan administration. We reviewed documentation for each of the areas to verify that: 1) payments were accurate and in compliance with AHIF guidelines; 2) loans contain required documentation, 3) loans were set-up properly, and 4) loans were adequately serviced throughout the life of the loan.

Number of Observations by Risk Rating

	High	Moderate	Low
AHIF Audit	N/A – No Observations Reported		

Background, Objectives and Approach

Background

Overview

The Affordable Housing Investment Fund is the County's main financing program for affordable housing development with over 100 active projects and approximately \$325 million in active principal balances. The program provides a revolving loan fund that provides gap financing to developers that preserve or build Committed Affordable Units ("CAFs") in the County. Key aspects of the AHIF loan administration function are centralized within the Housing Division of the CPHD Department with certain aspects facilitated by the Department of Management and Finance and Treasurer's Office. These responsibilities specifically include:

- Reviewing loan manager proposals to approve Notice of Funding Availability ("NOFA");
- Facilitation of loan manager negotiations & commission review(s) process;
- Reviewing and facilitation of Drawdown & Manual Warrant loan disbursements;
- Facilitating annual reviews & related payment processing for fixed/residual income;
- Operating project closing & refinancing procedures;
- Maintaining appropriate documentation, in compliance with the County level document retention policy and respective agreements; and
- Review and approval of invoices for payment to the contractor in line with the payment terms and conditions outlined in the agreement.

The Arlington County Board and commissions provide oversight and guidance over the AHIF program.

Previously effective as of December 2016 and updated May 1, 2020, the County implemented the *Arlington County Multifamily Program – Loan Portfolio Management Procedures and Guidelines*. The purpose was to define and implement a standard policy and process for the administration of loans and define roles and responsibilities for County personnel that monitor and manage key control procedures. Specifically, the policy establishes Housing Division Supervisor and Staff responsibilities, and defines internal controls surrounding loan set-up, annual reviews and payment processing. The document also outlines best practices for County compliance, quality assurance and recordkeeping, including all applicable regulations to which the AHIF Administrator(s) must adhere. As part of our review, we reviewed the processes for compliance with the new policy.

The AHIF loan administration process has three different sections that function to manage the AHIF operation successfully: 1) loan set-up, 2) payment processing, and 3) loan monitoring and loan closing.

Roles and Responsibilities

The following departments play key roles as it relates to AHIF:

Housing Division within the Community Planning, Housing and Development Department

The Housing Division facilitates each key process for loan administration relating to the AHIF. Services provided by the County and community partners through the Housing Division include: manual warrant processing, loan monitoring procedures, and record retention.

Department of Management and Finance

DMF manages approval of loan drawdowns. Once authorized by the County Board, County funds are disbursed through a manual warrant(wire), which requires evidence of County Board approval (typically a board report), demonstration that funds are available (e.g., current account balance from the County's PRISM system), a signed agreement or contract, and banking/wire information for the receiving organization. Manual warrants are used for one-time disbursements, as well as construction draws, on a reimbursement basis, during the duration of the project's buildout timeline. Manual warrants must be signed by the CPHD supervisor, as well as the County's Comptroller and the County's DMF Director. Once all signatures are received, the manual warrant is passed off to the Treasurer's office for disbursement. ACH are used for the Tenant Assistance Fund ("TAF") contracts to reimburse developers for rental assistance paid on behalf of tenants. TAF payments are paid with AHIF funds.

Background, Objectives and Approach (Continued)

Background (Continued)

Systems

There are two primary systems utilized by AHIF: PRISM and Arlington County Apartment Tracker (“ATRACK”).

- PRISM is the County’s general ledger, purchasing and accounts payable software and each project is established in the system. A project within PRISM includes a project-specific expense account code to help track funds disbursed to-date and remaining funds authorized. Similarly, when County loans start repaying, having project-specific revenue codes help staff track payment history by project. Account Code Combinations (“ACC”) in the County’s PRISM system track revenue or expenses and each include six segments: Fund, Natural Account, Cost Center, Project, Source of Funds, and Task.
- ATRACK is a custom internet-based system that allows the County to track all apartment complexes in the County, all CAFs and all loans to owner/developers. The CPHD Asset Manager and Development Specialist work together to set up new projects and/or new financing after settlement. Once the project is listed, the financial information including interest accruals, repayments, changes to loan terms, etc., is updated and reviewed by the Asset Manager. ATRACK can calculate and provide interest accruals, loan balances, number of affordable rental units, and other comprehensive reports that staff can use for analysis or to provide to internal or external stakeholders.

Loan Set-Up

Loan set-up begins with a sub-process called Notice of Funding Availability (“NOFA”), where the Housing Division receives loan applications. The Housing Division reviews the loan during this process for the appropriate documentation and eligibility. After selected via the NOFA Process, projects with staff recommendations for funding go through the County’s public process, which includes review by commissions such as the County Board appointed Citizens Advisory Commission on Housing (Housing Commission), as well as the County Board appointed Tenant/Landlord Commission. After receiving Commission approvals, following the public review process, the funding recommendation is sent to the County Board for final review and approval.

Fund disbursement is where approved loan packages have funds disbursed for their associated project. Approved packages are received by the Housing Budget and Management Specialist who then confirms: 1) County Board approval of the loan, 2) account code combination for AHIF fund disbursement in PRISM, 3) agreement signature and 4) accurate banking/wire information for the receiving organization, as verified via the wire instructions. For construction draws, verified costs are reviewed and signed off by responsible parties and also included. All of the appropriate documents and associated approvals are prepared in a packaged called a “manual warrant” and this document is reviewed and signed by the Housing Finance Supervisor, as well as the County’s Comptroller and the County’s DMF Director. The wire is then issued by the County Treasurer’s Office, who reviews and disburses funds as per the wiring instructions in the manual warrant.

Payment Processing

Borrowers/owners submit loan payments along with annual audited financial statements. Loan payments are based on the repayment terms specified in the loan agreement and promissory note, as well as the financial information provided by the developer each year.

After borrowers/owners audited financial statements and a loan payment has been received by the Asset Manager, the Asset Manager confirms payments match the amount within the loan agreement, promissory note, and audited financial statements. The Asset Manager as well as the Housing Budget and Management Specialist confirms the correct PRISM account code combination for the loan payment, and either will submit the check to the Treasurer’s Office for deposit or will notify the Treasurer’s Office that a wire is due to arrive.

Background, Objectives and Approach (Continued)

Background (Continued)

Loan Monitoring

The *Arlington County Multifamily Program – Loan Portfolio Management Procedures and Guidelines* require all Loan Holders to submit an annual operating budget for the upcoming fiscal year along with audited financial statements. Loan Holders’ annual operating budgets are the baseline performance goals for monitoring and review over the period. The primary monitoring procedures that are performed are desktop, in-person, and compliance reviews.

- Desktop reviews are performed by CPHD staff for every loan account. This is typically an overall review performed for the year to evaluate the performance of each property based on the proposed annual budget of the loan account. The desktop review details current project expenses, rental income, and various other asset/liability accounts based on ATRACK and all income, expense and other financial information. Annual desktop reviews include reviews of operating budgets, audited financials, and any other applicable correspondence or information. After the desktop review is complete, Housing Division Staff provides the owners, the Housing Division Director, and other internal stakeholders copies of a report detailing the results of the review.
- The Housing Division performs compliance reviews, such as Tenant File Compliance Reviews (see page 1 for definition) and Housing Quality Standards (HQS) reviews, based on sites that have an Affordable Housing commitment under the AHIF loan agreement. HQS are the U.S. Department of Housing and Urban Development’s minimum quality standards for tenant-based programs and are required both at initial occupancy and during the term of the lease.

Timeline

Below is a timeline of the *Arlington County Multifamily Program – Loan Portfolio Management Procedures and Guidelines*.

Date	Event Description
September, 2015	Arlington County adopted the Affordable Housing Master Plan, which is an element of the Arlington County Comprehensive Plan. The Affordable Housing Master Plan was developed as the County’s long-range vision for addressing housing needs through 2040, and defines the County’s housing policy. The Affordable Housing Master Plan is reviewed and revised as necessary at least once every five years to account for changing conditions within and beyond the County.
June, 2017	Arlington County engaged CliftonLarsonAllen to perform agreed-upon procedures in accordance with attestation standards established by the American Institute of Certified Public Accountants, for the purpose of assisting the County’s Community Planning, Housing, and Development Department with respect to the Affordable Housing Investment Fund Multifamily Housing Loan Portfolio of Arlington County through December 31, 2016, and issued a report thereon, dated June 30, 2017.
January, 2018	Arlington County began utilizing the NOFA process. The County uses this process to evaluate and compare projects prior to selection which form the Housing Division’s Staff recommendations for the following fiscal year’s pipeline. Selections are determined through an administrative process conducted by the Housing Division. The Housing Development, Finance, and Community Planning teams within CPHD each score appropriate sections of the applications.
May 31, 2020	Arlington County executed an update of policies and procedures based on current practices.

Background, Objectives and Approach (Continued)

Objectives and Approach

Objectives

AHIF loan administration encompasses all active loans administered under AHIF. Although certain aspects of the County's affordable housing loan administration function are centralized within the Housing Division, some of the functions such as, disbursement approval and general ledger account code administration are facilitated by other departments.

The audit period was July 1, 2019 to June 30, 2020. The objective of this internal audit was designed to assess whether the system of internal controls are adequate and appropriate, for effective loan administration processing.

A sample of six (6) loan files were tested for loan set-up and payment processing and seven (7) loans were tested for loan monitoring during the audit period. We tested loans for appropriate documentation relating to all documents and transactions during the period under review.

Approach

Our approach consisted of the following three phases:

Understanding and Documentation of the Process

The first phase of this audit consisted primarily of inquiry and walkthroughs, in an effort to obtain an understanding of the key personnel, risks, processes, and controls relevant to the objectives outlined above. The following was performed as a part of this phase:

- Conducted interviews with the appropriate representatives to discuss the scope and objectives of the audit work, obtain preliminary data, and establish working arrangements;
- Conducted interviews with key personnel to obtain a detailed understanding of the in-scope process(es);
- Reviewed the applicable policies and procedures and agreements related to this project;
- Performed walkthroughs to gain an understanding of the function and assess the design of internal controls; and
- Reviewed the applicable prior AHIF audit report to identify relevant observations and remediation steps.

Evaluation of the Design and Effectiveness of Process and Controls

The purpose of this phase was to test compliance and internal controls. Our fieldwork testing was conducted utilizing sampling and other auditing techniques to meet our audit objectives outlined above. The following was performed as a part of this phase:

- Gathered background information on process and controls related to the County's AHIF payment processing and related areas;
- Tested controls related to the following areas including payment processing and areas that directly and indirectly impact payments:
 - Payment processing – validated required payments are accurate, and are in compliance with AHIF guidelines and industry best practices;
 - Loan closing – validated evidence of required documentation;
 - Loan setup – validated verification of accurate and complete loan data within the system of record and evidence of data integrity reviews;
 - Loan administration – validated that adequate servicing actions are being adhered to and reflected in the system of record in alignment with industry best practices, including annual financial monitoring reviews, annual operating budget reviews, on-site financial monitoring reviews, and compliance / tenant income reviews.

Background, Objectives and Approach (Continued)

Objectives and Approach (Continued)

- Assessed adequacy and compliance with the safeguarding and retention of loan documents;
- Assessed adequacy of applicable asset management monitoring and oversight to validate preservation of collateral and financial interest;
- Gained an understanding of the status and details of staff efforts related to two recommendations, which resulted from a prior AHIF audit and assessing the adequacy of implemented efforts; and
- Assessed for process improvement recommendations, if any.

Status of prior audit recommendations

The following is a status report on the recommendations noted in the AHIF agreed upon procedures report dated June 30, 2017 as performed by a third party. No observations were identified as part of the 2017 AHIF audit, but the auditor provided opportunities to strengthen certain internal controls. The below status notes the progress made toward plan completion, as reported during our review. Through interviews with management and staff and internal control testing, the accuracy of the reported progress was verified and is reported as “Complete”, “In-Process” or “Open”.

Current Status					
	Prior Observation	Complete	In-Process	Open	Reference
Observations	<p>Project and Loan Servicing Setup Worksheets</p> <p>“The Arlington County Multifamily Loan Program Loan Portfolio Management Procedures and Guidelines (the Guidelines) contain instructions for the various processes in the loan cycle including underwriting, fund disbursement, loan filing, annual borrower requirements and oversight procedures. In addition to these procedures we recommend creating worksheets to document the performance and review of these processes. In addition to providing an audit trail of procedures performed it will also act as a guide for others to perform the procedures in the event of extended staff absences or the loss of a staff person.</p> <p>For instance, a file setup worksheet similar to Appendix A could be used to guide the creation of project loan files and the setup of electronic records in PRISM and ATRACK. For instances, ATRACK requires certain loan information in order to calculate accrued interest and repayment amounts. The worksheet should incorporate those procedures included in the Guidelines and provide a place for staff to sign and date upon completion. An area for a reviewer signature and date is also recommended to document the approval of the loan file creation and ensure all necessary information was uploaded electronically. Upon completion this checklist would remain in the project loan file.”</p>	X			<p>An Excel based “File Setup Worksheet” has been created to confirm the contents of the hardcopy file, electronic file, and loan information in ATRACK.</p> <p>We selected a sample of six (6) loans and verified that the “File Setup Worksheet” had been utilized; no exceptions were noted.</p>

Background, Objectives and Approach (Continued)

Objectives and Approach (Continued)

Status of prior audit recommendations (continued)

Current Status					
	Prior Observation	Complete	In-Process	Open	Reference
Observations	Annual Monitoring Worksheets “The Housing Division should create a formalized standard checklist to use for the desktop review of each project to ensure similar information is reviewed for each project. The desktop review should be performed by one person who completes, signs and dates the checklist. A separate person should review the file and sign/date the checklist as a reviewer. Suggested minimum information to include on the checklist: <ul style="list-style-type: none"> • Date audited statements submitted • Type of opinion on financial statements (unmodified, modified, adverse) • Net assets (current year and prior year) • Net income (current year and prior year) • Net increase/decrease in cash (current year and prior year) • Indicate whether owner submitted insurance certificate listing County as an additional insured • Calculation of loan repayment based on terms of loan agreement and the current year financial statements. Compare this amount to the amount received from borrower” 	X			An Excel based “Annual Monitoring Worksheet” has been created to confirm that all required annual monitoring information has been received, reviewed, and reconciled where appropriate. The information is forwarded to the Housing Director, Finance and Operations Manager, and Development Director once completed. We selected a sample of seven (7) loans and verified that the “Annual Monitoring Worksheet” had been utilized; no exceptions were noted.

Background, Objectives and Approach (Continued)

Objectives and Approach (Continued)

Reporting

At the conclusion of this audit, we vetted the facts noted during the audit with the appropriate Stakeholder(s) and then prepared a draft report. The draft report was submitted to the appropriate Stakeholder(s) for review. An exit meeting was held with the Stakeholder(s) and RSM to formally review and discuss the draft report and modify accordingly. The report was finalized upon authorization from the Department of Management and Finance.



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