

2013 State of Hawaii Auditors Report Summary
Summarized June 2013 for Policy Center Work Sessions
Management & Financial Audit of Homestead Services Division at DHHL

*As of June 30, 2011, there were 9,922 homestead leases statewide and 26,170 applicants waiting for homestead leases.
State Auditor, 2013*

As of June 2012, the combined outstanding amount for all 4,897 loans reported by DHHL was \$589 million. Insured loans constituted the largest single category of loans, accounting for 3,135 loans totaling \$471 million, nearly 80% of the outstanding amount. Direct loans, including reassigned loans, totaled \$79 million and guaranteed loans totaled \$39 million.

*Commissioner responsibilities are not clearly defined and commissioners lack data and analysis of loan obligations. As of June 2012, DHHL loan obligations totaled more than \$588 million, of which \$83 million is delinquent and could pose a solvency risk to DHHL finances.
State Auditor, 2013*

Previous Findings from 1993 & 2002 Reports

In 1993, our Audit of DHHL, Report No.93-22 found that neither the HHC nor DHHL had effectively carried out its responsibility under the HHCA to return native Hawaiians to the land. Our findings included: 1) HHC had not given sufficient policy direction and had not exercised necessary oversight to hold DHHL accountable; 2) DHHL lacked written policies and formal plans to direct its programs and had not developed effective management systems; 3) DHHL's collection on delinquent loans was poor; and 4) DHHL had assumed potential liability that exceeded statute limit.

*In 2002, we reported in our Audit Report No 02-13, deficiencies specifically related to the HSD, which included: 1) information on applicants not always current or accurate; 2) DHHL ineffective in managing outstanding loans and written collection policies not enforced; 3) loan guarantees were not properly monitored; and 4) beneficiaries still waiting for homesteads.
State Auditor, 2013*

Findings in the 2013 Report

Hawaiian Homes Commission

1. Commission fails to meet its fiduciary obligations through its inattention to loan risk guidance;

Department of Hawaiian Home Lands

2. DHHL's lax management of lessee loans undermines its ability to serve all beneficiaries.

*We found that the Commission, as a whole, may not fully understand its role as fiduciary and that individual commissioners are ill-prepared to perform their duties. The roles and responsibilities of the Commission are not clearly defined and the Commission lacks tools to aid in prudent trust administration.
State Auditor, 2013*

DHHL's delinquent loans are increasing in number and amount, posing a solvency risk. However, the extent of delinquent loan risk is not reflected in DHHL reports to the Commission. State Auditor, 2013

There was no mention of risk, risk appetite, risk management or risk tolerance in DHHL's strategic plans covering 2003-2017. In fact, we found the Commission's role in the DHHL strategic planning process has been limited to giving approvals rather than setting strategy, goals and objectives. State Auditor, 2013

DHHL lacks a tracking system to monitor contested cases and therefore is not monitoring delinquent lessee's compliance with Commission orders. There are no policies and procedures for monitoring compliance. As a result, DHHL cannot assure compliance with commission orders. State Auditor, 2013

Recommendations Made in the Report

Regarding Commission

1. Fulfill role as fiduciary by acknowledging and mitigating loan risk.
 - a. Adopt and communicate a risk management plan that includes an appropriate risk appetite to support a sustainable direct loan program;
 - b. Adopt and disseminate guidance through policies and procedures and performance goals relating to direct loan issuance, delinquent loan collections and monitoring contested case hearing orders;
2. Comply with administrative rules requiring the exercise of such care and skill as a person of ordinary prudence would exerciseincluding cancelling leases where loans are not in compliance with commission orders.
3. Clarify administrative rules relating to the oversight authority of the Commission and that delegated to the Chair of the Commission (and also the Director of DHHL).

Commission members need more support and written guidance if they are to fulfill their role as an executive board and administer the trust properly. The Commission's lack of written policies was also identified in our 1993 Audit of DHHL. State Auditor, 2013

.....we found that DHHL has not compiled the HHC policy decisions; in fact, DHHL has provided few written documents to support and guide commissioners in setting policies and overseeing DHHL's programs and the land trust. State Auditor, 2013

Regarding DHHL

1. Loan Origination. Adopt a manual that provides firm criteria for reviewing and approving loan applications including policy and procedures requiring a risk rating and credit counseling for each loan applicant;
 - a. Ensure loan officers adhere to trust responsibilities by adequately analyzing applications and only recommending loans for applicants that are financially capable;

DHHL's documented policies and procedures show, and our interviews confirm, that the Commission lacks strategic perspective on loan risk by having neither articulated a risk appetite nor adopted loan underwriting or policies for direct, guaranteed and insured loan obligations or monitoring loans. State Auditor, 2013

2. Loan Reporting to Commission. Adopt and implement reporting methods that bring loan delinquency issues to the attention of the Commission.
 - a. Coordinate resources of the Loan Services Branch and Fiscal Office to provide the commission with adequate information to make informed decisions on loan risk exposure;
 - b. Require the Fiscal Office and HSD to create a more effective report that would allow commissioners to quickly understand the true position of DHHL's direct loans. More financial information should be provided to commissioners, for a more complete picture of the status of delinquencies.

The Homestead Services Division's Loan Services Branch does not provide sufficient monthly delinquent loan totals or other data to the Commission and it has done no meaningful analysis of the direct loan program profitability.....State Auditor, 2013

Despite direct loan delinquency rates increasing during the past four years, DHHL has done little to highlight the problem to the Commission with individual reports on financial subjects. For example, Commission members would have to dig through and compare DHHL audited financial reports to learn of a nearly 50% increase in DHHL loan loss allowances to \$15.1 million from FY2009 to FY2011..... State Auditor, 2013

3. Delinquent Collection Procedures. Develop policies and procedures outlining the contested case hearing process including procedures on how DHHL carries out the Commission orders to ensure lessees comply with terms and conditions;
- a. Clearly outline the responsibilities of staff in collecting on delinquent loan related contested cases;
 - b. Establish policies and procedures and enforcement action for chronically delinquent lessees;
 - c. Re-institute clear written collection procedures for each phase of delinquency in order to avoid inconsistent practices among collection staff;
 - d. Document standards and objectives with respect to delinquent loan collections;
 - e. Require complete and accurate documentation of all collection activity, loan officers should properly file and maintain loan files in accordance with best practices;
 - f. Periodically review policies that govern income analysis and interest rates to determine whether they meet program goals;
 - g. Address delinquent loans in a timely manner recognizing loans of last resort are inherently more risky
 - h. Redefine how delinquent loans are characterized as 30, 60, 90, 120 days delinquent;
 - i. Customize automated delinquency reports to ensure management and commissioners receive critical information necessary for identifying deficiencies and weaknesses in delinquent loan collections and to promptly remedy them;
 - j. Adopt strategies or plans to address chronically delinquent accounts;
 - k. Formalize current unwritten payment plans and use salary assignments and garnishments;
 - l. Consider debt restructuring when repayment under current terms and conditions is doubtful;
 - m. Consider concessions like reducing interest rate, extending loan maturity, re-amortization and/or reducing accrued interest;
 - n. Clearly outline the responsibilities of the enforcement team in the monitoring of delinquent loan related contested cases;
 - o. Ensure information needed to obtain the status of each contested case is available and readily obtainable

The loan manual lacks detail and direction to guide loan specialists in determining whether an applicant can repay a loan.....the manual does not define 'satisfactory income and credit'. As vague as these rules are, we found that loan specialists often use their own judgment.
State Auditor, 2013

DHHL has vague policies and few standards governing its direct loans, including loans it underwrites directly as well as insured and guaranteed loans that have been reassigned to DHHL for delinquent collection.....DHHL also has weak internal controls governing loan collections and monitoring compliance with Commission orders and does not coordinate the oversight of either, resulting in a lack of accountability.....
State Auditor, 2013

DHHL and commission have not reassessed loan interest rates since 1995. In addition, an estimate used to calculate household expenses for determining loan eligibility has not been updated in a decade, meaning the branch may be underestimating the cost living and miscalculating lessee's ability to pay off loans.
State Auditor, 2013