

EAST BATON ROUGE
MORTGAGE FINANCE AUTHORITY



ADVISORY SERVICES REPORT
ISSUED OCTOBER 5, 2005

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August 24, 2005

**MR. RANDY BONNECAZE, CHAIRMAN,
AND MEMBERS OF THE BOARD OF TRUSTEES
EAST BATON ROUGE MORTGAGE FINANCE AUTHORITY**
Baton Rouge, Louisiana

We visited the East Baton Rouge Mortgage Finance Authority (Authority) to determine the propriety of allegations received by my office. During our visits, we also reviewed certain procedures and practices of the Authority.

This report focuses on exceptions and deficiencies relating to the fiduciary responsibility of the Board of Trustees (Board). Attachment I provides our findings and recommendations resulting from our assessments for consideration by the Board. The response from the chairman is presented in Appendix A and the response from the East Baton Rouge Parish Mayor-President is presented in Appendix B.

Our findings and recommendations are intended to improve controls over financial operations, provide advice in implementing good business practices, and ensure compliance with state laws. However, the Board should consider the costs of implementing our recommendations compared to the benefits they will provide. This assessment is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Respectfully submitted,

Steve J. Theriot, CPA
Legislative Auditor

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The East Baton Rouge Mortgage Finance Authority (Authority) is a municipal public trust which was created, organized, structured, and empowered by written instrument (trust indenture) on August 14, 1974, pursuant to the provisions of the Louisiana Public Trust Act (Louisiana Revised Statute 9:2341, et seq.).

Article 1.1 of the trust indenture states that the purposes of the Authority is to promote and provide financing of residential housing, development, and rehabilitation, both single-family and multi-family, in accordance with and in furtherance of the needs of the beneficiary, its agencies and instrumentalities, in order to promote the health, safety, welfare, and economic well-being of the inhabitants, residents, and citizens of the Parish of East Baton Rouge, Louisiana (parish).

However, to date, the Authority has not offered any financing programs related to multi-family housing. The Authority has only provided citizens of the parish with financing programs related to single-family residential housing.

The trust indenture names the parish as the beneficiary and provides, in part, that the parish has no legal title, claim or right to the funds, property, et cetera, of the Authority, its income, or to any part thereof, or to demand or require any partition or distribution. It further provides that the parish, prior to the termination of the Authority, is entitled solely to the benefits as administered by the board of trustees (Board), and upon termination, will receive the residual.

As opposed to how other municipal public trusts are operated in Louisiana, the entire administration/operation of the Authority is privatized/contracted to a third-party (Financial Consulting Services, Incorporated or FCSI). Since operations began in 1979, FCSI has been the sole “turnkey” administrator and agent of the Authority.

For the five-year period from January 1, 2000, through December 31, 2004, the Board paid approximately \$3.42 million (average of \$684,000 per year) to FCSI to “be” the Authority. The Board’s current contract/agreement with FCSI extends to December 31, 2006.

Although FCSI is referred to as the “program administrator” of the Authority, its role is more encompassing than the traditional role of a program administrator. FCSI provides and maintains the official public office of the Authority and its other primary responsibilities include (1) the day-to-day administration, including program administration; (2) administrative staff support for the Board and its committees; (3) bookkeeping and computer services; (4) general office administration; and (5) the development of each new bond issue and loan program.

The Authority generally issues 30-year tax-exempt mortgage revenue bonds (debt) in the market to obtain funds to provide below market interest-rate loans to first time homebuyers. The bond funds are primarily used to purchase 30-year fixed-rate mortgage loans (assets) that are securitized/backed by the Government National Mortgage Association (Ginnie Mae) or the Federal National Mortgage Association (Fannie Mae). Area lending institutions are responsible for taking loan applications, making loan commitments, and holding loan closings. The Authority contracts with a mortgage servicing company to “service” (collect and remit monthly principal and interest payments) the individual loans.

EAST BATON ROUGE MORTGAGE FINANCE AUTHORITY

In 26 years (1979-2004) of operations, the Authority has sold approximately \$983 million in bonds of which \$839 million of the proceeds have been used to provide 14,072 low-interest mortgage loans, an average of 541 loans per year. The Board approves all bond issues of the Authority. Also, the Louisiana State Bond Commission approves each bond issue, which includes disclosure of the professionals hired (bond counsel, underwriter, financial advisor, et cetera) and fees to be paid in connection with the issuance of the bonds. Bonds are solely the obligations of the Authority and not of the state of Louisiana or the parish (beneficiary).

At December 31, 2004, the unrestricted net assets (surplus) of the Authority totaled approximately \$28 million which is significantly more than any other Louisiana municipal public trust. Earnings of the Authority are generated primarily from investments, including mortgage-backed securities and mortgage loans and from fees (“Authority Fees”) charged to homebuyers in the form of an increased interest rate on their mortgage loans. Neither the parish nor the state appropriate or provide funds to the Authority.

Board of trustees composition. The affairs of the Authority are overseen by nine trustees who are required to be residents of the parish. Trustees serve six-year terms and are eligible for reappointment for additional terms. At the end of a term of a trustee, a successor is nominated by the mayor of Baton Rouge (chief executive officer of the parish) and approved/appointed by a majority of the East Baton Rouge Parish Metropolitan Council (governing body of the beneficiary). Trustees serve without compensation; however, they receive a \$200 per diem and reimbursement for expenses incurred in the performance of their duties as trustees.

Currently, the Board is comprised of the following individuals:

Trustee Name	Title	Tenure
Randy Bonneau	Chairman	13 years
Astrid Clements	Vice-Chairman	20 years
Loretta Pourciau	Secretary-Treasurer	8 years
Jake Netterville	Previous Chairman (1998-2001)	19 years
Robert “Bobby” Gaston, III		23 years
William “Billy” Gauthier		23 years
Sidney Longwell		19 years
Jacqui Vines		3 years
Steve Hicks		8 months

In addition, to ensure effective liaison with the beneficiary and to ensure public disclosure of the operations of the Authority, the trust indenture requires the parish attorney and parish finance director (or their respective designated representatives) to serve as ex-officio, non-voting members.

Findings and Recommendations

The following are the findings and recommendations relating to our assessments. The recommendations are presented to improve the controls that safeguard, manage, and account for assets of East Baton Rouge Mortgage Finance Authority (Authority) and ensure compliance with applicable state laws. However, the Board of Trustees (Board) should consider the costs of implementing these recommendations compared to the benefits they will provide. For those recommendations not implemented, the Board should be aware of the risks of not implementing such controls.

The chairman's response to our findings and recommendations is included as Appendix A and the East Baton Rouge Mayor-President's response is included as Appendix B.

No Written Strategic Plan

The Board controls \$28 million of unrestricted net assets (surplus) and does not have a formal/written strategic plan for both short-term and long-range goals of the Authority. A strategic plan provides a vision to determine current and future priorities for operating the Authority and creates shared commitments between the Board and public regarding the goals and strategies required to appropriately address the priorities.

Recommendation: We suggest that the Board, as trustees in their fiduciary capacity, develop and adopt a written strategic plan that includes the objectives for both short-term and long-range goals for the Authority. The Board should monitor the plan on a periodic basis and use the plan in decision-making processes and for budgeting (e.g., programs to undertake, et cetera).

No Errors and Omissions Insurance

The Board has no insurance coverage to defend the Authority from potential liability claims arising from errors and omissions of its trustees. In addition, the chairman, vice-chairman, and secretary/treasurer are not covered by a fidelity bond as required by Louisiana Revised Statute 9:2343A(2).¹ Sound business judgment requires the Board, in its fiduciary capacity, to minimize any potential risk of loss to the Authority.

Recommendation: We suggest that the Board explore the marketplace for errors and omission insurance coverage options for trustees. We also suggest that any trustee (e.g., chairman, vice-chairman, and secretary/treasurer) who is a signatory on checks or who can authorize the transfer of funds be covered by an adequate fidelity bond in accordance with state law.

¹ Louisiana Revised Statute 9:2343A(2) requires every trustee, officer, and employee of a public trust who handles funds of a public trust shall furnish a good and sufficient fidelity bond in an amount and with surety as may be specified and approved by a majority of the trustees, such bond to be in a surety company authorized to transact surety business in the state. The trustees may, at their election, purchase good and sufficient fidelity bonds.

Administrator/Agent

The Board has not provided an open and competitive atmosphere in its process of awarding the administrative and agent work of the Authority. Also, the Board failed to exercise its fiduciary responsibility in a prudent manner by not fully protecting the interests of the Authority under its current contract with the administrator/agent.

Selection Process

In 1979, without seeking competitive bids, the Board appointed Financial Consulting Services, Incorporated (FCSI) to be the administrator and agent of the Authority. Since 1979, the Board has continually extended the contract without seeking competitive bids for the work. Although there is no legal requirement to competitively bid such services, the Board has a fiduciary responsibility to ensure that an open and competitive atmosphere is always provided when contracting out work of the Authority.

For example, in 1992, the Board approved a *Master Program Administration Agreement*, which consolidated the duties and responsibilities of FCSI, and in 1996, it approved the current *Amended and Restated Master Program Administration Agreement* (contract), all without seeking competitive bids.

In 1996, the Board's fiduciary responsibility was compromised by exercising influence in directing this public work to a specific group of private individuals. Without an open and competitive process, the public cannot be assured that all services are necessary and that they are being performed in the most cost-effective manner possible.

- In the 1996 contract, the Board dictated that the failure of FCSI to be sold to three specific individuals on or before June 1, 2000, would be cause for termination of FCSI's existing contract. In strict accordance with the contract, Dr. William D. Ross, Jr., President of FCSI, sold FCSI to his son (15% ownership interest to William D. Ross, III), to the Board's financial advisor (60% ownership interest to Michael G. McMahon), and to a third individual (25% ownership interest to Victoria M. Theriot).

Contract

The Board contracted the entire administration/operation of the Authority without retaining adequate control to ensure FCSI's accountability as follows:

- The contract fails to require FCSI to be accountable to the Board for the expenditure of the public funds paid it (\$628,331 in 2004) to operate the Authority. As such, the contract fails to provide an adequate system of checks and balances. Without FCSI providing a detailed breakdown of its expenditures to the Board, the Board cannot ascertain the nature or the reasonableness of the fees it pays FCSI to "be" the Authority.

We made four unsuccessful attempts to ascertain the nature and costs of operating the Authority as follows:

- April 28, 2005, verbal request to the vice president of FCSI
- May 19, 2005, verbal request to the president of FCSI
- June 1, 2005, letter to the president of FCSI
- July 22, 2005, verbal request to the chairman for assistance

In our June 1 letter, we also asked the FCSI president to provide us with certain other information, including details on what employees of FCSI, including himself, work on behalf of other entities, including the time spent on business of the Authority and on business of other entities.

On June 22, Mr. Michael McMahon, President of FCSI, provided us with his written responses to our letter; however, he did not provide us with the nature and costs of administering the Authority nor did he provide us any information on the time spent on business of the Authority and on business of other entities. Mr. McMahon stated, in part, “The Master Program Administration Agreement between FCSI and the Authority does not require any such revelations to the Authority, and counsel advises that it is inappropriate for a staff member of the Legislative Auditor to request FCSI’s private financial records especially since such disclosure would breach obligations which FCSI owes its employees.”

Also troubling was the chairman’s refusal to assist us in trying to obtain the records from FCSI. In a principal-agent relationship, the agent assumes an obligation of loyalty to the principal. The fiduciary relationship of trust between the Board and FCSI is unlike the relationships between the Board and other professionals (e.g., bond counsel, underwriters, et cetera). As the “turnkey” administrator/agent, FCSI has a continuing fiduciary relationship with the Authority, whereas other professionals are hired and paid on an “as needed” basis.

Although the 27-page document provided to us is a 5-year “evergreen” (renewed annually) contract, the chairman informed us that it has been reduced to a 3-year evergreen contract. As we read through the Authority’s current contract with FCSI, we found the following additional deficiencies:

- Although the contract requires an annual performance evaluation of FCSI, it does not provide the specific performance criteria or goals and objectives for which FCSI is to be evaluated by the Board. Furthermore, the Board does not prepare its own independent evaluation of FCSI’s performance. Rather, FCSI prepares a self-evaluation and submits to the Board.

- The compensation provision of the contract is burdensome as it requires prolonged recordkeeping and onerous recurring computations of certain fees for the duration of bond issues and mortgage loans which can extend up to 30 years.

It does not appear reasonable for the Authority to continue paying fees to FCSI, for up to 30 years, when the majority of the loan administration work is done during the first two years of a bond issue (when mortgage loans are originated by lenders and sold to the loan servicing company). Two of the four components that comprise the total fees paid to FCSI are “Mortgage Loan Administration” and “Computer Services” and are summarized as follows:

Mortgage Loan Administration

In 2004, FCSI was paid \$293,339 (average of \$24,445 per month and 47% of the total fees paid to FCSI) for loan administration services. According to the contract, FCSI is responsible for requiring the lenders and the master servicer to perform all services and duties that are customary to the origination and servicing of mortgage loans.

This recurring fee varies each month because it is computed on the outstanding principal amount of mortgage loans in all active/outstanding bond issues. At December 31, 2004, there was approximately \$163 million of outstanding mortgage loans in 25 outstanding bond issues dating back to 1984 (21 years ago).

Computer Services

FCSI is paid to maintain computerized data on all mortgage loans originated under the bond programs. In 2004, FCSI was paid \$58,868 (average of \$4,905 per month and 9% of total fees paid to FCSI) for computer services. This recurring fee is computed based on the number of loans originated in each bond program.

For as long as each bond issue is active/outstanding (up to 30 years), FCSI is paid a fee of \$0.40 per month per mortgage loan originated, regardless of whether the loan was subsequently sold or paid off. At December 31, 2004, there were 2,989 loans originated in 25 outstanding bond issues dating back to 1984.

- The contract fails to set forth a definitive or maximum annual amount to be paid to FCSI; therefore, the Board can only estimate the amount of public funds that will be paid each year to administer the Authority.

Furthermore, the contract details the duties/roles to be performed by FCSI; however, it does not set forth a separate fixed fee for each role. Without itemizing the fees for each specific role performed, the Board cannot compare and ascertain whether fees paid FCSI are reasonable in the marketplace.

Certain roles are grouped and identified in the contract as “Board Staff Administration” services. The Board and the president of FCSI negotiate a fixed fee for all of the services combined. In 2004, the Board paid \$213,436 to FCSI (average of \$17,786 per month and 34% of total fees paid to FCSI) for the following:

- Providing and maintaining the official office of the Authority
 - Providing administrative staff support for the Board and committees
 - Providing general office administration
 - Providing accounting/bookkeeping services
 - Providing public and governmental relations services
 - Promoting programs through homebuyer seminars
 - Representing the Authority on various task forces and housing groups
 - Providing supervision of performance of trustee
 - Providing advice and counseling on Board policies
 - Providing advice on investments and administration of capital account
 - Providing administration of the operating account
- Although FCSI is paid a substantial amount of money to provide and maintain the official office and perform all administrative functions, the contract does not provide any benefit to the Authority for FCSI’s use of the office and resources (e.g., staff, supplies, et cetera) for work it does for other entities.

FCSI does not work exclusively as the Authority. From the Authority’s office in Baton Rouge, FCSI also provides services (e.g., loan compliance agent and bookkeeping services) for other entities. However, we were unable to determine the percentage of time spent by FCSI on other work because the president refused our requests for such information (see finding, *Administrator/Agent*).

- The contract does not require FCSI to routinely solicit requests for proposal (RFPs) for professional services (e.g., bond counsel, underwriter, et cetera) needed for bond/securities issues. FCSI only solicits RFPs for mortgage servicing services. Although there is no legal requirement to solicit RFPs for professional services, the Board has a fiduciary responsibility to ensure that an open and competitive atmosphere is always provided.
- The contract does not require FCSI to develop a written disaster recovery/business continuity plan (plan) for the Authority. As such, FCSI has not developed a plan. The Board has a fiduciary responsibility to reduce the risk that untimely or excessive delays in processing data may occur and that data may be lost if FCSI is unable to continue operations of the computer system or office in the event of a disaster.
- The contract does not require FCSI to ensure the public's access to the Authority. The Authority (1) has no telephone number listed in its name; (2) is not publicized in the telephone book; (3) is not listed as a tenant on the lobby directory of the office building; and (4) has no e-mail address or Internet presence.

Recommendation: We suggest the Board terminate the contract because FCSI, as appointed agent of the Authority, refused to be accountable to the Board and public for the expenditure of public funds paid it to administer the Authority.

In the future, if the Board chooses to contract out administrative services, it should competitively bid this administration and require the winning bidder to be fully accountable to the Board. It is further recommended that the Board only enter into contracts that adequately protect the interests of the Authority and public.

Comparison of Fees

We compared the fees paid to FCSI with the fees paid by a comparable Louisiana municipal public trust. Our comparisons revealed, without an apparent explanation, that the Authority paid \$364,686 (58%) more for services in 2004. The Board has a fiduciary responsibility to apply sound business practices in managing funds of the Authority in the most cost-effective manner possible.

Selection of Comparable Municipal Public Trust

In terms of total assets, the three largest Louisiana municipal public trusts are the Finance Authority of New Orleans, the East Baton Rouge Mortgage Finance Authority, and the Parish of Jefferson Home Mortgage Authority. Since our objective was to compare fees/costs paid for similar services, we assessed the operations of each of them to determine the similarity of their work/services performed in 2004.

FINDINGS AND RECOMMENDATIONS

Our assessments revealed that the Authority's operation in 2004 was very similar and comparable to the operation of the Parish of Jefferson Home Mortgage Authority (Jefferson). In 2004, the work of both the Authority and Jefferson were confined to providing one program to its citizens, the financing for single-family residential housing.

By contrast, the operation of the Finance Authority of New Orleans (FANO) in 2004 involved much more than a single-family bond program. As an example, FANO's operation included administering/operating two related nonprofit corporations [a 501(c)(3) created in 1993 and a 501(c)(25) created in 2003] that help low-income families, one of which was involved in a multi-family housing (263 unit apartment complex) restoration project. Also, FANO did not allocate its direct/overhead (labor, fringe benefits, et cetera) costs or indirect costs among the various programs administered nor did it separately account for the sole costs of administering its single-family bond program.

Therefore, based on our assessments of operations, it appears reasonable that the fees paid to FCSI only be compared with the fees paid by Jefferson. A brief summary of the similarities of the Authority and Jefferson is as follows:

	Authority	Jefferson
Programs provided/administered	Single-Family Bond Program	Single-Family Bond Program
2004 bond issue	\$25 million	\$20 million
Number of bond issues (since inception-1979)	25	24
Number of employees	5 (FCSI staff)	4 (parish employees)
Parish population (2000 census)	412,852	455,466
Loans originated (since 1979)	\$839 million	\$642 million
Total assets (FY 2004)	\$331 million	\$219 million
Total operating revenues (FY 2004)	\$14 million	\$8 million
Total operating expenses (FY 2004)	\$16 million	\$11 million

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Comparison

As mentioned previously, we were unsuccessful in obtaining a detailed breakdown of expenditures of the public funds paid to FCSI to operate the Authority. In 2004, the Board paid \$628,331 to FCSI compared to \$263,645 paid by Jefferson for similar services as summarized below:

	<u>Authority</u>	<u>Jefferson</u>
Fixed Costs		
Loan administration	\$293,339	
Board staff administration	213,436	
Computer services	58,868	\$1,088
Salaries		151,741
Retirement		18,133
Rent - office		17,160
Insurance and taxes		14,364
Rent - equipment		4,021
Supplies		3,329
Repairs and maintenance		2,499
Printing		2,280
Postage		2,022
Miscellaneous		1,789
Telephone		1,735
Furniture and equipment		1,379
Dues and subscriptions		605
Total Fixed Costs	<u>565,643</u>	<u>222,145</u>
Variable Costs		
Program development	62,688	
Loan administration		20,500
Loan Compliance Underwriting		21,000
Total Variable Costs	<u>62,688</u>	<u>41,500</u>
Total Costs	<u>\$628,331</u>	<u>\$263,645</u>

The above comparison reveals that the fixed costs of the Authority are not within what appears to be a reasonable range of the fixed costs of Jefferson. This is concerning because fixed costs are paid year after year regardless of whether a new bond/loan program is implemented. By contrast, variable costs are paid only when there is a new program.

Also contrary to the Authority, Jefferson does not pay fees for program development. In fact, we are not aware of any other Louisiana municipal public trust paying such fees. Under the Board's contract with FCSI, program development is defined as services associated with the planning, development, and implementation of new qualified mortgage bond programs. FCSI is paid a one-time fee equal to 0.15% (15 basis points) of the original principal amount of the funds deposited into the acquisition fund for the purchase or origination of new mortgage loans. For example, a \$25 million bond issue generates a program development fee of \$37,500 (\$25,000,000 x 0.15%).

Furthermore, FCSI was paid \$293,339 (fixed cost) for loan program administration services compared to \$20,500 (variable cost) paid by Jefferson, a difference of \$272,839. As discussed previously (see finding, *Administrator/Agent*), the contract requires FCSI to be paid a recurring fee based on the outstanding principal amount of mortgage loans in all active (new and existing) bond issues. Unlike the Authority, Jefferson does not pay recurring fees on existing/old loans. Jefferson contracts out loan administration for new programs only and pays a "one-time" fee.

Recommendation: We suggest that the Board explore the costs (fixed and variable) and benefits of obtaining office space and employing its own staff to perform the administrative work, bookkeeping services, et cetera, of the Authority.

Lack of Independence

The Board failed to obtain independent advice on the reasonableness of fees paid to FCSI in connection with bond/securities issues.

In addition to FCSI performing all administrative/agent duties of the Authority, the president of FCSI individually served as the Board's financial advisor in bond issues, a dual role/relationship that is a clear conflict. During the 4½-year period from January 2000 to July 2004, the president of FCSI received fees totaling \$206,056 for his separate role as financial advisor.

Although the Board formally approved CSG Advisors, Inc., (CSG) as its financial advisor in bond issues and disclosed CSG as such to the Louisiana State Bond Commission, it was Michael McMahan, President of FCSI, who primarily provided the services to the Board and who was the ultimate recipient of the fees paid by the Authority during the 4½-year period. The president of CSG told us that Mr. McMahan was not an employee of CSG but that there was an "affiliation" arrangement with him. Mr. McMahan told us his relationship with CSG began in April 1999 and ended in July 2004. Mr. McMahan, who acquired his majority ownership interest in FCSI in 2000, told us he had been the Board's financial advisor since 1992 and that the Board was aware of his affiliation with CSG from the beginning. Mr. McMahan said he received 100% of the gross fees for his work as financial advisor. He said that the first couple of CSG checks issued by the Authority were sent to CSG for endorsement and then forwarded to him. He said the practice of sending the checks to CSG for endorsement was stopped and the CSG checks issued thereafter (during the period) were deposited into his bank account. However, throughout the 4½-year period, the Board continued to approve and disclose/report CSG as its financial advisor in bond/securities issues.

As financial advisor, the president of FCSI clearly lacks the independence to provide advice to the Board on the reasonableness or necessity of his company's fees. A financial advisor's primary responsibility is to provide advice on all financial matters pertaining to a proposed bond/securities issue. Therefore, the president of FCSI as financial advisor is responsible for advising the Board on the reasonableness and necessity of all fees, including the fees (program development fees, loan administration fees, and computer service fees) to be paid to his company that are generated by the bond issues.

Recommendation: For a proper system of checks and balances, we suggest that the Board obtain independent advice on the reasonableness of all fees generated and paid in connection with bond/securities issues.

Lack of Controls Over Certain Payments To FCSI

There was a lack of controls over certain payments made to FCSI in 2003 and 2004 as follows:

Travel Reimbursements

The chairman authorized travel reimbursement payments to FCSI, although travel costs are not a part of the contract. There was no formal approval by the Board nor was there a resolution passed amending the terms of the contract with FCSI.

FCSI was reimbursed \$7,940 for certain travel costs incurred in 2003 and 2004. The Authority reimbursed FCSI for the travel costs incurred by its vice-president to attend four out-of-state conferences (Phoenix, Chicago, Orlando, and Memphis) sponsored by the National Association of Local Housing Finance Agencies (NALHFA) and to attend a bond closing in Atlanta, Georgia.

Recommendation: The Board should immediately cease paying travel obligations of FCSI. We suggest that the Board implement checks and balances to ensure that all future payments to FCSI are made in accordance with the contract.

Financial Advisory Services

In the 2004 bond issue, the chairman authorized \$12,500 to be paid to FCSI for financial advisory services, services which are beyond the scope of the contract. There was no formal approval by the Board nor was there a resolution passed amending the terms of the contract with FCSI.

Furthermore, although the Board approved the *State Bond Commission Checklist* (checklist) that was submitted to the Louisiana State Bond Commission for approval, the checklist failed to disclose FCSI or its president as financial advisor. In addition, the \$12,500 financial advisory fee was incorrectly reported as program development fees on the checklist.

Recommendation: We suggest that the Board implement checks and balances to ensure that the *State Bond Commission Checklist* is complete and accurate without exception and that any future payments to FCSI are made in accordance with the contract.

Lack of Controls Over Travel by Trustees

There was a lack of controls over travel by certain trustees in 2003 and 2004 as follows:

Bond Closing

Authority funds totaling \$12,881 were spent unnecessarily for seven trustees to travel to Atlanta, Georgia, for a bond closing held on September 16, 2003. There was no documentation to substantiate the business necessity for seven trustees to travel and attend the closing or the necessity for five trustees to stay over three nights and two trustees to stay over two nights. The Board has a fiduciary responsibility to apply sound business practices in managing funds of the Authority in the most cost-effective manner possible.

Although bond closings are an important part of each bond transaction, only the participation of the chairman and secretary/treasurer is required and their physical presence at the closing is optional. Their participation is generally brief as they are only required to sign certain documents. We did not find a valid reason why the bond documents were not signed in Baton Rouge and delivered to bond counsel in Atlanta.

A summary of the unnecessary costs are as follows:

	<u>Cost</u>
Per diems	\$5,200
Lodging	4,180
Airfare	1,449
Auto mileage	615
Restaurants and lounge	612
Vehicle rentals	296
Parking	228
Taxi	120
Tips	103
Telephone	<u>78</u>
Total	<u>\$12,881</u>

We could not determine the nature of items purchased from the restaurants and lobby lounge because credit card slips were generally the only documentation submitted for these reimbursements.

Recommendation: We suggest that the Board exercise fiscal restraint by stopping the unnecessary travel to out-of-state bond closings. In addition, all travel reimbursements should be supported by detailed receipts supporting the business nature of the expenditures. Also, we suggest that the travel policy be amended to prohibit the reimbursement for alcohol purchases.

Conferences

There is no documentation to substantiate the business necessity or the cost benefit to the Authority for certain trustees' early travel or extended stay at conferences. Our review of three conference trips revealed that the Authority paid \$3,487 for additional lodging and per diems of certain trustees.

Although each of the conferences was held over a 3-day period, they were actually 2½-day conferences. Each conference meeting began on a Thursday morning and ended at noon on Saturday. Therefore, it is reasonable to expect that the Authority would pay for three nights (Wednesday, Thursday, and Friday) of lodging and expenses and that the trustee would return home on Saturday afternoon/evening.

A brief summary of the additional lodging and per diems paid in connection with the three conferences attended between November 2003 and October 2004 are as follows:

- Three trustees attended the NALHFA Fall Educational Conference held in Phoenix, Arizona, on November 13-15, 2003. Two of the trustees stayed four nights (November 12-15) at the conference hotel resulting in one extra day of lodging costs and per diem payments totaling \$803.
- Two trustees attended the Florida Association of Local Housing Finance Authorities Educational Conference training sessions held in Key West, Florida, on July 15-17, 2004. Both trustees stayed five nights (July 13-17) at the conference hotel resulting in two extra days of lodging costs and per diem payments totaling \$1,467.
- Three trustees attended the NALHFA Fall Educational Conference held in Chicago, Illinois, on October 14-16, 2004. All three trustees stayed four nights at the conference hotel resulting in one day of extra lodging costs and per diem payments totaling \$1,217.

Recommendation: We suggest that the trustees reimburse the Authority for the additional lodging costs and per diem payments. In the future, we suggest that documentation be provided by trustees, and maintained on file, to substantiate the business necessity for any early travel or extended stay at conferences. Travel that is unnecessary should not be paid by the Authority.

Unnecessary Per Diems

The Authority is paying unnecessary per diems as a result of committee meetings not being held on the same day as the monthly board meetings. The Authority pays \$200 per diems to trustees for attending board meetings and meetings of standing and special committees. The attorney general has generally defined “per diem” to mean “by the day.” The Board has a fiduciary responsibility to manage funds of the trust in the most cost-effective manner possible.

In 2004, the Authority paid \$21,800 to trustees to attend committee meetings, all of which could have been saved had the committees met on the same day as the board meetings. It does not appear to be burdensome for trustees to attend committee meetings and board meetings on the same day. We were informed that, on average, committee meetings last about 45 minutes and board meetings last about one hour. There are six committees and none met on the same day during the year. One committee (Loan and Program Review) meets monthly, one (Investment) meets quarterly, three (Nominating, Budget, and Audit) meet annually, and one (Executive) meets as needed.

Recommendation: In an effort to eliminate unnecessary per diem costs, we suggest that committee meetings and board meetings be conducted on the same day.

Grants

The Board may be providing grants for a purpose that is beyond the mission of the Authority. Furthermore, grants are not always supported by formal/written agreements. The Board has a fiduciary responsibility to disburse funds of the Authority in strict compliance with the Authority’s mission. Also, sound business judgment requires that grants be supported by a formal/written agreement that provides for the terms and conditions of the grant.

In 2005, without a written agreement, the Board committed funds totaling \$1.5 million to the Chamber of Greater Baton Rouge for economic development. However, although economic development is important, we did not find that the trust indenture specifically provides funding for economic development. Economic development generally relates to recruiting and retaining business and industry, whereas the mission of the Authority is to provide citizens of the parish with financing related to residential housing (single-family and multi-family).

The chairman informed us that the Board relied on the opinions of current and former legal counsel and on Louisiana Attorney General (AG) Opinion No. 93-87 in providing grants for economic development. However, reliance on the 1993 AG opinion may not be appropriate because it was case specific to the Rapides Parish Finance Authority whose trust indenture was amended in 1991 to specifically allow funding for economic development.

The Board also gave out grants totaling \$905,250 during the previous 13 years (January 1, 1992, to December 31, 2004) to the following organizations/individual without always entering into formal/written agreements:

Organization/Individual	<u>Amounts</u>
Boo Thomas - Plan Baton Rouge	\$334,675
Baton Rouge Area Foundation	274,075
Mid-City Redevelopment Alliance	150,000
Chamber of Greater Baton Rouge - Economic Study	58,000
Capital Region Competitive Strategy Study	50,000
Mid-City - Dillard's Property Appraisal	25,000
Plan Baton Rouge - Capitol House Appraisal	12,500
Mid-City Housing Fair	<u>1,000</u>
Total	<u>\$905,250</u>

Recommendation: We suggest that the Board consider amending the trust indenture to clarify and/or expand the mission and powers of the Authority. We also suggest that all grants be supported by a written agreement that provides for the specific terms and conditions of the grant.

Noncompliance With Trust Indenture

The Board failed to comply with certain trustee provisions of the trust indenture. Three violations of the trust indenture occurred as follows:

Non-Resident Trustee

In clear violation of the trust indenture, a trustee continued to serve and participate in the business affairs of the Authority after moving his residency outside the parish. Also, the Board has no formal reporting or monitoring procedures in place to ensure that each trustee is qualified to serve. Furthermore, the Board has a fiduciary responsibility to timely notify the mayor and council of a trustee's disqualification.

Mr. Henry "Hank" Henagan served as trustee for at least six years after he moved out of East Baton Rouge Parish. He resigned in January 2005. Mr. Henagan represented (signed affidavit) to the chairman that he moved his residency to East Feliciana Parish in January 1999. During the six-year period from January 1999 to January 2005, he was paid \$41,400 in per diems.

However, Mr. Henagan's representation of the date he moved (1999) is contrary to property tax records of East Feliciana Parish, which reflect that he maintained a residence homestead exemption in 1997 and 1998 (two years previous). He served as chairman in 1997 (served four years from January 1, 1994, through December 31, 1997); therefore, it is reasonable to question the legal status of bond and legal documents executed/signed by him on behalf of the Authority during the time he was apparently disqualified to serve on the Board.

FCSI's president and vice president informed us that they did not know the exact dates but that, in 2003 or prior, Mr. Henagan's change in residency was verbally communicated to the chairman and to the former bond counsel (resigned in May 2003). The chairman and previous chairman told us they did not recall any such communication from FCSI. The former bond counsel recalled receiving a telephone call from the vice president in the summer of 2002 relating to the issue. The former bond counsel also told us that he spoke to the chairman about the issue in March 2003. Both the current and previous chairman maintain they were not aware of Mr. Henagan's move prior to the issue being brought up in 2004 by the mayor's office.

Recommendation: Although the Board obtained an opinion from its legal counsel, we suggest that the Board request a formal opinion from the Louisiana Attorney General. The Board has a fiduciary responsibility to determine the legal status of bond/legal documents signed by Mr. Henagan during the period of his apparent disqualification, including board actions voted upon by him and legality of seeking reimbursement of per diems paid him during the period of disqualification.

Also, we suggest that the Board establish formal procedures to monitor the residency status of trustees to ensure compliance with the trust indenture. In addition, we recommend that the Board establish procedures for timely notifying the mayor and council (governing body of the beneficiary) of a trustee's disqualification.

Liaison

Prior to 2004, the East Baton Rouge Parish Attorney and Director of Finance did not serve as ex-officio, nonvoting trustees as required by the trust indenture.

Both the current and previous chairman told us that they were unaware of this requirement prior to the issue being brought up in 2004.

Disclosure of Operations

Prior to 2004, the Board failed to file written quarterly reports on the operations of the Authority with the East Baton Rouge Parish Clerk for distribution to the mayor and council members as required.

Both the current and previous chairman told us that they were unaware of this requirement prior to the issue being brought up in 2004.

Recommendation: We suggest that the Board enhance its disclosure to the parish (beneficiary) by requiring all proposed bond/securities issues of the Authority to be submitted to the East Baton Rouge Parish Metropolitan Council for approval.

Noncompliance With Bylaws

The Board's financial review of the operations of the Authority does not encompass a review and comparison of budgeted amounts to actual results on a quarterly basis as required by Article 6.1 of the Authority's bylaws. The bylaws provide for the orderly administration and regulation of the affairs of the Authority.

Recommendation: We suggest that the Board strictly comply with the Authority's bylaws and review a financial statement with budget comparisons on at least a quarterly basis.

Computer Backup Tape

The computer server is backed up daily; however, the backup tape is not taken offsite each day. Good controls require that financial records of the Authority be properly safeguarded. If not, in the event of a disaster (e.g., fire, flood, et cetera), financial records could be destroyed and not be readily reconstructed/replaced.

Recommendation: We suggest that the backup tape be taken offsite each day and kept in a secure place.

Chairman's Response

EAST BATON ROUGE MORTGAGE FINANCE AUTHORITY

8641 United Plaza Blvd., Suite 206
Baton Rouge, LA. 70809
225-922-5111 FAX 225-922-5114

September 30, 2005

Mr. Steve J. Theriot
Legislative Auditor
PO Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

As chairman of the East Baton Rouge Mortgage Finance Authority, I appreciate the opportunity to respond to your advisory services report on the operations of our organization. Our response is important as it affords us the opportunity to discuss how we will implement many of your recommendations as well as clarify and set the record straight on certain issues and conclusions reached by your office. On September 29, 2005, our Board of Trustees voted to approve the attached response without objection.

We understand that the purpose of an advisory services review is to provide constructive recommendations and enhancements to operating procedures and processes. We also understand that the purpose is not to comment on and recognize an entity's business practices that are operating very efficiently and in a fiscally responsible manner.

Our record of performance speaks for itself. The EBRMFA has:

- Provided over 14,000 low-interest mortgage loans to first-time homebuyers
- Been awarded an A3 bond rating by Moody Investors Services, Inc.
- Generated funds through the issuance of bonds that are solely the obligation of the Authority and not the State of Louisiana or the Parish of East Baton Rouge
- Accumulated an unrestricted surplus of approximately \$28 million

The primary emphasis of your report is your concern with our contract with Financial Consulting Services, Inc. (FCSI). Our response includes convincing documentation that our contract with FCSI is not only cost effective for the performance achieved, but also plays a major role in the high bond rating that we have earned from Moody's Investor Services, Inc. The A3 bond rating has provided us the means of obtaining excellent interest rates on our bonds sold, which in turn allows us to offer lower interest rates on loans to first-time homebuyers.

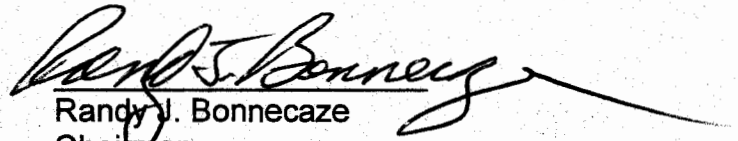
As outlined in our response, we will implement or consider the implementation of many of your recommendations. However, we strongly disagree with your recommendation to terminate our contract with FCSI and we have submitted convincing documentation of why this contract has brought great benefits to EBRMFA at responsible and competitive costs. We have also received legal opinions from three separate law firms that state termination of FCSI's contract could subject the EBRMFA to significant legal exposure and damages.

Mr. Steve J. Theriot
Legislative Auditor
September 30, 2005
Page 2

The decision to proceed with privatization of our operations was made in 1974 by the original Board of Trustees, which was comprised of some of the most outstanding civic, business, legal and labor leaders of our community. That original Board of Trustees made the decision to privatize as well as the decision to select FCSI as our program administrator. As you know, privatization of services is a direction in which many governments are moving, including our own City-Parish and Louisiana state governments.

The outstanding Board of Trustee members who helped launch EBRMFA to its successful start in 1974 and made the very prudent decisions that are now being questioned 30 years later were L.W. Eaton, Jr., Harvey Honore, Edward W. Stagg, the Rev. T.J. Jemison, Claude Kirkpatrick, James R. McDowell and Ira J. Woodfin. Anyone who has lived in Baton Rouge for a while knows the high caliber and civic mindedness of these gentlemen, most of whom are now deceased.

Sincerely yours,


Randy J. Bonnecaze
Chairman

Response of the East Baton Rouge Mortgage Finance Authority

To

Louisiana Legislative Auditor's Advisory Services Report

September 30, 2005

1) AUDITOR'S RECOMMENDATION: *We suggest that the Board, as trustees in their fiduciary capacity, develop and adopt a written strategic plan that includes the objectives for both short-term and long range goals for the Authority. The Board should monitor the plan on a periodic basis and use the plan in decision-making processes and for budgeting (e.g., programs to undertake, etc.)*

EBRMFA RESPONSE: The Chairman will recommend that the Board commit to writing the findings of its strategic planning meetings regarding the unrestricted funds.

The Authority's surplus is due to the exceptional performance of the Board and its administrator, FCSI. These funds have been prudently invested, averaging approximately 6½% earnings over the past five years. That a 'written plan' has not been developed does not mean that good planning has not been developed and implemented. The Board has discussed during at least three strategic planning sessions its plan for the use of our unrestricted net assets and how these funds can be applied to innovative programs to advance the mission of the EBRMFA to provide housing opportunities for the residents of East Baton Rouge Parish. It is important to point out that the EBRMFA utilizes funds from its cash reserves each year in order to effectively finance our annual mortgage lending programs. The EBRMFA also uses significant funds from this reserve to assist first-time homebuyers by providing them with needed down payment assistance. These unrestricted funds also play an important role in EBRMFA's ability to maintain its high A3 rating with Moody's Investors Service. EBRMFA's A3 rating is the second highest in the nation among the local mortgage finance authorities that are rated by Moody's. In its ratings report on EBRMFA, dated October 7, 2003, Moody's states:

“The A3 rating reflects: EBRMFA’s satisfactory financial position, as reflected in an unrestricted fund balance equal to 5.7% of outstanding bonds; a low risk profile as evidenced by highly-rated MBS-collateralized bond programs; conservative investment practices; and the Authority’s overall sound management.”

2) AUDITOR'S RECOMMENDATION: *We suggest that the Board explore the marketplace for errors and omission insurance coverage options for trustees. We also suggest that any trustee (e.g., chairman, vice-chairman, and secretary/treasurer) who is a signatory on checks or who can authorize the transfer of funds be covered by an adequate fidelity bond in accordance with state law.*

EBRMFA RESPONSE: The Board has complied with LRS 9:2343A(2) by requiring our program administrator (FCSI), who handles funds for the Authority, to have the required fidelity bond. The Chairman will also recommend that the Board approve purchase of a fidelity bond for Board officers. Additionally, we will consider the purchase of errors and omissions insurance coverage for all trustees. Fortunately, in its 30 years of operation, neither the EBRMFA nor its officers would have had to utilize such insurance and bond coverage.

3) AUDITOR'S RECOMMENDATION: *We suggest the Board terminate the contract because FCSI, as appointed agent of the Authority, refused to be accountable to the Board and public for the expenditure of public funds paid it to administer the Authority. In the future, if the Board chooses to contract out administrative services, it should competitively bid this administration and require the winning bidder to be fully accountable to the Board. It is further recommended that the Board only enter into contracts that adequately protect the interests of the Authority and public.*

EBRMFA RESPONSE:

Selection Process. As the Auditor stated in his report, there is no legal requirement for the EBRMFA to bid out professional services. The Auditor further states that the Board should consider the costs of implementing his recommendations compared to the benefits they will provide. The Board has exercised its fiduciary responsibility to ensure that the contract with the administrator is prudent, cost-effective and provides efficient and competent service. The results of the performance of the administrator prove the wisdom of the EBRMFA's selection.

The EBRMFA was the first local mortgage finance authority formed in the United States. The decision to proceed with privatization of our operations was made in 1974 by the original Board of Trustees, which was comprised of some of the most outstanding civic and business leaders of our community. The original Board included members L.W. Eaton, Jr., Harvey Honore, Edward W. Stagg, the Rev. T.J. Jemison, Claude Kirkpatrick, James R. McDowell and Ira J. Woodfin. Senator Eaton served as the first chairman. The original Board of Trustees made the decision to privatize and to select FCSI as our administrator and advisor.

In 1974, FCSI was owned by Dr. William D. Ross, Dean of the LSU School of Business. Terms of the contract have been modified slightly over the years but it remains relatively unchanged from its original form. Rather than be criticized for their decision made some 30 years ago, the founding EBRMFA Board members should be recognized for their foresight and wisdom in contracting for private administration of the Authority's activities. The present Board and past boards have made the business decision that it was more prudent, due to the exceptional performance of the Authority's administrator, to continue to have FCSI as the administrator, with appropriate oversight, rather than seek competitive proposals from unproven companies. The EBRMFA contract with FCSI was commended

by Moody's in their analysis of why the EBRMFA was awarded an A3 rating. In its original opinion of May 2002 assigning the A3 rating, Moody's said the following:

**AUTHORITY BENEFITS FROM EXPERIENCED AND CAPABLE
MANAGEMENT TEAM.**

"The EBRMFA is governed by a nine-member Board of Trustees, which for the past 23 years has contracted out the authority's day-to-day operations management and program administration (to) Financial Consulting Services, Inc. (FCSI). Throughout this long-term relationship, FCSI has maintained EBRMFA's official office and has capably performed all management functions including bond program administration, asset & liability management, implementation of investment policies, development of mortgage lending programs, and monitoring of participating lender, servicer, and trustee activities. Overall, FCSI is viewed by Moody's as competent in managing EBRMFA's core businesses and is fully dedicated to fulfilling the Authority's mission to increase the supply of affordable housing within East Baton Rouge Parish."

Privatization of services is the direction in which many governments have moved, including our own City-Parish and the State of Louisiana.

Sale of FCSI. In 1996, the Board, in an effort to ensure that the Authority would continue to be administered in an effective and prudent manner, held discussions with Dr. Ross regarding his succession plan for FCSI. Dr. Ross made the decision to sell his interest in FCSI, after obtaining the written consent of the Board, to two longtime employees and to an individual who had served as the financial advisor to the Authority for 11 years as well as having served as a consultant to FCSI for eight years. These three individuals had a combined 50 years of experience working with the EBRMFA. The Board had and continues to have confidence in these individuals. The Board was concerned with FCSI's succession plan in light of two past situations that could have transferred the ownership and/or management of FCSI to other parties.

Contract. Prior to expiration of the present contract with FCSI on December 31, 2006, the Chairman will ask the Board to seek proposals from companies qualified to provide program administrative services. The compensation provisions mentioned by the Auditor, although straightforward to us, will be reviewed, evaluated and modified as is deemed appropriate. We will also investigate the benefits and cost effectiveness of EBRMFA maintaining its own staff.

Private Records of FCSI. As stated previously, the original Board in 1974 privatized operations of the EBRMFA. The Legislative Auditor thoroughly examined the books and records of the EBRMFA over a six-month period. The Authority's external auditors, Deloitte & Touche, audit the books and records of the EBRMFA annually and have issued clean opinions each year. The issue is not with the books of the EBRMFA, but is one in which the Auditor feels that he should have access to the corporate books and records of

FCSI. We are not aware of any law, rule or regulation that requires FCSI to open all of its records to the Legislative Auditor. Legal opinions have been issued stating FCSI is not required to reveal its private records to the EBRMFA and we are not aware of any opinion that has been issued to the contrary.

Termination of FCSI contract. The Legislative Auditor contends that the EBRMFA should terminate its contract with FCSI because FCSI would not disclose its private records to him. We do not consider this to be a reasonable recommendation in that three separate law firms have issued opinions stating that such termination could subject the EBRMFA to significant legal exposure and damages. It is important to note that the current contract expires on December 31, 2006, and that prior to that date, the Board will be asked to seek proposals from qualified companies.

RFPs for Professional Services. The Board will be asked to consider requesting more RFPs, where and when deemed feasible. The Board has already taken the step to solicit RFPs for underwriter and financial advisor in our upcoming bond issue.

Disaster Plan. The Board will work with FCSI to develop a written disaster recovery/business plan to reduce the risk of adverse effects to the computer system or office in the event of a disaster.

Public Access to the Authority. The EBRMFA will have its telephone number listed in the telephone directory and will consider the feasibility of having an Internet presence. The EBRMFA's name is listed on the door to the office and on the directory of the second floor on which the office is located. We have asked FCSI to instruct the building manager to place EBRMFA's name and suite number in the ground-floor lobby directory.

4) AUDITOR'S RECOMMENDATION: *We suggest that the Board explore the costs (fixed and variable) and benefits of obtaining office space and employing its own staff to perform the administrative work, bookkeeping services, etc. of the Authority.*

EBRMFA RESPONSE. The Auditor's comparison of fees is flawed in that it compares the EBRMFA with the Parish of Jefferson Home Mortgage Authority—an authority that operates only with an administrative and clerical staff and utilizes outside contract services. A more accurate comparison would be with the Finance Authority of New Orleans, which operates on a business model similar to that of the EBRMFA. The New Orleans authority has a full-time professional management team that includes an executive director, a deputy executive director and a chief financial officer. The FCSI staff of president, executive vice president and vice president provides services that are similar to those provided by the New Orleans authority's staff.

The Auditor's report states that the EBRMFA was not compared to the New Orleans authority because the New Orleans authority includes two related non-profit corporations. A review of the audit report for New Orleans clearly shows that the activity of the two non-profit corporations is insignificant as compared to its single-family program. The two non-profit corporations' assets are only 1½% of total assets of the New Orleans authority, their revenues are only 4%, and expenses are only 5% of the total revenues and expenses of the New Orleans authority.

The New Orleans authority's primary emphasis is on single-family programs, a fact confirmed by its executive director who stated to us: "The organization remains focused on single-family bond programs as the foundation of its operation and mission." A recap of relevant data for all three authorities is as follows:

	<u>EBR</u>	<u>N.O.</u> (Single family programs only)	<u>Jefferson</u>
Total Assets	\$331 Million	\$343 Million	\$219 Million
Total Operating Revenues	\$ 14 Million	\$ 17 Million	\$ 8 Million
Total Operating Expenses	\$ 16 Million	\$ 17 Million	\$ 11 Million
Unrestricted Net Assets (Surplus)	\$ 28 Million	\$ 13 Million	\$ 3 Million
Operating Costs	\$566,000	\$557,000	\$222,000

By comparing EBRMFA to the New Orleans authority (single-family programs only), it is obvious that the fees paid to FCSI are comparable to the operating costs of the New Orleans authority. The New Orleans authority is much closer in size and operates under a similar business model as the EBRMFA.

EBRMFA's performance has been excellent, resulting in having unrestricted net assets (surplus) of \$28 million, compared to \$13 million for New Orleans and \$3 million for Jefferson.

To further analyze the appropriateness of the fees earned by FCSI, the Authority engaged Deloitte Financial Advisory Services, LLP, to provide a third-party analysis of the services provided and fees earned by FCSI. After an extensive analysis and comparison with a national peer group, Deloitte concluded its study with the following:

"Based on the cost approach, the benchmark study suggests the estimated annual fees for FCSI's services would range from:

\$500,000 to \$800,000"

"Based on the financial performance of EBR compared to other MFAs, we would expect FCSI's fees would be at the upper half of this range:

\$650,000 to \$800,000."

As the Auditor's report pointed out, FCSI earned \$628,331 for services it provided to EBRMFA in 2004. The \$628,331 figure includes operating costs of about \$566,000 and about \$63,000 earned by FCSI for program development fees associated with new bond issues. This earned amount is well within the range Deloitte's study suggests the EBRMFA would be expected to pay for such services.

Even though both of the analyses above clearly show that the fees paid to FCSI are reasonable for the performance achieved, the Chairman will recommend, prior to the expiration of the current contract with FCSI, that the Board explore such costs and benefits of obtaining office space and employing our own staff.

5) AUDITOR'S RECOMMENDATION: *For a proper system of checks and balances, we suggest that the Board obtain independent advice on the reasonableness of all fees generated and paid in connection with bond/securities issues.*

EBRMFA RESPONSE: The Board did obtain independent advice from its financial advisor, CSG Advisors, Inc., in connection with its bond issues. In fact, as we pointed out to the Auditor, the EBRMFA paid significantly less in fees in connection with its bond issues than did the Jefferson and Orleans parish authorities. Michael G. McMahon entered into an agency agreement June 1, 1999, whereby CSG designated Mr. McMahon as its agent, to act on behalf of CSG. The Legislative Auditor's report states that it is a conflict to have CSG as financial advisor since Mr. McMahon is their agent and is also employed by FCSI. The president of CSG stated that he did not think a conflict existed. We do not believe that the EBRMFA arrangement relative to advisors and administrators is unusual. The Louisiana Local Government Environment Facilities and Community Development Authority had the same company act in the capacity of program administrator and financial advisor on several of its bond issues. To help clarify this matter, an ethics ruling has been requested from the Louisiana Board of Ethics.

The Board has requested proposals from financial advisory firms for its upcoming bond issue.

6) AUDITOR'S RECOMMENDATION: *The Board should immediately cease paying travel obligations of FCSI. We suggest that the Board implement checks and balances to ensure that all future payments to FCSI are made in accordance with the contract.*

EBRMFA RESPONSE: We agree that any payments to FCSI that are not specifically called for in the contract be documented as to the business decision reached to make such payments. In Board minutes of a meeting held on Nov. 8, 1984, the then-existing Board approved the reimbursement of conference travel expenses of FCSI and it has been a policy to continue to do so. The Vice-President of FCSI represents the EBRMFA at conferences, attends very informative educational sessions, and is able to network with finance authority members and staff from around the country, all adding to her ability to assist the EBRMFA in achieving exceptional performance.

7) AUDITOR'S RECOMMENDATION: *We suggest that the Board implement checks and balances to ensure that the State Bond Commission checklist is complete and accurate without exception, and that any future payments to FCSI are made in accordance with the contract.*

EBRMFA RESPONSE: The EBRMFA will continue to ensure that the State Bond Commission checklist is complete and accurate. The 2004 State Bond Commission checklist properly reported CSG as financial advisor. Any payments to FCSI that are not specifically called for in the contract will be documented as to the business decision reached to make such payments.

8) AUDITOR'S RECOMMENDATION: *We suggest that the Board exercise fiscal restraint by stopping the unnecessary travel to out of state bond closings. In addition, all travel reimbursements should be supported by detailed receipts supporting the business nature of the expenditures. Also, we suggest that the travel policy be amended to prohibit reimbursement for alcohol purchases.*

EBRMFA RESPONSE: The Chairman disagrees that the travel to the bond closing in Atlanta discussed in the Auditor's report was unnecessary. The Board agrees, and had agreed prior to the September 2003 bond closing in Atlanta, to hold bond closings in Baton Rouge at bond counsel's office. The 2003 \$25 million bond closing, previously planned in Baton Rouge, was held in Atlanta due to our previous bond counsel, located in Baton Rouge, resigning for personal reasons, in the midst of the origination of the issue. A decision was made, with time being of the essence, to appoint Kutak Rock as bond counsel, since they were already involved in the 2003 bond issue as special tax counsel. Kutak Rock's Atlanta office was servicing the Authority and facilitated the bond closing at their office. The Board felt that it was prudent and was their fiduciary responsibility to attend the bond closing to meet with and discuss the bond transaction and any issues with our new bond counsel. The 2003 bond issue was the first time that the "FNMA Private Placement Forward Delivery Structure" had been utilized by the Authority which entails pricing each \$4 million or \$5 million tranche as funds are drawn instead of pricing the entire \$25 million bond issue upfront. This concept saved the EBRMFA funds by eliminating negative arbitrage, which would have resulted from investing funds at a lesser rate than the bond interest rate.

The October 2004 bond closing was held in Baton Rouge and future bond closings will be held at our joint bond counsel's Baton Rouge office. The EBRMFA has a strict policy regarding documentation of travel reimbursements and supporting receipts and as the Auditor's report suggests, the Chairman will instruct members to obtain itemized restaurant receipts in addition to credit card receipts.

9) AUDITOR'S RECOMMENDATION. *We suggest that the trustees reimburse the Authority for the additional lodging costs and per diem payments. In the future, we suggest that documentation be provided by trustees, and maintained on file, to substantiate the business necessity for any early travel or extended stay at conferences. Travel that is unnecessary should not be paid by the Authority.*

EBRMFA RESPONSE: The Chairman agrees that the EBRMFA should not pay for any unnecessary travel and we have no cause to believe that any such travel has occurred. The Board makes every effort to follow travel policies established for state officials, which permit reimbursements for actual, reasonable expenses. We agree that documentation be provided and maintained substantiating any early travel or extended stay at conferences and no reimbursement be made if documentation for extended stay is not provided. Examples referred to in the Auditor's report involved mostly overnight stays on Saturdays when a conference ended earlier that day. It is common knowledge that lower airline rates can often be obtained by an overnight stay on Saturdays. The EBRMFA's policy permits members to stay overnight on a Saturday for a conference that ends on Saturday if a reduced airline fare offsets the cost of the overnight stay. The Authority's policy also permits an overnight stay—depending on conference location, time change, ground transportation, etc.—if a connecting flight into Baton Rouge is not available or is not available at a reasonable time Saturday night. We also note that in referring to a

conference in Florida attended by two Board members, the Auditor states the conference began on July 15, when the conference actually began on July 14. The conference referred to in Chicago took place in 2004, not 2003.

10) AUDITOR'S RECOMMENDATION: *In an effort to eliminate unnecessary per diem costs, we suggest that committee meetings and board meetings be conducted on the same day.*

EBRMFA RESPONSE. The Board, through its various committees, has a responsibility to oversee the operations of the EBRMFA to ensure that the Authority is operated in a prudent, fiscally responsible manner. EBRMFA board members have not charged for any unnecessary per diems. All per diems have been for necessary and productive meetings. Nevertheless, the Chairman will attempt to improve coordination of committee meetings and Board meetings without sacrificing the efficient operation of the Authority. It is important to note that committee meetings are substantive and are scheduled in order to give each committee sufficient time to effectively conduct business. The Budget Committee meets annually to discuss, analyze and adopt the Authority's budget for the coming year. The quarterly Investment Committee meetings entail conferring with representatives of J.P. Morgan/Chase, discussing and analyzing the performance of the Authority's \$23 million investment portfolio, and discussing investment options. The annual Audit Committee meeting is held with the Authority's auditors, Deloitte & Touche, reviewing, discussing and analyzing the Authority's annual audit report. The Loan and Program Review Committee reviews the loan delinquency of the Authority's loan portfolio and recommends appropriate action to be taken. In addition, the committee reviews all details of new bond programs.

11) AUDITOR'S RECOMMENDATION: *We suggest that the Board consider amending the trust indenture to clarify and/or expand the mission and powers of the Authority. We also suggest that all grants be supported by a written agreement that provides for the specific terms and conditions of the grant.*

EBRMFA RESPONSE: We do not know the legal resource used by the Auditor to state that the EBRMFA may be providing grants for a purpose that is beyond our mission. To the contrary, the Louisiana Attorney General has issued opinions to the Rapides Parish Mortgage Authority and the Calcasieu Parish Trust Authority specifically stating that grants can be awarded by public trusts for a public function or purpose. The EBRMFA has obtained written legal opinions from two of Louisiana's largest and most reputable law firms regarding this issue and both opinions confirmed that issuing certain grants is within the purview of the Authority's mission. Specifically, the law firm of Jones, Walker, Waechter, Poitevent, Carrere & Denegre L.L.P examined the EBRMFA's grant to The Greater Baton Rouge Chamber of Commerce's *Campaign for a Greater Baton Rouge* and opined that it was within our authority to make this grant.

Grants made by the EBRMFA from Jan. 1, 1992, through Dec. 31, 2004, were made as a result of requests from the mayor-presidents during those years. The first grant to Plan Baton Rouge was in a formal contract with Ms. Elizabeth "Boo" Thomas that was shown to the Legislative Auditor. A written agreement is in the process of being completed for the Chamber grant, which was authorized at the July 2005 meeting of the Board. The Chairman will recommend that the Board agree to participate in grants only after hearing presentations from the organizations seeking the grants and entering into formal

contracts/agreements for larger grants. Follow-up presentations are made to the Board detailing progress being made on the grants. The Chairman will ask the Board to amend the trust indenture to clarify that the mission and power of the Authority includes making grants for a public function or purpose.

12) AUDITOR'S RECOMMENDATION: *Although the Board obtained an opinion from its legal counsel, we suggest that the Board request a formal opinion from the Louisiana Attorney General. The Board has a fiduciary responsibility to determine the (1) legal status of bond/legal documents signed by Mr. Henagan during the period of his apparent disqualification, including board actions voted upon by him; and (2) legality of seeking reimbursement of per diems paid him during the period of disqualification.*

EBRMFA RESPONSE: The EBRMFA will seek such a legal opinion from the Attorney General. As noted by the Auditor, the EBRMFA has obtained a formal opinion from our legal counsel that Mr. Henagan's service as a member of the Board during the period January 1999 to January 2005, while he was not a resident of East Baton Rouge Parish, did not compromise any formal decisions of the Board. Mr. Henagan was appointed to the Board by the Mayor-President, as are all board members. In regard to per diem payments to Mr. Henagan, the legal opinion advises that repayment of per diems are not mandated by law in that Mr. Henagan performed the work as he continued to fill the position as a de facto trustee. The EBRMFA's trust indenture states that "a trustee shall continue in office until his successor has been duly appointed and qualified." The City-Parish Plan of Government states "...and all officers and members of boards and commissions appointed for fixed terms, shall hold office until their successors are elected or appointed and qualified." The Chairman will recommend that the Board establish formal procedures to clarify who is charged with the responsibility to monitor the residency status of trustees, to establish procedures for trustees to sign an annual affidavit certifying to their residency, and to establish a procedure for timely notifying the Mayor-President and Council of a trustee's disqualification.

13) AUDITOR'S RECOMMENDATION: *We suggest the Board enhance its disclosure to the parish (beneficiary) by requiring all proposed bond/securities issues of the Authority to be submitted to the East Baton Rouge Parish Metropolitan Council for approval.*

EBRMFA RESPONSE: The Mayor-President of East Baton Rouge Parish is required to and has always signed a certificate approving the issuance of the EBRMFA's bonds for the purpose of Section 147(F) of the Code and Section 215 of TEFRA.

Liaison. Until 2004, the Board was not aware of the ex-officio trustee issue and the Authority has never had ex-officio trustees since its creation in 1974. The EBRMFA addressed the issue as soon as it arose in 2004 and it was corrected.

Disclosure of Operations. This issue and the issue of ex-officio members were brought to the attention of the Board during a meeting with the Mayor-President's office in 2004. Subsequently, the EBRMFA has provided written quarterly reports to the Mayor-President and Council members since the first quarter of 2004.

14) AUDITOR'S RECOMMENDATION: *We suggest that the Board strictly comply with the Authority's bylaws and review a financial statement with budget comparisons on at least a quarterly basis.*

EBRMFA RESPONSE. The Board had attempted to review fully accrued (GAAP) financial statements on a quarterly basis, but, with the large number of individual bond funds, found that the cost of implementing this process outweighed the benefits. The operating account is reviewed on a monthly basis. The Chairman will ask the Board to consider amending the bylaws in this regard.

15) AUDITOR'S RECOMMENDATION: *We suggest that the back-up tape be taken offsite each day and kept in a secure place.*

EBRMFA RESPONSE: The Chairman agrees that the back-up tape should be taken offsite each day and kept in a secure place. A computer back-up policy assuring daily offsite storage of the back-up tape has been written and implemented.

Mayor-President's Response



Office of the Mayor-President

City of Baton Rouge
Parish of East Baton Rouge

222 St. Louis Street
Post Office Box 1471
Baton Rouge, Louisiana 70821

225/389-3100
Fax 225/389-5203

MELVIN L. "KIP" HOLDEN
Mayor-President

September 26, 2005

Mr. Steve J. Theriot
Legislative Auditor
Post Office Box 94397
Baton Rouge, La. 70804

Dear Mr. Theriot:

I have extensively reviewed the Legislative Auditor's Advisory Services Report ("Report") which addresses your office's assessments of the allegations and the procedures and practices of the East Baton Rouge Mortgage Finance Authority ("Authority"). In accordance with your cover letter, I am offering the following response. It is my understanding from your comments and guidance during the Exit Conference that a "general" response is acceptable.

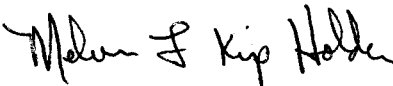
Initially, let me make certain that the record reflects that your Report and its findings address concerns that occurred prior to my taking office on January 3 of this year. To that extent, it should be noted that as soon as this Administration became aware in January of this year that a member of the Board of Trustees of the Authority was no longer qualified to serve because he had moved out of the Parish, we requested his removal and immediately replaced him in late January of this year with a new member who met all qualifications under the law and the governing documents of the Authority.

You have identified, and take strong exception to, twelve (12) areas of practice and procedure of the Authority. Generally, all of your findings give me great concern. Some of these practices and procedures cause greater concern than others, but certainly all of them should be addressed in an aggressive and appropriate manner. I can assure you that I will see that all of your findings and recommendations will be properly addressed and remedied in accordance with and in substantial compliance with your recommendations.

Mr. Steve J. Theriot
Legislative Auditor
September 26, 2005
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Without having the benefit of the response of the Chairman of the Authority and his explanations to your findings, it is very difficult and perhaps inappropriate for me to initiate the corrective measures that your Report and its findings demand at this time. Before I move to take any action, I will review the Chairman's response. However, given the nature, severity and extensiveness of your findings, and the fact that so many members of the Authority have served for such a lengthy period of time, it seems to me that it is imperative that (i) substantial amendments of the Indenture of Trust, (ii) changes in the practices and procedures, (iii) the installation of governmental oversight and (iv) reorganization of the composition and leadership of the Board of Trustees of the Authority be strongly considered. Additionally, regardless of the Authority's response and explanation, it seems appropriate that I, as the Chief Executive Officer of the Parish of East Baton Rouge, along with the governing authority of East Baton Rouge Parish, the Metropolitan Council, move to (i) take the necessary legal steps to address all areas of concern, (ii) restore and/or implement the appropriate procedures and practices and (iii) institute the oversight and accountability that has been lacking prior to this Administration taking office.

Sincerely,

A handwritten signature in black ink that reads "Melvin L. Kip Holden". The signature is written in a cursive, slightly slanted style.

Melvin L. "Kip" Holden
Mayor-President