

EXECUTIVE DIGEST

HOMEOWNER CONSTRUCTION LIEN RECOVERY FUND

INTRODUCTION

This report contains the results of our performance audit of the Homeowner Construction Lien Recovery Fund (HCLRF), Department of Commerce, for the period October 1, 1992 through September 30, 1995 and our financial audit for the period October 1, 1992 through September 30, 1994.

AUDIT PURPOSE

This performance and financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness and efficiency. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements. Also, this audit complements the departmentwide financial audit.

BACKGROUND

HCLRF is governed by Sections 570.1101 - 570.1305 of the *Michigan Compiled Laws* (Act 497, P.A. 1980) and is administered within the Department of Commerce.

HCLRF was established in January 1982 to protect homeowners from lien claims for residential construction and

remodeling. It also protects persons providing labor, materials, or equipment for real property improvement. Only persons who have paid into HCLRF are entitled to recover from HCLRF. HCLRF will pay a maximum of \$75,000 per residential structure for unsatisfied liens. If the Department makes a payment from HCLRF as a result of actions or inactions of a licensee*, HCLRF will file a complaint against the licensee. The licensee's license may be revoked until the licensee has repaid HCLRF the amount paid plus the cost of litigation and interest.

HCLRF is self-supporting from fees charged to licensees and other lien claimants (persons). HCLRF is to maintain a minimum balance of \$1 million. If, on December 1 of any fiscal year, the balance in HCLRF is less than \$1 million, the director of the Department may require an additional assessment not to exceed \$50 per person unless the Legislature adopts a resolution to prohibit the additional assessment.

All HCLRF costs are appropriated and expended directly from the General Fund. Operating transfers are made from HCLRF to reimburse the General Fund for the expenditures. For fiscal year 1993-94, HCLRF reported operating transfers to the General Fund of \$1,026,230 and revenues and other financing sources of \$407,378. As of September 30, 1995, HCLRF had one direct employee. In addition, the Department provides fiscal and management services to HCLRF.

**AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS**

Audit Objective: To assess the effectiveness of HCLRF's operations.

Conclusion: Our assessment concluded that HCLRF was generally effective; however, we determined that the Department should investigate expediting HCLRF's complaint processing track (Finding 1).

Audit Objective: To assess the adequacy of HCLRF's internal control structure*.

Conclusion: We determined that HCLRF's internal control structure was not adequate. Our assessment identified the following material weaknesses*:

- HCLRF did not establish controls to ensure that the Department recorded costs for HCLRF's settled and pending litigation in accordance with generally accepted accounting principles and Department of Management and Budget (DMB) policy (Finding 2).

The Department agreed with our related recommendation and will work with the Department of Attorney General to ensure that the Department is notified of pending litigation.

- HCLRF, the Department, and DMB had not established internal controls to ensure that the General Fund was reimbursed on a timely basis and that operating transfers from HCLRF to the General Fund were equal to HCLRF's costs (Finding 3).

The Department agreed with our related recommendation and indicated that it will be in compliance beginning October 1, 1996.

Our assessment also identified reportable conditions* related to revenues and receivables, accounts payable, and supporting documentation (Findings 4 through 6).

Audit Objective: To assess HCLRF's compliance with applicable laws and regulations that could have a material effect on its financial statements.

Conclusion: We determined that HCLRF generally complied with applicable laws and regulations that could have a material effect on its financial statements. However, our assessment identified the following material instances of noncompliance:

- The Department published annual financial statements of HCLRF that were not in compliance with the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide (Finding 7).

The Department agreed, in part, with our related recommendation. In the future, it will publish and distribute the relevant portion of the *State of Michigan Comprehensive Annual Financial Report*.

- The Department did not collect an estimated \$92,500 of construction lien fees from applicants for electrical

contractor's licenses prior to the licenses being issued by municipalities (Finding 8).

The Department agreed with our related recommendation conceptually, but felt that the licensing authorities for this profession would be the appropriate initiators of requesting revised legislation.

Our assessment also identified a reportable condition related to the administrative cost limitation (Finding 9).

Noteworthy Accomplishment: We commend the Department for its efforts to collect the assessment from the electrical contractors licensed by municipalities. Although the statute requires all licensed electrical contractors to pay the assessment, the Department has no control over the municipalities; thus, very little (approximately \$11,250 of the estimated \$103,750) has been collected.

Audit Objective: To audit HCLRF's financial statements as of and for the fiscal years ended September 30, 1994 and September 30, 1993.

Conclusion: We expressed a qualified opinion on HCLRF's financial statements for the fiscal years ended September 30, 1994 and September 30, 1993 because the Department did not record the cost for settled and pending litigation in the proper fiscal year (Finding 2) and did not properly reconcile operating transfers to the General Fund with HCLRF's costs in fiscal year 1992-93 (Finding 3). The effects of these and other errors identified during our review of the financial statements are identified on page 17. The

results of our audit of the financial statements are further discussed in our independent auditor's report on the financial statements.

As noted in the conclusion for our compliance objective, our review also disclosed a material instance of noncompliance in that the Department did not publish HCLRF's annual financial statements in compliance with the *Michigan Compiled Laws* and DMB Administrative Guide (Finding 7).

**AUDIT SCOPE
AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Homeowner Construction Lien Recovery Fund for the period October 1, 1992 through September 30, 1995 and to examine the financial records for the period October 1, 1992 through September 30, 1994. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our methodology included reviewing HCLRF's legislation and procedures. We also analyzed HCLRF's lien claim data base and reviewed lien claim files to assess the effectiveness of its operations.

**AGENCY
RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 9 findings and 11 corresponding recommendations. The Department agreed with all 11 recommendations, and it has either taken steps or will take steps to comply with the recommendations.

The Department complied with 5 of our 10 prior audit recommendations; did not comply with 3 of the recommendations, which were modified and are included in this report; and 2 recommendations were not within the scope of our audit and, therefore, were not followed up.