TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

Room E1.028
Capitol Extension
1500 N. Congress
Austin, Texas

Thursday,
February 16, 2012
7:30 a.m.

COMMITTEE MEMBERS:

TOM GANN, Chair
LOWELL KEIG, Member

STAFF:

TIMOTHY K. IRVINE, Executive Director

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P R O C E E D I N G S

MR. GANN: I call this meeting to order, please. This is the Audit Committee for the Texas Department of Housing and Community Affairs; it's currently about 7:34. This is February 16, 2012, and we're at the Capitol Extension building, Room E1.028, 1500 North Congress Avenue, Austin, Texas.

Roll call.

Leslie Bingham, absent.

Tom Gann, present.

Lowell Keig?

MR. KEIG: Here.

MR. GANN: Just a note for all those that may be interested and may not, we will have public comment, but it's going to be at the point that the motion has been made and before the vote. Where we're having a situation like that for public comment, please hold it for that time.

Okay. Report items: Sandy Donoho.

MS. DONOHO: Good morning, Mr. Chair, committee member, Mr. Irvine. And for the record, I'm Sandy Donoho, Director of Internal Audit.

Item 1 is presentation, discussion, and possible approval of the Audit Committee minutes for September 15, 2011. The minutes for the September 15, 2011, Audit Committee meeting are in your board book.

Are there any questions regarding these minutes?

MR. GANN: No questions.

MS. DONOHO: Staff recommends approval of the minutes.

MR. GANN: I move and second. All those in favor?

No comment on that, is there? I guess we'd better ask for every item.

(No response.)

MR. GANN: All those in favor say aye.

(A chorus of ayes.)

MR. GANN: No opposed.

Item 2.

MS. DONOHO: Okay. Item 2 is presentation and discussion of audit results from the State Auditor's Office.

As you know, the department's governing statutes require an annual audit of the department's books and accounts, an annual audit of the Housing Trust Fund, and an audit of the financial statements of the Housing Finance Division and the Supplemental Bond Schedules.
These are required by our bond indentures.

This year the State Auditor's Office performed that work under contract with the department. Lisa Collier, assistant state auditor, and Amadou N'gaide, managing senior auditor, are here from the State Auditor's Office to discuss the results of this work, so I'd like to introduce them.

MR. GANN: While you're coming up, I'd just like to say welcome, because I think this is the first time this has happened, I know, since I've been up here, that the state auditors come in and present their reports. We appreciate it.

MS. COLLIER: Good morning, Mr. Chairman, member. For the record, my name is Lisa Collier. I'm an assistant state auditor for the State Auditor's Office, and I was also the audit manager for the financial statement audit.

Amadou's going to make our detailed presentation, but I had a couple of brief comments I wanted to make before turning it over to him.

As you know, this is the first year we conducted this audit. We appreciate the professionalism of Housing staff. We also appreciate how helpful everyone was in either providing us with requested information or answering our questions. We just wanted to pass that along to you.

MR. GANN: Thank you very much.

MR. N'GAIDE: Good morning, Chairman, member.

My name is Amadou N'gaide, and I was the project manager for the team -- the State Auditor's Office team that audited the department's financial statements for fiscal year 2011, and I just would like to thank you for giving us the opportunity to present the results of our work to you this morning.

In our report dated December 20, 2011, we concluded that the department's financial statements and revenue bond program, enterprise fund financial statements were materially correct and presented in accordance with accounting principles generally accepted in the United States of America.

We also concluded that the department computation of its unencumbered fund balance complied with the Texas Government Code.

We issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards. I believe that the previous auditors referred to that report as report management.

And our procedures did not identify any material weakness in internal control over financial reporting and on compliance with laws and regulations that materially affected the financial statements or the computation of the unencumbered fund balances. And the major controls that we tested for the purpose of forming our opinions were operating effectively.

But I also just would like to note that our audit procedures were not intended to provide an opinion on internal controls over financial reporting or to provide an opinion on compliance with laws and regulations. Therefore, we do not express an opinion on the effectiveness of the department's internal control over financial reporting and compliance with laws and regulations.

In addition to auditing the department's financial statements and the computation of the unencumbered fund balances, we performed agreed-upon procedures to assist the department in determining whether its submission of certain information to the US Department of Housing and Urban Development Real Estate Assessment Center agreed with the related hard-copy documents.

And we concluded at the end of that -- those procedures that the submission was done accurately and in accordance with those hard-copy documents.

On December 28, 2011, we also issued a report to the Legislative Audit Committee summarizing our work of the department's financial statements, and it is a normal practice of our office to issue reports to the Legislative Audit Committee on all the projects that we complete.

We communicated certain issues that were not material or significant to the audit objectives in writing to the department's management. Most of those issues were related to information technology.

Auditing standards required that we communicate certain matters to those charged with governance and to the Audit Committee in this instance, so I'm going to highlight some of the key points related to that communication.

As stated in our engagement letter dated May 8, 2011, our responsibility as described by professional standards is to express an opinion on whether the department's management presented the financial statements with your oversight fairly and, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

Our audit does not relieve management of their responsibility. We identified some misstatements that were not material or significant to the financial statements during the course of the audit, and those were corrected by management, by the department, on a timely basis.

We requested certain representations of management in our representation letter dated December 28, 2011, and we also requested a representation letter from the department's general counsel regarding the existence of certain contingent liabilities that might require disclosure in the financial statements, and nothing came to our attention in those representations that needed to be disclosed in the financial statements.

Management is responsible for selection and use of appropriate accounting principles, and the significant accounting policies of the department -- that the department uses are described in note 1 to the financial statements.

The department implemented Government Accounting Standard Board number 54, more commonly known as GASB 54, during the course of the audit, which changed the description of classification of fund balances in the balance sheet of the governmental fund.

And during that process the department coordinated with the Comptroller's Office, and we were involved in that process, to make sure that the classifications were in accordance with GASB 54.

We did not encounter any restrictions in performing our procedures. During the course of the audit we had access to all individuals and records that we needed to perform our work.

We had consistent and repetitive status meetings with management during the course of the audit, to make sure that all the issues were discussed and clear, and we appreciated their cooperation during that process. And we did not encounter any disagreement with management during the course of the audit.

And finally, we did not find any evidence of fraud, illegal acts, violations of contracts during the course of the audit. This concludes my presentation. I'll be glad to answer any questions that you may have.

MR. KEIG: As far as internal controls, does the SAO have any intentions to do a full audit of internal controls in the foreseeable future, or would it be more fair to say that if you'd found some red flags during your agreed-upon procedures that you were looking at on internal controls, then you might have put that on your list of things to do in the future?

MR. N'GAIDE: I think --

MS. COLLIER: At this time we don't have any plans to conduct any other audits at Housing other than when we go back for the fiscal year 2012 financial statement audit.

MR. KEIG: Okay.

MR. GANN: I don't have any comments other than I really did appreciate the report; definitely a good report as far as we're concerned. You build our confidence, and not only management, but our director, too, which we've had growing confidence in for a couple of years now since I've been on the board.

We appreciate y'all coming.

Any other comments?

MR. KEIG: I've got a couple of questions for management, but --

MR. GANN: Okay.

MR. KEIG: And I need advice of counsel on this, is under note 10 on page 34, there's a reference to ongoing HOME compliance matters.

Is that a matter that we should or -- should more appropriately take up in executive session with the rest of the board, since it could be legal related?

MS. DEANE: The Open Meetings Act would only allow us to go into closed session for matters -- audit matters related to fraud, waste, and abuse, and this probably does not rise to that level of fraud, waste, and abuse.

MR. IRVINE: But I would be glad, if you want, to describe in more detail what the issues are.

MR. KEIG: Yeah, just a --

MR. IRVINE: Sure.

MR. KEIG: -- short update on that.

MR. IRVINE: We have a number of older multifamily assets that were originated using HOME funds only. These span back to the mid-1990s, and some of those assets have become noncompliant under the HOME rules.

We are working to attempt to restore those assets to compliance. HUD has specifically identified them, and HUD has advised us that we need either to restore them to compliance, to provide qualifying replacement units, or work out some sort of repayment arrangement with HUD using nonfederal funds.

If the repayment arrangement is used to resolve all or part of these assets, there are possible ways that a repayment could be structured in terms of future grant reductions.

So that's the nature of the problem.

MR. KEIG: And we don't have a ballpark estimate at this time, I assume.

MR. IRVINE: I would say that the number of the assets that have been specifically identified by HUD probably involved somewhere on the magnitude of $7 million in total assets.

MR. KEIG: Okay. Thanks.

The nonmaterial issues that were reported to management that were IT related and that sort of thing, have those items been implemented the corrective action?

I'm not sure who to address that to.

MR. IRVINE: I'm not aware of any uncorrected IT matters, but don't have --

MR. KEIG: I don't think it was just IT matters, but that were -- that was some of the items that were on there, I guess.

Ms. Donoho, do you know anything about those items, as to whether those have been corrected?

MS. DONOHO: I think there were a couple -- well, I think David looks like he wants to talk about this. I'll be happy to let him do that.

MR. KEIG: Thanks.

MR. GANN: Thank you very much.

MR. CERVANTES: There were --

MR. GANN: Please identify yourself.

MR. CERVANTES: David Cervantes, Director of Financial Administration.

MR. GANN: Good morning.

MR. CERVANTES: Good morning. How are y'all?

I can address one of the items. There were four items that were verbally communicated; three of the items were IT related, so I can't really give you a background on that.

But there was one item in respect to one of the statements that we're required to issue, and that's the statement of cash flows. And in respect to the statement of cash flows, the recommendations that were made by the State Auditor's Office have been implemented.

And so that particular item has been addressed over the last -- you know, since we've received that information.

MR. KEIG: Ms. Donoho, can you address the other ones --

MS. DONOHO: Sure.

MR. KEIG: -- that were on there and what you might know about what the status was?

MS. DONOHO: Sure. I'd be happy to.

The first one had to do with patching on our systems, on our IT systems, for our PeopleSoft and Oracle and Solaris database operating systems, and Midas. And I believe that -- my understanding from conversations with Curtis Howe, the IT director, is that there are some of our systems that they made decisions not to install patches to those systems because of how it affects the integrity of the system, and because those systems are for the most part internal to the agency, so the risk is lower, the IT risk is lower.

There's also a issue about six staff members have write access to PeopleSoft application design module, and I'm not really sure about that one. My understanding is that because our IT division is so small there are some instances where people have to have access that they wouldn't ordinarily have, but that it is really limited.

So that may be one of those situations --

MR. KEIG: Do you know if they fixed that role-based control, if they removed the people who do not need the access?

MS. DONOHO: I would have to ask Curtis about that. I don't know, but I would assume, yes, because I do know that Curtis is pretty good about fixing these things when they're brought to his attention.

Also, the other one was seven programmers and one system analyst that had access to the PeopleSoft server operating system, but I believe that their access level was not particularly high.

And then there was a password issue related to that as well; it was kind of a combined finding.

One thing I will say is that these did not rise to the level of material weaknesses or significant deficiencies, so they weren't reportable issues. I think if SAO had felt like they were issues that were important enough, they would have put them in the report.

MR. KEIG: Our PeopleSoft system, is it only employees that are using that, or do we have any kind of contractors outside the agency that are involved with our system? We say it's internal. Is it truly internal, or are we, by not using these patches, you know, increasing our risk unnecessarily.

MR. CERVANTES: I can address the question about the users. The users of the PeopleSoft system are internal users. In respect to outside parties, I wouldn't categorize them as outside parties. We do have one consultant that we employ in terms of doing maintenance to the PeopleSoft system, but that is pretty much the extent of the external support that we have on the system.

MR. KEIG: Do we have some type of confidentiality agreement with this consultant?

MR. CERVANTES: I believe there are stipulations in the arrangement that we have with the consultant. And of course, the solicitation for services obviously is something that we work through the Department of Information Resources in terms of securing their services. So pretty much all of the arrangements that are made are run through those channels.

MR. KEIG: Because the PeopleSoft people would have access to social security numbers, health insurance coverage, and things like that. Right?

MR. CERVANTES: That is correct.

MR. KEIG: I just want to make sure we've got that buttoned down real tight.

MR. CERVANTES: I don't want to speak for Mr. Howe, and we can probably get an answer -- more specific answer by the time, you know, we get to the actual board meeting, but I know that they have the oversight on the controls in relation to what you're referring to, is to ensure that there is no breach or possibility of breach, whether it's the content of the information or the use of the system.

As I said, I don't want to intrude in Curtis's territory, but I know in general that is the -- you know, the infrastructure that's laid there in terms of security provisions.

MR. KEIG: Do you think it might be helpful to visit with Curtis before the board meeting so we can --

MR. IRVINE: I will try to get Curtis over here before the board meeting.

MR. KEIG: I know it's early still. Okay.

All right. Thank you guys.

MR. GANN: Amadou and Lisa, I can't see you over there for the Texas flag, but we really do appreciate you all coming in and delivering these reports personally, and good reports, too, let me say. Thank you so much.

You're welcome to stay. I know you two love this kind of stuff. You can leave anytime you want to. Thank you for coming.

Item number 3.

MS. DONOHO: Okay. Item 3 is presentation, discussion, and possible action on the 2012 Audit Committee charter and Board Resolution Number 12-018.

The internal audit standards require we have an annual discussion regarding the audit standards, our code of ethics, and the definition of internal audit. These issues are all addressed in our charter and our board resolutions.

So first I'll talk about the definition of internal audit. Internal audit is an independent objective assurance and consulting activity designed to add value and improve an organization's operations; helps organizations accomplish their objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management controls and governance.

The Internal Audit Division follows the Institute for Internal Auditors international standards for the professional practice of internal auditing and the US Government Accountability Office's government auditing standards for every audit that we do.

The standards are required by our charter and by the Internal Auditing Act, which is the state statute that covers internal auditing, and they ensure that the division's work is independent, thorough, accurate, reliable, and objective.

The Internal Audit Division has adopted and complies with the Institute of Internal Auditors code of ethics. There's also a requirement of our charter to comply with the code of ethics.

The code of ethics requires auditors to uphold the principles of integrity, objectivity, confidentiality, and competency, as well as 12 rules of conduct related to these principles.

Organizational independence requires Internal Audit to report to a level of the department that allows us to fulfill our responsibilities without interference from management and to be free of operational and management responsibilities that could impair our ability to independently review the department.

Our charter assures our organizational independence by requiring that I report to the chair of the Audit Committee as well as to the entire governing board.

Individual independence requires the audit staff to have an impartial, unbiased attitude and to avoid conflicts of interest. The Internal

Audit Division meets the independence requirements, in my opinion.

Internal Audit standards require annual approval of the internal audit charter and the board resolutions regarding internal audit.

The content of the charter and the resolutions has not changed since their last approval on January of 2011. The newest version of the charter corrects some minor typographical and formatting issues. We've had our charter since 2001, and every year we update it.

There are copies of both of these documents in your board book; they are also in the consent agenda for the board meeting.

Are there any questions on the charter, the board resolution, our standards, the code of ethics, or auditor independence?

MR. KEIG: No. Just a comment that you provided us with a redlined copy as well, and I noticed that there were some grammatical fixes and that sort of thing but no substantive big changes this year.

MS. DONOHO: Okay. So staff recommends approval of the Audit Committee charter and Board Resolution number 12-018.

MR. KEIG: Move to approve.

MR. GANN: Second.

Mr. Director, do we still need to have public comment requests at this time on something like this? I mean, I'm just asking now.

MR. IRVINE: I think you can always ask for it. With only one member of the public here --

MR. GANN: I didn't think so either, but I don't see any, so all those in favor say aye.

(A chorus of ayes.)

MR. GANN: Disapprove, say no.

(No response.)

MR. GANN: Unanimous.

Item 4.

MS. DONOHO: Item 4, presentation and discussion of the status of the fiscal year 2012 internal audit work plan.

We have eight audits on our plan this year. We've completed two audits, which we'll talk about under agenda item 5, and we have three audits that are currently underway.

We anticipate that our website management audit will be completed in March, the HOME multifamily audit will be completed in April, and the Section 8 audit in May.

This leaves us with three audits -- homeless housing and services program, loan processing, and human resources -- to complete this summer. Human resources is a very small audit; it's 120 hours. So I believe that we will be able, given our current staffing level, to meet the plan and to complete all the audits as scheduled.

In addition we completed our quality assurance and self-assessment review, which we'll also talk about under agenda item 5, and the charter and board resolutions that we just talked about.

We're working on updating our policies and procedures to comply with the new standards. We've actually done that; I just need to make a final review of those policies and procedures and sign the final documents.

Our 2013 risk assessment preparations for peer review and our 2012 annual report are always completed in July and August. So we're on target as planned.

Are there any questions regarding the work plan?

MR. KEIG: I have none.

MR. GANN: None.

MS. DONOHO: Okay. Item 5 is presentation and discussion of recent internal audit reports.

We're released two internal audit reports and one review since our last Audit Committee meeting. Let's talk about the easy stuff first.

The quality assurance and self-assessment review was completed in September 2011. We're required by statute to comply with the standards of the Institute for Internal Auditors that we just talked about earlier.

These standards require us to perform self-assessment on our audit working papers and to report to our governing board at least once a year on the status of our quality assurance program.

The self-assessment process requires us to perform a detailed review of our charter -- which we just talked about -- our audit working papers for the past year and our policies and procedures.

To perform this review we used a working paper review tool that was developed by the State Agency Internal Audit Forum, which is a group of state agency internal auditors. I'm an officer of the forum, and I'm currently chair of their peer review committee, which developed the tool that we use to evaluate our working papers.

To ensure objectivity, the review of our audits for the last year was completed by our newest staff member who did not do any work on those audits. As a result of the self-assessment review, we believe we're in full compliance with the definition of internal auditing, the required auditing standards, and the code of ethics.

This belief is further supported by the results of our last peer review. Our next peer review is due in December 2012.

Are there any questions regarding our self-assessment report?

MR. KEIG: No.

MS. DONOHO: Okay. The next audit is contracting for services. This one was released in January. The objective of this audit was to determine if contracts for services awarded in accordance with rules, regulations, and applicable laws.

We reviewed the department's process for contracting for services. We found that there are good controls over the following processes: preparation of the solicitation; this includes submitting the procurement documents to the Comptroller's Office; advertisement of the solicitation; administrative review of bid responses; negotiation of the final awards; and completion of the purchase order for the final contracts.

However, we determined the controls over the processes for scoring and recommending awards could be improved. None of the issues that we identified affected the outcome of the award for the five contracts we reviewed; I want to make that perfectly clear up front. The people who were awarded those contracts should have been awarded those contracts, in our opinion.

However, the five contracts that we looked at totaled 5.2 million, and they represented 88.3 percent of the total contract awards for the 11 contracts that the agency had that exceeded $100,000 since September 2009.

For example, there were inconsistencies in the number of evaluators scoring each proposal for three of the contracts, and two of the contracts where the scoring packet wasn't in complete agreement with the evaluation criterion that was defined in the request for proposal.

We recommended that the division implement policies and procedures for scoring in award processes. Improving controls over these processes will allow for more consistent contracting process and will help continue to ensure that the awards go to the right bidders.

Are there any questions regarding this audit?

MR. KEIG: No.

MR. GANN: I have none.

MS. DONOHO: Okay. And finally I want to talk about our most recent audit, which is a follow-up audit of the Neighborhood Stabilization Program. This was released on January 31.

At the request of the board, we included a follow-up audit of the Neighborhood Stabilization Program, also called NSP, in this year's audit plan.

As you recall, we originally audited NSP as part of our 2010 audit plan. We completed our fieldwork on the original NSP audit in

December of 2010, and the report was released in April of 2011.

Last August management reported to us they had implemented 15 of the 19 recommendations in the original report. We went back to take a look. Results of that follow-up work are what we're talking about now.

We found that nine of the original 19 recommendations, or 47.4 percent, were fully implemented. This means that the level of documentation and the accuracy of NSP data in the housing contract system has improved. The timeliness and support documentation for draw processing has also improved.

However, of the remaining six issues that were reported as implemented, four were implemented too recently for us to test; there weren't enough transactions, because they were implemented around the end of August, so not enough transactions had passed through the system at the point where we did the audit to be able to say that those findings were fully implemented, so we're considering them partially implemented. We'll go back and take a look again.

In two of those remaining six issues, the actions taken by management were not sufficient to satisfy the recommendations. As a result, we determined them to be not implemented. And, again, we'll go back and take a look when we do our prior audit issues.

The four issues that management reported as not implemented are monitoring key program elements, reconciling the housing contract system with HUD's Disaster Recovery Grant Reporting System, or DRGR, and maintaining supporting documentation to verify that obligations were made; in other words, that the money was committee by HUD's September 3, 2010, deadline; and finally, ensuring that loan files provided to Legal are complete and accurate.

We recommended NSP continue to implement our prior audit recommendations. We also performed some additional work to look at acquisitions.

When we did our first audit, the program wasn't far enough along for us to look at acquisitions, so this time it was, and we decided that we needed to do that work as well.

We determined that although NSP funds were used to acquire property for rehabilitation, redevelopment, and land banking as required -- that's the good part -- documentation indicating the subrecipient had clear title to the property was not always available.

We visited 155 NSP properties to verify their existence, and we were able to locate all of these properties. I personally went with one of my staff and looked at 155 properties. Some of the new construction that we saw, especially in the Valley, was very, very nice; those houses are gorgeous.

We reviewed files for 161 properties -- the 155 plus a few more -- and found that in 21 cases, or 13 percent, there was no documentation that the property deeds were recorded.

If you don't record a property deed, I think it increases the risk that someone else may have a higher-priority claim to the property.

In nine case, or 5.6 percent, there wasn't evidence of a title insurance policy which indicated all liens were properly satisfied. Without documentation of the title insurance policy, the department doesn't have assurance that the title was clear when the property was acquired by the subrecipient.

We recommended that NSP obtain and maintain deeds and title insurance policies and verify that the title policies indicate that all outstanding liens were satisfied.

Are there any questions on this report?

MR. KEIG: I've got a few questions.

On some of these items, like filing of deeds, whose responsibility was it to get the deed filed?

MS. DONOHO: That would be --

MR. KEIG: The local agency. Right?

MS. DONOHO: Right. The title company.

MR. KEIG: So even though we need to have some controls in place to make sure that happens -- a checklist or something -- that wasn't our primary responsibility, to get the deed filed itself.

MS. DONOHO: I would agree with that, yes.

MR. KEIG: Okay.

MS. DONOHO: However, I think that the department needs to make sure that its files are complete, needs to make sure, especially in the case of these properties that have been foreclosed on in some instances, or abandoned, or cities or counties have taken liens against the property for things like cleanup and things like that, these are properties that have a lot of baggage with them.

MR. KEIG: Right. So --

MS. DONOHO: And I think it's important to make sure --

MR. KEIG: Yeah. Our folks need to inspect what they expect of the local agencies.

MS. DONOHO: Especially if we don't have a title insurance policy for those properties.

MR. KEIG: Okay.

MR. GANN: While you're in that section, I think this is a common occurrence that happens in any town, really, or any county. Part of that procedure usually is -- it may be an attorney, but it may be a title company, you know, generally, and then they file it, but they never get it back. It's not as important to them, maybe, even if you're in the local town.

So we're not responsible for doing that, but we are responsible for having it in our file, is what I'm looking at. Is that correct?

MS. DONOHO: Right.

MR. GANN: And I was curious. Is there a checklist like he mentioned earlier -- is there a checklist? I mean, seemed like it would be like a red flag if these certain items weren't there.

MR. IRVINE: Mr. Chairman, I mean, our standard protocol -- and I'd ask Marnie to come forward and provide detail or correct me, whatever -- is when we have a real estate transaction that's being closed, Legal supervises the preparation of the closing materials; that includes preparation of the note, deed of trust, review of the title policy, the exceptions on title policy and so forth, and signs off on all of that and essentially provides an instruction letter to the title company: Close this transaction by obtaining execution of these documents; send them back to us.

Now, in some counties those things take a very, very long time, and we do need to have, absolutely, procedures in place to ensure there is follow-up on those items, but I believe as a business operating risk, we are acting in a situation where the risks have been assessed, documented, and appropriately placed with the title company.

MS. HOLLOWAY: Marnie Holloway. I'm the director of the Neighborhood Stabilization Program. Good morning.

All of our real estate transactions are closed with title companies with benefit of a title commitment, and as Mr. Irvine described, all of those documents are reviewed both by my staff and by Legal Services prior to closing.

At the actual closing the way that the Neighborhood Stabilization Program is operating, all of those documents are scanned and emailed back to us, and my staff verifies that everything has been properly executed and is ready to go.

At that point the title company, of course, is responsible for recording and for returning to us all of the trailing documents.

For some title companies, particularly in the larger urban areas or for the commercial transactions, that's 20 days to get everything back to us. For other title companies, particularly -- I know one of the transactions that was of a concern was at the city of Seguin, and it's a smaller title company, and it can take 90 days or longer to get that title policy back.

We, when we receive those trailing documents, verify that they match all of our records. They are scanned and forwarded to the Loan Servicing Division. I believe that Loan Servicing, through the Midas system right now, has check boxes for the deed of trust, which of course secures our investment in the property; and the title policy, which further secures that there hasn't been some cloud on title previously.

We have not had a check box for that warranty deed, and I definitely need to take a look at adding it. I would also mention that -- and I don't know exactly which transactions Internal Audit looked at. Not all of our investments in NSP properties actually are purchase money financing.

So, you know, there are a number of transactions out there that the subrecipient already owned the property, and we're just securing our investment. So there wouldn't have been a warranty deed at that closing; the warranty deed already existed.

In those instances it should have been part of the records previously, and I believe that we discussed that with Internal Audit, and I'm sure that they double-checked that also.

MS. DONOHO: We did take that into consideration. I'd also like to bring up that the ones that we found in error were much older than 90 days, you know, so we did find some where it was a recent closure; we didn't count those. The ones that we counted were the ones that were very, very old that those documents should have been received.

MR. GANN: How far out did you get?

MS. DONOHO: I know it was more than 90 days. I think that was our cutoff.

MR. GANN: Okay.

MR. KEIG: I'm a little concerned that we've had this audit, results out for, I don't know, a month, and something that seems like an easy fix, adding to our checklist the warranty deed, is not something that's happened yet.

And so I guess what I'd like to do is encourage your division to whatever you can do to step up the process and expedite getting these items knocked out.

I know that there's tons of work to do on the program itself as you go along, but could y'all do that, try to expedite these things?

MS. HOLLOWAY: Absolutely. And we are committed to clearing the rest of the items that need to be cleared. We've already started working on a number of them.

There was a suggestion from Internal Audit regarding some changes to our SOPs that were created out of findings from the first audit. We've already made those changes so that we're moving forward already. We're -- next time Internal Audit comes in, we're ready to go.

MR. KEIG: And one thing I noticed from the management comments on the audit was that we didn't have any target dates for completion of the corrective action.

Have you submitted something since the management comments, in writing, to Internal Audit with target dates?

MS. HOLLOWAY: There are a number of items that we had provided to Internal Audit when the report was first published. Because, of course, they haven't had an opportunity to examine those items, you know, they don't appear here.

MR. KEIG: Okay. So the answer right now is no. There's not been a list of target dates for completion.

Understand that with auditing standards and what we just approved the charter -- and it is a "should"; it's not a "shall." But they need to have target dates for completion of items that need to be implemented.

MS. HOLLOWAY: I understand.

MR. KEIG: So I'd like to ask if you could get that over to them, and when do you think you could get a list of those dates over to Internal Audit?

MS. HOLLOWAY: I'm sure that a week from today we'll have that information.

MR. KEIG: That'd be great. And I know it's not the only thing you have to do. I understand that you've got a lot on your plate.

MS. HOLLOWAY: Yes, we do.

MR. KEIG: Okay. Great. Something else I understand is that we have provided your division with some additional FTEs to try to help out.

MS. HOLLOWAY: There is an item on the board agenda for today that will actually allow an additional FTE and -- in my direct staff and provide an FTE in the multifamily division.

We're going to move all of the NSP multifamily transactions over to that division so that we can tap into that expertise. So that's the item that's on the agenda later.

MR. KEIG: Do you feel like when you get those two FTEs that you'll have the help you need to knock out these audit items and get the program running as smoothly as you possibly can?

MS. HOLLOWAY: I believe so.

MR. KEIG: Okay.

MR. GANN: I think you covered it.

MR. KEIG: Thanks.

MR. GANN: We appreciate it.

MS. HOLLOWAY: Thank you.

MS. DONOHO: Are there any other questions?

MR. GANN: I'm just curious. Was there anything else that turned up that may not have been included in your report earlier? We found that on another issue, so I --

MS. DONOHO: One of the things that we noted that we did not put in this report was the department has an enterprise risk management system where each division assesses their risks independently, and then that rolls up into the agency-wide risk assessment.

Internal Audit also uses the results of the enterprise risk management system to roll into our risk assessment and take into consideration when we decide what to audit, and every division is supposed to participate in that.

Our NSP division did not participate in that process last year, so we weren't able to use that information, and it didn't roll into the agency's risk assessment either. And that was something that we pointed out to them just informally.

MR. GANN: I'd just like to make one last comment, that when you prioritize your things -- and there's a difference between a deed and a recorded deed, and they look a lot alike, but there's -- a little bit of difference is really significant, so I would make that one of my high-priority items, is to make sure you have the recorded deed, because you do get a copy of it when you get -- do y'all have a HUD 1 that comes back with your closings?

MS. HOLLOWAY: Uh-huh.

MR. GANN: Okay. Good.

Okay. Any other comments on that from anybody?

MR. KEIG: No. Thanks.

MS. DONOHO: Item 6 is presentation and discussion of the status of external audits.

Looking at the table in your book, there were five external audits, reviews, or monitoring visits for fiscal year 2012, so far. Two are completed, and the reports were released. We're going to talk about one of these under agenda item 7. The other one was the SAO report that you just heard about.

One is complete, but the report has not yet been released. This is the annual statewide audit by KPMG that they do under contract with the State Auditor's Office. We anticipate seeing this report in early March.

There are two underway. One is a HUD OIG review of the

Neighborhood Stabilization Program. We expect a draft report from HUD OIG on the NSP monitoring -- or audit, I guess, in March.

The other one is a remote monitoring review of the National Foreclosure Mitigation Counseling Program, and this is being done by Mayer Hoffman McCann, PC, under contract with NeighorWorks. This review just started last week.

Five external audits or reviews in the first six months of the year is a drop in coverage from last year, when we had 16 for the entire year, so at this point in our fiscal year we should be about seven, eight, nine neighborhood.

As the department's funding decreases and our federal oversight agencies decrease their monitoring efforts in proportion to our funding, we hope that the assurance provided by Internal Audit becomes even more useful to the department and to the board.

Are there any questions on the status of the externa audits?

MR. GANN: No.

MS. DONOHO: Okay. Item 7 is presentation and discussion of recent external audit reports.

As I said earlier, there were two. One was the State Auditor's Office; the other one is a DOE monitoring report of the Weatherization Assistance Program. This one came out in November.

DOE reviewed financial and program information at the department, and they looked at two of our subrecipients: Economic Opportunities Advancement Corporation in Waco, and Brazos Valley

Community Action Agency in College Station.

Their review included looking at the departments Davis-Bacon procedures, reviewing certified payrolls for several subrecipients, and also looking at some financial and program information.

They didn't identify any findings at the department level, so that's good news. If you remember, the last couple of years we've been auditing Weatherization and Internal Audit; we've had a lot of DOE monitoring visits, and we've had, you know, findings that they've had. This time they had no findings, so I think that that speaks to how that program is progressing and the hard work that the people in that division have done.

They did identify one finding at the subrecipient level, and they had three concerns, two of those at the subrecipient level.

Their cover letter, if you notice in their book, says four concerns, but the report only talks about three, just so there's no confusion.

The concern that they had for the department I wanted to talk about first, they said that the department is not weatherizing units under the annual DOE award; the only expenditures under the DOE award appeared to be administrative training and technical assistance cost. There were no program operation costs and no production listed on the reports for the last quarter.

Program 2011 carryover was almost as much as the annual award. My understanding is that's because of the ARRA funding, that the ARRA funding was spent first. I believe that's correct.

They recommended that the department submit a plan of action to produce units under the regular DOE grant and to expend enough funds to reduce the carryover amounts.

They also discussed in the report the department's plan to move the weatherization monitoring function to the Compliance Division. As you recall, this is a discussion that we've been having for a couple of years now. It was originally based on an audit recommendation that we made in Internal Audit to consider separating monitoring and program officer functions.

The intent of our recommendation was to increase the likelihood that issues would be identified and corrected if there wasn't a close working relationship between the monitors and the subrecipients and that the monitors had a certain level of independence from the day-to-day operations of the subrecipients' programs.

DOE's concerns on the other side were how much attention the weatherization program will get if the monitors are also responsible for monitoring other programs, how grant funds will be used to pay for weatherization monitoring if the grant funds can't be commingled, what happens if there's a reduction in force in the Compliance Division or a reduction of travel funds, and the challenge in developing state plans for the DOE grant if those monitors are combined.

In addition, they also said that that structure was tried in other states and was not entirely successful. They requested that, if the department chooses to move the monitoring function, they determine direct lines of communication and establish protocols to provide the same level of oversight as was previously provided.

MR. GANN: This may be a good time to let Tim let something about maybe how -- where's management on those items.

MR. IRVINE: Well, first of all, management is in the process of some organizational changes, improvements, whatever you want to call them, and we will provide a detailed report on the larger organizational changes at the board meeting.

But with respect to this specific issue, our -- we are on plan to transition the monitoring responsibilities for all the community affairs programs to our monitoring function under Patricia Murphy around the time that the ARRA activity is completed. Patricia and her team are already undertaking self-education and training, looking at protocols and so forth. I've been discussing these issues with Patricia, also with Brooke and Michael, and, you know, we'll absolutely make sure that the programmatic activity continues to have a good technical assistance and training dimension from the program side.

I would also say that Patricia historically, in administering her monitoring function, does provide a lot of training. I mean, she does great training for tax credit properties and so forth, and, you know, I think, frankly, a little more formalized and a little more structured compliance-based training will be really helpful to this network.

MR. GANN: Patricia Murphy can be mean sometimes. She's really good, let me tell you.

(General laughter.)

MR. GANN: I have personal letters to that position that I had to receive when I was in the program. I'll bring them up here one day. So I'm glad to see you put Patricia on the job.

Any other comments? I didn't mean to cut you off there.

MR. IRVINE: No. We're certainly aware of the issues that DOE has raised, but we're working on creating, frankly, a management environment where, at the line level, there is appropriate independence and separation of duties, but where at the management level we're frankly a whole lot more communicative, and I'm very confident that in this new structure there will still be a lot of input to ensure that there's a good, robust TA function.

MR. GANN: And there's always fine tuning when you're changing things.

MR. IRVINE: Totally.

MR. GANN: We appreciate you, Tim.

MS. DONOHO: I wanted to bring that issue up because DOE brought it up in their monitoring report and also because it came out of Internal Audit recommendation to consider separating those.

The DOE monitors are here this week, and I did have an opportunity to sit down and talk with the monitor who wrote this report and is here this week, and he told me that his concern about this was not so much all of these issues as that he felt like our subrecipients needed a lot of technical assistance and training and that he felt like if the monitors solely monitored and moved to Patricia's division, that they wouldn't get the technical assistance and training.

But my understanding from talking with management is that there's a plan for that, and, you know, just from having audited this division, I think the people who are training and providing technical assistance find it difficult to then come back and criticize. Sometimes it's better to separate those, and that's where our recommendation came from.

So I felt a little bit better about this process after having talked with him.

MR. IRVINE: And I would point out two things: First of all, we have spent literally millions of dollars on a weatherization academy, and they have had a tremendous amount of training with the benefits of the ARRA funds.

I would also point out that for this next year that's coming up on us, no additional ARRA -- no additional DOE weatherization funding will be coming to Texas; all they will have is their routine funding that they have not been expending, and it will be a vastly reduced program, so the ability to interface with folks, you know, it will be as close to one on one as you can get.

MR. GANN: I think that particularly program increased 2500 percent, so there's going to be a drastic decline. That's great.

Any other comments?

MR. KEIG: No.

MR. GANN: Okay.

MS. DONOHO: Okay. The one finding that they did have was that the subrecipient in Bryan did not remove an unvented space heater from a bathroom. They asked that the contractor return for that.

There was a two-ton AC unit that was replaced with a 3-1/2 ton unit in Waco. This was a cost difference of $186. They recommended that monitoring staff review the cost sizing criteria and installation of that unit.

And then there was an attic door hatch that was not insulated, and that's a DOE requirement.

In addition -- and this is the really good news -- they closed out nine findings from prior monitoring visits, so they followed up on their own findings, which meant I didn't have to. And they closed them out for us.

MR. GANN: Well, from what I understand, this is remarkable. That's the small type items that they were finding. I think your staff -- would you want to recognize your staff, that particular group that actually did that program? That's a fantastic report, as far as I'm concerned.

MR. IRVINE: Well, Michael DeYoung's here, and he's the guy that's --

MR. GANN: Michael, you did a good job. I've seen you out there in the territory and a lot of tours and things, and it was impressive.

MR. IRVINE: And I would also like to recognize Brooke's role in the success of the weatherization program. I mean, I think that she's developed an incredible ability to take performance, translate that into metrics, and use that as a way to predict very accurately who's going to spend, who's not going to spend, who's got issues, who doesn't have issues, and it's given us an ability to manage this program proactively such that we are on track to complete full expenditure of our ARRA weatherization funds.

MR. GANN: Great team. We appreciate you.

Next?

MS. DONOHO: Okay. Item 8 is presentation and discussion of the status of prior audit issues.

Of the 41 current prior audit issues -- and let me explain a little bit how we got to 41: Your last board book we had a different number, and what happens is when we talk about findings during an Audit Committee meeting, then we add them to our list afterwards, so the number jumped up between the last Audit Committee and this one, because all the ones we talks about at the last Audit Committee meeting, plus things that we were working on at that time all added up to that 41.

Nineteen of those issues that were reported as implemented we verified and closed during this period. There were three issues that were reported by management as implemented; those are on the list in your board book, and we'll verify and close those once we've looked at all the necessary supporting documentation.

There are 19 issues for NSP, and those were reviewed during the follow-up audit. They are not on the attached list, but they are in our count, because they were prior audit issues from before.

We will add back the 10 issues that we were unable to clear to our list, and we'll clear them as soon as management reports that they're implemented and provides us with the supporting documentation or the program ends, which I believe the last date to spend the funding on that is March of 2013.

So we're really down to the three that we have here, plus the 10 for NSP that we need to follow up on.

Are there any questions regarding the prior audit issues?

MR. GANN: No.

MS. DONOHO: Then that concludes the agenda items.

MR. GANN: Any other comments?

MR. KEIG: None from me.

MR. IRVINE: I just would like to close on a Kumbaya moment. I mean, I think that we've been through some very difficult audit issues; it's no secret. And I just want you to know that I have a very strong belief in the value of a good, robust independent audit structure. I really appreciate the kind of picky questions that you ask. They're useful.

I appreciate the findings that Sandy does provide to us, because they do enable us to recalibrate and improve the program, and I would like to say that in the program staff that's been responding to these issues, you know, anytime you get bad news it's a little hard to embrace that, especially if you're already really, really overwhelmed taking care of other stuff.

But I want to give you a personal assurance that we are collectively committed to making this process effective and putting it to good use.

MR. GANN: Far as I'm concerned, we have no doubts what's going to happen, so we appreciate you, Tim, a whole lot.

Anything else?

(No response.)

MR. GANN: Then we are adjourned.

(Whereupon, at 8:31 a.m., the meeting was concluded.)

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C E R T I F I C A T E

MEETING OF: TDHCA Audit Committee

LOCATION: Austin, Texas

DATE: February 16, 2012

I do hereby certify that the foregoing pages, numbers 1 through 42, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Nancy H. King before the Texas Department of Housing & Community Affairs.

02/22/2012
(Transcriber) (Date)

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