TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE

Capitol Extension Building
Room E 1.016
1400 Congress Avenue
Houston, Texas

Thursday, January 17, 2002

9:00 A.M.

The meeting convened, pursuant to notice, Vidal Gonzalez, Chair, presiding.

MEMBERS IN ATTENDANCE:

ELIZABETH ANDERSON
SHADRICK BOGANY
RUTH CEDILLO

ALSO PRESENT:

DAVID GAINES
SAM RAMSEY

AGENDA

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P R O C E E D I N G S

MR. GONZALEZ: We'll call the committee meeting to order, and we'll go over the roll call.

Beth Anderson?

MS. ANDERSON: Present.

MR. GONZALEZ: Shadrick Bogany?

MR. BOGANY: Here.

MR. GONZALEZ: Okay. We do have a quorum.

We'll go to our first item, the presentation, discussion and possible approval of minutes of Audit Committee meeting of August 21, 2001.

Do we have any additions or corrections to the minutes?

(No response.)

MR. GONZALEZ: If not, I'll entertain a motion to approve them.

MR. BOGANY: So moved.

MS. ANDERSON: Second.

MR. GONZALEZ: We have a motion by Shadrick seconded by Beth. All those in favor?

(A chorus of ayes.)

MR. GONZALEZ: All opposed?

(No response.)

MR. GONZALEZ: The motion carries.

And we'll call on David Gaines for the external audit report.

MR. GAINES: Good morning, Mr. Chairman, members of the committee and Ms. Cedillo.

The first item on the agenda today is external audits. They've recently completed their annual audit of the department's general purpose financial statements and the Revenue Bond Enterprise Fund financial statements.

And I'd like to introduce George Scott of Deloitte & Touche, who's going to discuss the results of that audit, and Julia Petty, the manager in charge of the audit.

MS. PETTY: Thank you.

MR. SCOTT: Good morning.

MR. GONZALEZ: Good morning.

MR. SCOTT: I'm George Scott; I'm a partner with Deloitte & Touche, who's responsible for the audit this year. And with me is Julia Petty, senior manager, who oversaw the day-to-day operations of the audit.

Before you today are two reports, the financial statements, which are prepared by management. First off is the general purpose financial statements of the Texas Department of Housing and Community Affairs, and secondly is the Revenue Bond Enterprise Fund, which is a subset of the first document. Our opinions, which are right in the front of the financial statements: Both of the opinions are clean opinions. In our opinion, the financial statements do present fairly the financial position of both the Revenue Bond Fund and the department.

As you will notice on this page, our opinion on the general purpose financial statement is in the fourth paragraph, which I just stated. In order to come to that opinion, we are required by both government auditing standards and generally accepted auditing standards to plan and perform audit procedures in order to reach a position that the financial statements are free from material mis-statement. And in order to do that, we test a variety of records and documents and we interview individuals from throughout the organization.

And we would like to express our appreciation for the courtesies extended to us during the course of the audit. This was the first year that we had performed the audit, and the first-year audit is always a difficult process to go through because we are asking more questions probably than the staff was used to and management was used to. And the courtesies extended to our folks during the audit -- and to us -- are greatly appreciated.

During the course of the audit, there were no disagreements with management as to the proper application of accounting policies and procedures. All documents that we requested were made available to us. We had complete access to individuals throughout the organization. There were no restrictions at any time placed upon the procedures that we did.

The -- as the opinion states, the applications of accounting policies and procedures were consistent from year to year; there were no significant changes in the way -- in presentation or the way certain accounting is recognized, how revenues are recognized, and so forth. So that's consistent from year to year.

Also, during the course of the audit, we evaluate the internal control environment. We identified no area that we believe is a material weakness in the control environment. And that -- it would include also on the basic financial statements and as it was under the revenue bond program, also.

Also, another document that we had given to you today is just a letter from us that basically goes through what I've just said. It talks about the purpose of the audit, the key issues on the audit. All audit adjustments that were identified in the course of the audit were booked by management; there were no unreported, uncorrected mis-statements that were not booked by management. There are requirements now that if those situations occur, we do report that to you as a board and give you an idea -- show what the impact to the financial statements would have been if those had been booked.

Also, during the course of the audit, no other consultation came to our attention with other accountants or audit firms. This is, again, a requirement that is being stressed more that -- and, again, nothing of that nature occurred, but that is what's called opinion shopping; it's an if-you-don't-like-the-answer-your-auditor-is-giving, call-another-auditor-and-see-if-you-can-get-the-answer-you-want type of thing. And that did not occur during the course of the work, and there was no issues discussed with us prior to retention.

Again, those are issues again discussing independence and so forth. There were no issues in that area. Again, there were no other difficulties that were identified in the course of the audit.

One thing I would bring to your attention -- and this is -- certainly doesn't affect this year's financial statements, but there are new -- there is a new requirement for presentation and reporting of governmental activities that will take effect next year. It will substantially change how these financial statements look.

And we're alerting all of our clients and our -- the Board specifically that what -- the financial statements and how you see them presented this year will be significantly different next year because of these new changes. The Governmental Accounting Standards Board, which sets reporting requirements for all governments in the State of Texas, as well as the United States, has changed its presentation. And next year, you will see a significant change in how that's done.

One of the things that will be added to your report next year will be a management discussion and analysis, where management will discuss as part of the financial statements -- the basic financial statements if the organization financially is better or worse off than it was the prior year and explain that to -- in a general way to the reader, similar to what the SEC organizations are doing now. It's not the same, but it's very similar.

So there are several changes like that that are going to occur which will change this report. So management has quite a task in front of them to deal with some of those extensive changes.

With that, we'd be very happy to answer any questions that you might have for us.

MR. GONZALEZ: Any questions?

MR. BOGANY: No.

MR. GONZALEZ: Okay. A good report. We appreciate it.

MR. SCOTT: Thank you, very much.

MR. GAINES: Thank you, George.

The next item on the agenda is the internal auditing report, controls over single-family loans. And I'm going to turn that discussion over to the lead auditor on the project, and that's Mr. Sam Ramsey.

MR. RAMSEY: Good morning, everyone.

MR. GONZALEZ: Good morning.

MR. BOGANY: Good morning.

MR. RAMSEY: Just to get right into it here -- does everyone have a copy of the report?

MS. ANDERSON: Yes.

MR. BOGANY: Yes.

MR. RAMSEY: Good deal. I'll just briefly go over a few things before we try to entertain any questions you might have.

But the audit itself was a scheduled review that was included in our work plan as approved last year. So the primary reason for the review was to make a determination regarding, Did the -- oh. I'm sorry.

(Pause.)

MR. RAMSEY: Let me start over again here then.

The primary reason of our review was to make a determination regarding the adequacy of controls over single-family loans serviced by the department to ensure that the financial interests of the State were protected.

Our scope was primarily -- although the department is involved with many different types of loans, our review focused on those loans considered to be the highest risk. Our report, starting on page 2, provides a detailed narrative on those loans as to what was included in that review and those that were not.

As to those loans reviewed by us, they included: Single Family Lending Division's Downpayment Assistance Program loans and HOME's Homebuyers Assistance Program loans that provided downpayment and closing costs assistance to qualified homebuyers, OCI's Home Construction and Acquisition Loan Program that provided interest-free loans for low- and very-low-income families to build their own homes, and it also included OCI's Contract for Deed Conversion Program whereby contracts for deeds were converted into a traditional note and a deed of trust was created.

Overall, we found controls in place over single family loans serviced by the department were generally adequate with the exception of the HOME Program -- Homebuyers Assistance Program loans administered by the HOME Program. Looking on page 4 of the report, there's a little more detail regarding that particular issue, but I'll just briefly go over it right now.

With regard to that particular program, we noted that for a great majority of the loans, the department lacks sufficient accounting of the loans to protect the State's financial interest. Although we noted the department has made some improvements in this process for collecting loan documents since 1999, the department has had and continues to have problems in attaining the necessary loan documents and does not have a full accounting of all the loans made under the program.

Before I go on, does anybody have any questions right now with regard to this particular issue?

(No response.)

MR. RAMSEY: Some lesser issues that we noted pertained to the reconciliation --

MS. ANDERSON: I'm sorry. Sam, could I ask you a question?

MR. RAMSEY: Sure.

MS. ANDERSON: With regard to that issue, the -- there's a management discussion that talks about the implementation of a new system --

MR. RAMSEY: Correct.

MS. ANDERSON: -- as being a major portion of the remediation activities to help deal with that issue.

MR. RAMSEY: That's what we're --

MS. ANDERSON: In your opinion, will that new system address the things that you documented in your report?

MR. RAMSEY: Well, we're always hopeful that with a new system, we'll address all those issues, of course, but we haven't really looked at it in detail. But from what we've been told, it should address a lot of the issues as far as ensuring --

MS. ANDERSON: Document --

MR. RAMSEY: -- documentation is correct, and so forth. A lot of this issue is going back. This is kind of an historical issue all the way back to the early '90s as far as most of these loans are concerned. The efforts recently have been well-done as far as trying to collect the documents they need, but it's just that a lot of this is actually going back for older loans -- even though there's some issues with some of the current stuff, too.

But, hopefully, with the new system and the way it's supposed to be integrated, all -- as far as one seamless operation, it should help. It should be helpful, yes.

MR. GAINES: I'd just --

MR. RAMSEY: And with our follow-up, hopefully, we'll be able to make an assessment of that, too.

MS. ANDERSON: Great. Thank you.

MR. GAINES: I'd just like to make one comment in that respect because this response comes up frequently -- that, "The new central database will take care of the problem," or, "The new system will correct it." And often times, these system implementations go on much longer than anyone plans or anticipates.

So as an auditor, I believe that you need systems in place. And sometimes those systems, if necessary, are five-column pads --

MS. ANDERSON: Well -- and if --

MR. GAINES: -- tracking the loans going forward is critical regardless of the system being used.

MS. ANDERSON: Okay. Thank you, David. And if the system -- if we're sort of making a big bet on this system, that it really is -- that it's central to our future, then it means we want to make sure that that implementation is appropriately resourced so it doesn't encounter delays that [indiscernible] projects and that sort of thing.

MR. GAINES: Yes, ma'am.

MR. RAMSEY: Does that answer your question pretty much?

MS. ANDERSON: Yes. Thank you.

MR. RAMSEY: Okay.

MR. GONZALEZ: Does anybody else have anything?

Yes, sir?

MR. BOGANY: Will the Genesis Program take care of the loans that were done previously, or what -- will it just keep us from --

MR. RAMSEY: Basically, that's how they were initially captured for the initial draws, in other words. So we don't necessarily have the documentation to know primarily if they were -- a loan was generated. We basically looked at the contracts through the years and looked at the criteria within the contract to see if a loan would -- should have been created, in other words.

And some of the older loans basically indicated that the contractors could basically set these out as grants.

MR. BOGANY: Okay.

MR. RAMSEY: So a portion of what has been captured in Genesis already has all this information in there; it's just a matter of going through it and trying to identify which ones are loans and which are not. So -- but to answer your question, Genesis has that basic information in there.

MR. BOGANY: Okay. One last question in regards to personnel. I'm assuming you've got to have some live interaction along with Genesis. Any recommendations personnel-wise to help make this, to implement this Genesis Program that may help it?

MR. RAMSEY: Well, the Genesis Program has been around for awhile.

MR. BOGANY: Okay.

MR. RAMSEY: And pretty much -- I'm not quite following exactly what you're saying.

MR. BOGANY: My question is that, If you implement the Genesis Program, is there some personnel issues that may help, also, in doing your audit that you noticed that we needed to do better to maybe make this -- help?

MR. RAMSEY: There's always opportunities for improvement. Yes, there -- in a sense, it's -- a lot of times, it's a resource issue and a priority issue as far as going back to some of these things that are in Genesis. And I think that's what HOME's going to be trying to do right now.

MR. BOGANY: Okay. Thank you.

MR. GAINES: If I may, Mr. Bogany?

MR. BOGANY: Yes?

MR. GAINES: Genesis has been a historical program. So they're going to a new program, Number One. And the primary issue with Genesis relating to this issue is that it does not specifically identify which disbursements are the loans.

And so while the disbursements are on the system -- there's a huge number of disbursements. So what management needs to do is identify which of those are loans and then go about accumulating the documentation to support those loans.

As far as management issues, the big issue here is coordination between the HOME Program and the loan administration program. And I believe that coordination -- they have been working much closer together since late 1999 and 2000.

MR. BOGANY: Okay. Thank you.

MR. GONZALEZ: Anything else?

MS. CEDILLO: That was -- exactly what I was going to point out was the fact that we needed that coordination, because loan servicing cannot service those loans if they're not getting the information from the program area.

MR. RAMSEY: Okay.

We have some other issues involved in the report. Like I said, overall, we found things to be generally adequate, but we found some -- more or less some quality assurance issues of -- quality control issues that we're going to touch on.

The reconciliation process between the department's loan servicing and account management system -- basically, the program to monitor the loans that are out there, the payments, and so forth, and the department's accounting records -- needs a little improvement to ensure the completeness and accuracy of both systems.

Like I say, while we know the processes were primarily adequate, we did notice some differences. And one of them was that there was one account that was an ongoing reconciling item of about -- they had a policy of if it was less than $10,000, it was considered acceptable. We recommended that they go back and identify this difference and ensure that there's no difference at all.

And, in addition, there was another account, totalling over $6 million, that had not been reconciled. So basically, the difference between the accounting records and the loan servicing account management system was about $330,000. And the response from management here is that they're going back to take care of this. I think this was just an oversight item on their part as far as why it didn't get reconciled.

A lot of our work in this particular review was looking at documentation. And although documentation supporting the loans being serviced by the department was generally adequate to protect the interests, our sample of 59 loans recorded on LSAMS identified incidences of missing and/or unrecorded loan documents. So this was not a major problem; it appears that this can be corrected by implementing some fairly simple quality control processes as far as a little better supervision and documentation, a control checklist, as far as them being more complete.

Finally, we did take a look at the overall loan collection and write-off processes and basically found that those were handled on a case-by-case basis and management's philosophy there was primarily to write those off as a last resort. We basically didn't find any policies on that.

We -- there weren't that many write-offs, to be quite frank, although we did note on the most recent delinquent loan list as of September 30 that there were 87 loans over 90 days delinquent. But we're just asking them to go back and evaluate what their policies should be and document those.

That's just a quick, general overview. Is there anything else you want to talk about about this?

MR. BOGANY: I have a question.

MR. RAMSEY: Sure.

MR. BOGANY: If you had to -- in your professional opinion, if you had to rate this program A through F, which would you give it?

MR. RAMSEY: Which problem would that be --

MR. BOGANY: The --

MR. RAMSEY: -- the HOME Program or OCI?

MR. BOGANY: The overall audit which you did in which you found --

MR. RAMSEY: There were good facets that we found there as far as how they were collecting. The only issue I have pretty much was on policy as far as what they were actually recording into the LSAMS system.

In other words, we had quite a few loans out there that we didn't have a complete package of documentation. And we were basically waiting until we got complete packages and until we got that recorded into the system and it essentially became officially a loan on the books. And that was the -- other than that, we found that they were doing a very good job as far as collecting the documentation they needed.

MR. BOGANY: The 87 loans over 90 days? That seems a little high to me.

MR. RAMSEY: That's -- we didn't really dive into that too deeply. And that's one of the reasons -- basically, I think, as I indicated, the policy has been that they write off loans as a last resort.

So I think they give these people as much leeway as they can. And these 87 loans that I'm talking about could be anywhere from 90 to who knows how long. But in talking with management, when things get up around 180 days or 270 days, that's when they start getting involved as far as talking to the individuals involved.

MR. BOGANY: Okay. Thank you.

MR. RAMSEY: So we basically would -- are recommending that management reassess this position because -- and not let things go that long.

MR. BOGANY: Okay.

MR. GAINES: And formally define their policy.

MR. RAMSEY: Yes.

MR. GAINES: It has not been reduced to writing, and it is on a case-by-case.

MR. BOGANY: Okay.

MS. ANDERSON: This may not be in this -- the jurisdiction of this committee, but as I -- as you look at where those 87 loans are, in which program they're concentrated, they're very concentrated in really three line items --

MR. RAMSEY: Right.

MS. ANDERSON: -- three programs.

MR. RAMSEY: That's correct.

MS. ANDERSON: And those programs they are -- you know, we've got the 20-percent-plus default rates in those programs or -- 20-percent-plus, over 90 days. So we might want to work at that to, you know, get something that we all understand, the criteria for making those loans, and, you know, are we doing the best we can there.

MS. CEDILLO: Exactly. And we agree with you, and -- keeping in mind that when we're foreclosing, we're foreclosing on very-low-income people that have family situations that -- I think the staff has been very good at taking those things into consideration. And that's why you hear, On a case-by-case basis. And we do have Sue Wash [phonetic] here if she would like to add anything to that. And Sue is our new manager of loan servicing.

MS. WASH: Hello. I'm -- I'd just like to explain on the delinquencies. A lot of those are in the contract for deed conversion; they're in the Rio Bravo area. And we're going to go, and we're going to review those with OCI next week. And we do meet with them monthly.

And a lot of those -- when they converted, they had a lot of homebuyer counseling when -- you know, it was going to be a successful program. Well, I want to re-review them with staff and with OCI because I think a lot of them -- they thought that they could maybe pay off in five or ten years, and I think they didn't realize that with the taxes that we escrow for, their payment was higher than they really could afford.

So we want to go through those, go through their household items, do a budget and see what they realistically can afford. And we will modify those and bring those current and extend the term on those, yes, ma'am.

MR. GONZALEZ: Okay.

MS. WASH: So I think that would help.

MR. GONZALEZ: What percentage of debt to income or -- how would you adjust the payments?

MS. WASH: They were originally approximately 40 percent, but then you don't know -- after they bought the house, you know, there's always more debt incurred. And that's why we need to relook at the budgets and see what they can afford. And taxes like -- in some like El Paso are extremely high, and they keep going higher. And we're trying to work with them and -- to make sure that they are filing their homestead exemptions. And we're just trying to help them in that way, also.

MR. GONZALEZ: How low would you think that we could go if we were adjusting?

MS. WASH: Well, if we could lower the term, hopefully, we can -- you know, we can go down 25 percent or so. And then if we could help on the tax if they're not filing homestead -- you know, we want to make sure that they are filing that. And they can save some money there, also. We just need to look at them all. And some of them have lost their -- you know, just in a lot of different cases, they've lost their jobs.

MS. CEDILLO: Thank you, Sue.

MS. WASH: Uh-huh.

MR. RAMSEY: Any other questions?

(No response.)

MR. RAMSEY: Thank you.

MR. GONZALEZ: Thank you.

MR. GAINES: Thank you, Sam.

MR. RAMSEY: Sure.

MR. GAINES: The next item on the agenda is the status of prior audit issues. If you'll look at your summary report in your materials, I'd like to provide just a couple of overview comments as to what you're looking at.

The internal auditing division maintains a database of the department's prior audit issues for tracking and reporting purposes. Audit issues are posted to the database after an audit report has been presented to you, and the status updates are posted as management provides an update or as subsequent audits address the audit issue. This is a summary report prepared from that database.

The summary report is supported by detailed information that includes the original audit report comments and management's responses. The detail also provides management's comments as they relate to each of the status updates. And this detail can be provided to you should you see the need for it in the future.

This report presents prior audit issues that have not been previously reported to you as implemented or otherwise resolved; once an issue is resolved, it's removed from the future reports.

MS. ANDERSON: Excuse me.

MR. GONZALEZ: Yes?

MS. ANDERSON: May I ask you a question? I apologize for this, but I'm lost in terms of what document you're discussing.

MR. GAINES: Oh. I'm sorry. It's the prior audit issues. That's Agenda Item -- well, it's the third report item.

MS. ANDERSON: I see it on your -- on the audit -- on the agenda. What I don't have is the back-up document.

MR. GAINES: Oh. Okay.

(Pause.)

MS. ANDERSON: Is that --

MR. GAINES: In the -- it's the --

MS. ANDERSON: I'm sorry. (Perusing documents.)

Oh. Here it is. Okay.

MR. GONZALEZ: It's the last page, also.

MS. ANDERSON: Okay. Thank you, very much. I'm sorry.

MR. GAINES: Okay. This report presents prior audit issues that have not previously been reported to you as implemented or otherwise resolved. Once an issue is reported as resolved, it's removed from future reports.

Now, the status of an issue if it's reported as resolved -- the status is based on either management's representations or based on independent assessment by internal auditors, external auditors such as Deloitte and Touche and maybe funding source agency program monitors.

In instances where it's reported by management as resolved, it is removed from future reports, but it's maintained on the database until it's independently confirmed and resolved by either internal audit or external audit. And that's normally done during the course of a follow-up audit in that area or as an audit objective -- a current audit objective relates to a prior audit issue.

And then, for those issues considered very significant, maybe there's a need for a specific project to go back and look at the status of that.

Are there any questions relating to the type of information being presented? And then I'll go into a couple of the -- an overview of the issues that are being presented.

(No response.)

MR. GAINES: Okay. There's 30 issues identified in your report; 19 of these issues have been reported as corrected or implemented, nine issues are in the process of being implemented, one issue has been delayed, and one issue has been classified as no action intended. I'm going to talk about a couple of these.

The issue that has been delayed is Issue Reference 187 on page 4 of your report. This is a Section 8 issue identified by the Department of Housing and Urban Development, or HUD, program monitors during the review conducted in August 2000. This issue relates to the department not having documentation to support the implementation of a family self-sufficiency program.

The department has requested an exemption from this program which is available under certain circumstances, and HUD has not yet responded to that exemption request. And that's why this particular issue is classified as delayed.

I also wanted to bring to your attention the issue where no action is intended. This issue is 226 on page 5. This issue relates to the need to report the results of a required bi-annual software audit in the information systems bi-annual operating plan, which was a requirement at the time of the audit.

Since that time, management reports that the bi-annual operating plan requirements have changed and that this is no longer a reporting requirement. Therefore there's -- this is not applicable, no action is intended, and it will be dropped from future reports.

One other issue I just wanted to bring to your attention that I consider of significance is Issue 252 on page 3 of the summary. This issue relates to the need for the department to reassess how it conducts its construction inspections; there's great variation in the frequency and extent of inspections from one program to the next, and this recommendation relates to exploring alternatives to the current processes in an attempt to promote efficiency and effectiveness.

The significance of this recommendation was enhanced last legislative session, when the department's enabling legislation was amended to require that the department responsible for compliance matters monitor for compliance with all applicable requirements during the entire construction phase. A recent monitoring report from one of our funding source agencies also criticized the construction monitoring function being performed for the program being monitored.

So this is an issue that has been around for awhile and needs to be dealt with. I believe, primarily, the delay has in large part been that a clear assignment of responsibility and authority has not been forthcoming. In our opinion, responsibility and authority need to be clearly defined and assigned to appropriate personnel for this issue to be adequately addressed.

MS. ANDERSON: So do you mean that one of the reasons for the lack of a consistent policy is that different people in different programs are doing construction monitoring and doing it different ways? Is that --

MR. GAINES: Historically, it has been program by program, deciding how it should be done. And this recommendation is just to reassess that. And with the new requirements placed on us recently, there may be a need for an entire reorganization relating to that function.

MS. ANDERSON: Okay. Thank you.

MR. GAINES: Typically, on these prior audit issues, I'll pull out two or three that maybe have been outstanding for a considerable period of time or that are more significant than others, but, at any time, if you have any questions going forward -- you'll have the opportunity, of course to look at your materials, but, if you have questions on any particular issue, we'll be glad to deal with those, also.

The next report item if there's no further questions on prior audit issues.

(No response.)

MR. GAINES: This is the summary status of internal/external audits. You'll note that a program-specific audit of the Section 8 program was conducted in August 2000. Do you all have that report in front of you? It's the summary status of internal/external audits.

(Pause.)

MR. GAINES: A program-specific audit was -- of the Section 8 program was conducted in August of 2001. And this audit was the result of a prior HUD monitoring report that was completed in September of last year -- of 2000, so about a year earlier. Most of the same -- the audit issues in the recent audit were also the same issues as in the previous HUD audit. And, accordingly, most of these issues have been implemented and are reported as such in the summary of prior audit issues that we just discussed.

The next audit, the State-wide single audit, is still in progress. KPMG, who is contracting with the State Auditor's office to complete this work, recently completed the field work of the department, and it is currently in its reporting stage. As that report is released, those results will be brought to you.

In November 2001, HUD released a monitoring report of the HOME Program and its monitoring responsibilities associated with one of its sub-recipients. I've delayed presenting this report to you because management has not formally responded to the report which, I believe, is due at the current -- at the end of the current month. At the end of January I believe is the current due date.

However, I would like for you to be aware of several of the issues that are significant in the report. And I can touch on these for you now if you'd like to; I'm prepared to do that. What I -- one of my goals is -- even though I've held off informally in presenting this report to you, the report is released, and I don't want you getting phone calls that -- on issues you aren't aware of. So I think I will touch on a few of the more significant issues relating to the report.

Overall, HUD reported that new construction for both single family and multifamily projects was very good;

however, there are considerable problems associated with the downpayment and closing costs assistance program, the owner-occupied rehabilitation program and the contract for deed conversion program.

The report concluded, "Properties acquired under these programs generally do not meet minimum habitability standards. Numerous instances of significant deficiencies were noted in the conditions of the properties that were visited."

As a result, HUD has instructed the department to reinspect all properties assisted with these funds in contracts with the sub-recipient that it was reviewing beginning with the State's 1998 program year through to the present and that all deficiencies noted during the reinspections be corrected.

HUD also stated that the department must put all remaining open contracts with the sub-recipient on hold until such time as all required inspections -- reinspections have been completed and violations corrected. The department must also review and revise its policies and procedures to ensure that in the future, all properties assisted with the HOME funds meet the State's minimum property standards.

Secondly, HUD found that the department is not providing adequate monitoring and oversight on an ongoing basis of its State recipients, especially in regard to construction activities. HUD noted that there's not documentation that newly constructed units are in compliance with the current edition of the model energy code.

HUD also noted an instance where a complex was not in compliance with Section 504 handicapped accessibility requirements relative to the units that are accessible to persons with visual and/or hearing impairments and that the calculation of the number of units required to be in compliance with Section 504 was understated by two. That calculation should have been seven in this instance, and it was calculated at five.

Accordingly, HUD stated that the department shall review all files for newly constructed HOME-assisted projects from 1998 through to the present and verify that the projects are in compliance with these requirements.

Third, HUD found that the department's monitoring process of the State recipients does not assure compliance with other federal program requirements. Under the contract for deed conversion program, HUD noted instances of lots purchased for the construction of housing for which construction was to begin with a one-year or -- within 12 months. Failure to begin construction within this time frame constitutes an ineligible use of HOME funds.

There were also two lots purchased which, in a letter from the department to the sub-recipients, could not be located. There was no evidence in the files that the sub-recipients had responded or that these were legitimate projects.

HUD reported that the department shall review all contract for deed activities from 1998 through to the present and document those activities that involved only the acquisition of vacant land. The department is to make a determination of the lots that remained vacant after 12 months and reimburse HUD from non-federal funds the full amount of HOME funds expended for these purposes.

HUD also noted that there was no documentation in the files that the sub-recipient executed sub-contracts with the third-party lender or the third-party lender executed sub-contracts with its lower-tiered providers for the purpose of taking loan applications. HUD stated that the department must ensure that no further federal funds be disbursed unless there are written and executed lower-tiered agreements between the State's sub-recipients and any subsequent sub-contracts.

Other compliance exceptions noted by HUD included a Land Use Restriction Agreement, or LURA, provision, which inappropriately waived a HOME occupancy requirement. This finding resulted in HUD reporting that the department must review all LURAs or similar agreements from 1998 through to the present and ensure that no prohibitive clauses are contracted for in the agreements. In such instances, the prohibitive clauses must be amended.

And I find these issues of considerable significance because of the demand it's going to place on the existing HOME resources, on the department's resources, going back to 1998 and working forward, as well as maintaining and fulfilling their current responsibilities.

Are there any questions or comments relating to the HUD monitoring review?

MR. BOGANY: I have one question.

MR. GAINES: Sure.

MR. BOGANY: The -- about the review in construction, is that part of the construction special program you thought needed to be restructured?

MR. GAINES: That would support or reinforce the need to implement that recommendation --

MR. BOGANY: Okay.

MR. GAINES: -- yes, sir.

MR. BOGANY: All right. And which -- who's over that program, the inspections?

MR. GAINES: It's program by program currently.

MR. BOGANY: Okay. So you don't have -- we don't have an inspection department that monitors all the different programs in checking them and making sure they're correct?

MR. GAINES: Not a centralized function.

MR. BOGANY: Okay.

MS. ANDERSON: David, in your experience, is this type of report and particularly the demands that it makes -- did they sort of throw the book at us, if I can use that slang?

MR. GAINES: Based on the examples they gave for one sub-recipient, it seemed like they were taking a real small sample result and projecting it as a problem to the entire population. And I believe the reason they're doing that is because of historical problems they've had with the department.

MS. ANDERSON: Okay. Thank you.

MS. CEDILLO: I'd like to make a comment. The method that was used during this monitoring visit was to request a list of documents from the sub-recipient. And the staff copied thousands of documents and provided them to the monitor, and the monitor was here in Austin. The sub-recipient is here in Austin.

And when the monitor wrote up the findings, she didn't request that someone drive her over to the sub-recipient's offices, which is just across town. And we have an issue with that, and we've set up an appointment with HUD to discuss the method that was used.

However, we're not saying that there aren't issues that merit our going back and setting up systems to make sure that these things don't happen with our sub-recipients. But it was a major project that was -- or major funding that was provided to the sub-recipient. And that's probably why HUD selected this one: Because we had so much money out there.

And -- but we do disagree with the fact that the monitor only requested certain items but then, when they wrote their monitoring letter, indicated they didn't have certain documents which were probably at the sub-recipient's office. And we could have provided that. So we are taking issue with the monitoring audit.

MR. GONZALEZ: Any other questions? Not a very good report.

(No response.)

MR. GONZALEZ: Any other issues?

(No response.)

MR. GONZALEZ: Okay.

MR. GAINES: The next summary of audits listed are internal audit projects. The single family loans projects has been completed, and that was the one just presented to you. The anticipated completion dates for the other projects listed need to be revisited, as does the audit plan as a whole that was just approved by the board in October 2001.

The plan was based on an assumption that the internal auditing division was going to be hiring another professional employee. Those plans have since changed, and we've lost that position as a result of positions being transferred to the Office of Rural and Community Affairs and the demand for positions by other areas of the department.

Accordingly, I just need to revisit the entire plan and bring that back to you to propose adjustments to that plan. And I hope to do that for the next Audit Committee meeting.

MR. BOGANY: I have a question.

David, let me ask you a question. Is your role -- I know what your role is in auditing and everything. But do -- as far as plans and coming in and saying, "Hey, we're going to restructure this and make this better," would that come from your end, and then we would have to implement it?

MR. GAINES: Well, my role is to audit areas that I perceived to be of high risk and, as requested by the board, make recommendations. The extent of my authority is how persuasive I can be.

MR. BOGANY: Okay. So if I went to you and said, "I'd like to restructure how the organization is set up and spread it out," would that be a plan that you would put together, or would you just say, No; This is your issues; Now you guys put it together?

MR. GAINES: Well, now, I'm certainly here to accommodate the board. And your request -- in that respect, I feel like I would probably first contact the HR director, who would be more experienced in that --

MR. BOGANY: Okay.

MR. GAINES: -- and start trying to identify criteria as to how -- what a typical organization might look like and compare that to what we have --

MR. BOGANY: Okay.

MR. GAINES: -- and make recommendations for differences that were identified.

MR. BOGANY: Thank you.

MR. GONZALEZ: Anything else?

MR. GAINES: Are there any other comments for today's report?

(No response.)

MR. GONZALEZ: No? A very good report.

If there's nothing else to come before the Audit Committee, we'll stand adjourned.

MR. GAINES: Chairman, if I may ask?

MR. GONZALEZ: Yes.

MR. GAINES: As far as the external auditors, do you see a need in having them stay for the full board meeting today?

MR. GONZALEZ: I would not think so, no.

MR. GAINES: Thank you, very much.

MR. GONZALEZ: We appreciate it.

The meeting's adjourned.

(Whereupon, at 9:42 a.m., the committee meeting was adjourned.)

C E R T I F I C A T E

MEETING OF: TDHCA Audit Committee

LOCATION: Austin, Texas

DATE: January 17, 2002

I do hereby certify that the foregoing pages, numbers 1 through 41, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Sunny L. Peer before the Texas Department of Housing and Community Affairs.

1/23/2002
(Transcriber) (Date)

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