AUDIT COMMITTEE MEETING
September 6, 2012
Lowell Keig, Chair

TEXAS DEPARTMENT OF HOUSING & COMMUNITY AFFAIRS
Building Homes. Strengthening Communities.

Leslie Bingham-Escareño, Member
Tom H. Gann, Member

AUDIT COMMITTEE
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

September 6, 2012
8:00 AM
Capitol Extension, Room E2.026
1500 North Congress Ave.

AGENDA

CALL TO ORDER, ROLL CALL — Lowell Keig, Chair

CERTIFICATION OF QUORUM — Lowell Keig, Chair

PUBLIC COMMENT
The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will solicit public comment at the end of the meeting and will also provide for public comment on each agenda item after the presentation made by the Department staff and motions made by the Committee.

The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will meet to consider and possibly act on the following:

REPORT ITEMS

Item 1	Presentation, Discussion, and Possible Approval of the Audit Committee Minutes for June 13, 2012	Lowell Keig, Chair
Item 2	Presentation, Discussion, and Possible Approval of the Fiscal Year 2013 Internal Audit Work Plan	Sandy Donoho Director, Internal Audit
Item 3	Presentation and Discussion of the Status of the Fiscal Year 2012 Internal Audit Work Plan	
Item 4	Presentation and Discussion of Recent Internal Audit Reports	
Item 5	Presentation and Discussion of the Status of External Audits	
Item 6	Presentation and Discussion of Recent External Audit Reports	
Item 7	Presentation and Discussion of the Status of Prior Audit Issues	
Item 8	Presentation and Discussion of the Status of the Fraud Hotline and Fraud, Waste and Abuse Complaints	

PUBLIC COMMENT ON MATTERS OTHER THAN ITEMS FOR WHICH THERE WERE POSTED AGENDA ITEMS.

EXECUTIVE SESSION — Lowell Keig, Chair
The Board may go into Executive Session pursuant to Texas Government Code §551.071 for the purpose of receiving legal advice from counsel on any agenda item and Texas Government Code §551.074 for the purpose of discussing personnel matters, including to deliberate the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of a public officer or employee including, specifically, the performance evaluation of the Internal Auditor.

OPEN SESSION
If there is an Executive Session, the Committee will reconvene in Open Session. Except as specifically authorized by applicable law, the Committee may not take any actions in Executive Session

ADJOURN

To access this agenda and details on each agenda item in the board book, please visit our website at www.tdhca.state.tx.us or contact Nidia Hiroms, TDHCA, 221 East 11th Street Austin, Texas 78701-2410, 512-475-3930 and request the information.

Individuals who require the auxiliary aids, services or sign language interpreters for this meeting should contact Gina Esteves, ADA Responsible Employee, at 512-475-3943 or Relay Texas at 1-800-735-2989 at least two days before the meeting so that appropriate arrangements can be made.

Non-English speaking individuals who require interpreters for this meeting should contact Nidia Hiroms, 512-475-3930 at least three days before the meeting so that appropriate arrangements can be made.

Personas que hablan español y requieren un intérprete, favor de llamar a Jorge Reyes al siguiente número (512) 475-4577 por lo menos tres días antes de la junta para hacer los preparativos apropiados.

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BOARD ACTION REQUEST

BOARD SECRETARY

SEPTEMBER 6, 2012

Presentation, Discussion, and Possible Approval of the Audit Committee Meeting Minutes Summary for June 13, 2012.

Recommended Action

Approve the Audit Committee Meeting Minutes Summary for June 13, 2012.

RESOLVED, that the Audit Committee Meeting Minutes Summary for June 13, 2012, is hereby approved as presented.

AUDIT COMMITTEE
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

June 14, 2012
8:30 AM
221 E. 11th St. Room 116
Austin, TX 78701

SUMMARY OF MINUTES

CALL TO ORDER, ROLL CALL; CERTIFICATION OF QUORUM
The Audit Committee of the Board of the Texas Department of Housing and Community Affairs of June 14, 2012 was called to order by Chair, Tom H. Gann at 8:30 a.m. It was held at the 221 E. 11th Street, Room 116, Austin, TX. Roll call certified a quorum was present.

MEMBERS PRESENT:
Tom Gann, Chair
Lowell Keig, Member

PUBLIC COMMENT
The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will solicit public comment at the end of the meeting and will also provide for public comment on each agenda item after the presentation made by the Department staff and motions made by the Committee.
NONE.

The Audit Committee of the Board of the Texas Department of Housing and Community Affairs will meet to consider and possibly act on the following:

REPORT ITEMS

AGENDA ITEM 1 PRESENTATION, DISCUSSION, AND POSSIBLE APPROVAL OF THE AUDIT COMMITTEE MINUTES FOR FEBRUARY 16, 2012
MOTION BY MR. GANN TO APPROVE; DULY SECONDED BY MR. KEIG, MS. BINGHAM-ESCAREÑO WAS NOT PRESENT; MOTION PASSED.

AGENDA ITEM 2 PRESENTATION AND DISCUSSION OF THE STATUS OF THE FISCAL YEAR 2012 INTERNAL AUDIT WORK PLAN
REPORT ITEM ONLY. NO ACTION REQUIRED.

AGENDA ITEM 3 PRESENTATION AND DISCUSSION OF RECENT INTERNAL AUDIT REPORTS
REPORT ITEM ONLY. NO ACTION REQUIRED.

AGENDA ITEM 4 PRESENTATION AND DISCUSSION OF THE STATUS OF EXTERNAL AUDITS
REPORT ITEM ONLY. NO ACTION REQUIRED.

AGENDA ITEM 5 PRESENTATION AND DISCUSSION OF RECENT EXTERNAL AUDIT REPORTS
REPORT ITEM ONLY. NO ACTION REQUIRED.

AGENDA ITEM 6 PRESENTATION AND DISCUSSION OF THE STATUS OF PRIOR AUDIT ISSUES
REPORT ITEM ONLY. NO ACTION REQUIRED.

PUBLIC COMMENT ON MATTERS OTHER THAN ITEMS FOR WHICH THERE WERE POSTED AGENDA ITEMS.

EXECUTIVE SESSION
The Committee may go into Executive Session (close its meeting to the public) on any agenda item if appropriate and authorized by the Open Meetings Act, Texas Government Code, Chapter 551 and under Texas Government Code §2306.039
NO EXECUTIVE SESSION WAS HELD.

ADJOURN
SINCE THERE WAS NO FURTHER BUSINESS TO COME BEFORE THE COMMITTEE, TOM GANN ADJOURNED THE MEETING OF THE AUDIT COMMITTEE AT 9:16 A.M. ON JUNE 14, 2012.

Brooke Boston, Board Secretary

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BOARD ACTION REQUEST

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation, Discussion and Possible Approval of the Fiscal Year 2013 Internal Audit Work Plan.

RECOMMENDED ACTION

WHEREAS, the Texas Internal Auditing Act and audit standards require the governing board to approve an annual audit work plan that is based on an agency-wide risk assessment as well as input from the governing board and executive management, and that outlines the internal audits planned for the upcoming fiscal year,

RESOLVED, the internal audit work plan for fiscal year 2013 is hereby approved as presented.

BACKGROUND

The annual internal audit work plan is required by the Texas Internal Auditing Act and by audit standards. The plan outlines the program areas that the Internal Audit Division will audit during the 2013 fiscal year as well as outlining the other planned activities of the Internal Audit Division.

Department of Housing and Community Affairs Internal Audit Division Fiscal Year 2013 DRAFT Internal Audit Plan			
Program Area/Division	**Audit**	**Hours 4160**	**Comments**
Asset Management	Asset Management	900	Scope will be Determined During Planning
Program Services	Program Services – Quality Assurance	1000	Scope will be Determined During Planning
Bond Finance	Housing Trust Fund Transfers	160	Scope will be Determined During Planning
Compliance	Compliance Monitoring	1000	Scope will be Determined During Planning
Agency-Wide	Loan Processing	1000	Scope will be Determined During Planning
Manufactured Housing Division	Mailroom Procedures and Processes	100	Scope will be Determined During Planning
Program Area/Division	**Management Assistance/ Special Projects**	**900**	**Comments**
Internal Audit	Conduct Annual Risk Assessment and Prepare Fiscal Year 2014 Audit Plan	120	Required by the Texas Internal Auditing Act and by Audit Standards
Internal Audit	Annual Review and Revision of Internal Audit Charter	20	Required by Audit Standards
Internal Audit	Review and Revise Internal Audit Policies and Procedures to Comply with New Auditing Standards	60	The IIA Will Be Releasing A Revised Version of the *Professional Practices Framework* in October 2012
Internal Audit	2012 Peer Review	160	Required by the Texas Internal Auditing Act and by Audit Standards
Internal Audit	Preparation and Submission of the Fiscal Year 2013 Annual Internal Audit Report	40	Required by the Texas Internal Auditing Act
Internal Audit	Coordinate with External Auditors	50	Ongoing Requirement
Internal Audit/IS	Consolidate ERM and Risk Assessment Processes	175	Consolidate ERM into TeamMate software to gain some efficiencies in risk assessment
All Divisions	Follow-up on the Status of Prior Audit Issues	125	Required by Audit Standards
All Divisions	Tracking the Status of Prior Audit Issues	50	Required by Audit Standards
All Divisions	Tracking, Follow-up and Disposal of Fraud Complaints	100	Internal Audit is Responsible for the Fraud Hotline and for Reviewing Fraud Complaints

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BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of the Status of the Fiscal Year 2012 Internal Audit Work Plan.

REPORT ITEM

The Internal Audit Work Plan for Fiscal Year 2012 was approved by the audit committee and by the board on September 15, 2011. This presentation outlines the final status of the plan.

BACKGROUND

There were 8 audits on the plan this year. We completed 7 of these audits:

- a Follow-up Audit of the Neighborhood Stabilization Program (NSP),
- an Audit of Contracting for Services,
- an Audit of Website Management,
- an Audit of HOME Multifamily,
- an Audit of Human Resources,
- a Review of the Housing Choice Voucher Program (Section 8) and
- an Audit of the Homeless Housing and Services Program (HHSP).

The audit of Loan Processing was postponed because of the timing of the Department's reorganization and restructuring of the loan servicing process.

In addition, we completed the following non-audit activities that are required by auditing standards:

- a quality assurance and self-assessment review,
- the annual review of the internal audit charter and board resolutions,
- an update of the Internal Audit Division's policies and procedures,
- our annual risk assessment and development of the fiscal year 2013 audit plan, and
- our reciprocal peer review work.

This concludes the Fiscal Year 2012 audit plan.

Department of Housing and Community Affairs
Internal Audit Division
Status of the Fiscal Year 2012 Internal Audit Plan
September 6, 2012

Program Area/Division	Audit	Hours	Comments
NSP	Neighborhood Stabilization Program (Follow-Up)	1000	COMPLETED
Community Affairs	Homeless Housing and Services Program	1300	COMPLETED
HOME	HOME Multifamily	1000	COMPLETED
Multiple Divisions	Loan Process	1000	Postponed – Moved to FY2013
Staff Services	Contracting for Services	120	COMPLETED
Human Resources	Human Resources	120	COMPLETED
Information Systems	TDHCA Website Management	120	COMPLETED
Community Affairs	Section 8	400	COMPLETED
Program Area/Division	**Management Assistance/ Special Projects**		**Comments**
Internal Audit	Conduct Annual Risk Assessment and Prepare Fiscal Year 2013 Audit Plan	200	COMPLETED
Internal Audit	Annual Review and Revision of Internal Audit Charter	40	COMPLETED
Internal Audit	Quality Assurance Self-Assessment Review	80	COMPLETED
Internal Audit	Review and Revise Internal Audit Policies and Procedures to Comply with New Auditing Standards	60	COMPLETED
Internal Audit	Preparation for 2012 Peer Review	160	IN PROCESS - SCHEDULED for NOVEMBER 2012
Internal Audit	Preparation and Submission of the Fiscal Year 2012 Annual Internal Audit Report	40	IN PROCESS - DUE NOVEMBER 2012
Internal Audit	Coordinate with External Auditors	60	Ongoing Requirement
All Divisions	Follow-up on the Status of Prior Audit Issues	200	Ongoing - Required by Audit Standards
All Divisions	Tracking the Status of Prior Audit Issues	200	Ongoing - Required by Audit Standards
All Divisions	Tracking, Follow-up and Disposal of Fraud Complaints	200	Ongoing - Internal Audit is Responsible for the Fraud Hotline and Fraud Complaints

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BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of Recent Internal Audit Reports.

REPORT ITEM

Internal Audit recently completed the following audits or reviews from our fiscal year 2012 work plan:

- a Review of the Housing Choice Voucher Program (Section 8), and
- an Audit of the Homeless Housing Services Program (HHSP).

BACKGROUND

A Review of the Housing Choice Voucher Program

The Housing Choice Voucher Program (Program) is also known as the Section 8 Program. The Program's administrative funding has not kept pace with its operating expenditures, and it is currently operating at a deficit of approximately $10,150 per month. Therefore, our objectives were not only to determine if the Program accurately determined participant eligibility and expended HUD funds according to rules and regulations, but also to identify opportunities for efficiencies in the Program's administration. As a result, the recommendations in this audit are options that management can consider as they move forward with changes to the Section 8 Program.

We found that:

- The Program expends funds according to HUD rules and regulations. We tested a random sample of 38 expenditures and found no errors.
- The Program accurately determines participant eligibility. We tested a random sample of 34 files and found that all participants were eligible.
- Application controls over the Housing Pro software used by Program staff are working correctly.

In addition, we identified opportunities to reduce costs and increase efficiencies in the Program. These opportunities include eliminating or reducing the use of local operators, reducing the fees paid to local operators, using time more efficiently, moving to a paperless environment, improving communication and information sharing, eliminating unnecessary reports and revising the quality assurance process.

An Audit of the Homeless Housing Services Program

The Homeless Housing and Services Program (HHSP) generally disburses funds in accordance with subrecipient contracts and has a process in place for its subrecipients to submit monthly performance reports. In addition, the subrecipients indicate that they track and maintain the supporting documentation necessary to ensure their compliance with the requirements of their contracts. However, the Department should improve its processes for disbursing funds, verifying matching funds and monitoring subrecipients in order to more effectively predict, identify, and prevent problems at the subrecipient level.

The Department does not review the draw requests for compliance with the subrecipient contracts. Two (25.0%) of the eight HHSP contracts had funds disbursed in one of the first four draws which exceeded 25.0% draw limit set out in the contract. Matching funds required by the contract are not verified to ensure that they are adjusted when the contracts are amended. In addition, not all of the subrecipients were monitored by the Department. Three of the eight subrecipients have never been monitored by the Department and the other five were monitored only once.

The HHSP was developed without the benefit of detailed legislative requirements. In addition, the Department only recently developed and approved the program rules. All eight original HHSP contracts were executed between January and April 2010. As a result, the contracts between the Department and the subrecipients are the principal source for program requirements and the primary criteria we used to evaluate the program.

The HHSP provides funding to the eight largest cities in Texas for services to homeless individuals and families, including services such as case management and housing placement and retention. The Legislature appropriated $20 million for HHSP in fiscal years 2010 and 2011. For fiscal year 2012, they did not appropriate any direct funding for HHSP but allowed the Department to apply available funds to the program. The Department allocated $5 million for HHSP in fiscal year 2012.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.state.tx.us

July 17, 2012

Writer's direct phone # (512) 475-3813
Email: sandy.donoho@tdhca.state.tx.us

RE: AN INTERNAL AUDIT OF THE HOUSING CHOICE VOUCHER PROGRAM (REPORT # 12-048)

To the Audit Committee and the Governing Board of the Texas Department of Housing and Community Affairs:

The Internal Audit Division has completed its audit of the Texas Department of Housing and Community Affairs' (Department's) Housing Choice Voucher Program (Program), also referred to as the Section 8 Program. This audit was an economy and efficiency audit, which is a type of performance audit. We chose to conduct this type of audit because the Program's funding has not kept pace with its expenditures, and it is currently operating at a deficit of approximately $10,150 per month. Therefore, our objectives were not only to determine if the Program accurately determined participant eligibility and expended HUD funds according to rules and regulations, but also to identify opportunities for efficiencies in the Program.

The Housing Choice Voucher Program

The Housing Choice Voucher Program is also referred to as the Section 8 Program.

HUD provides the Department with funds in the form of vouchers so that very low-income families, the elderly, and the disabled can afford decent, safe, and sanitary housing in the private market.

The vouchers are administered by public housing agencies (PHAs). The Texas Department of Housing and Community Affairs is designated as a PHA and serves 22 counties across the state.

We found that:

- The Program expends funds according to HUD rules and regulations. We tested a random sample of 38 expenditures and found no errors.
- The Program accurately determines participant eligibility. We tested a random sample of 34 files and found that all participants were eligible.
- Application controls over the Housing Pro software used by Program staff are working correctly.

In addition, we identified opportunities to reduce costs and increase efficiencies in the Program. These opportunities include eliminating or reducing the use of local operators, reducing the fees paid to local operators, using time more efficiently, moving to a paperless environment, improving communication and information sharing, eliminating unnecessary reports and revising the quality assurance process.

You will likely notice that this is not our normal format for an audit report. We chose to report in this format because we did not have any findings on our compliance objectives, and the results of our economy and efficiency work consists of options that management can consider as they move forward with changes to the Program. The recommendations in this report are merely options; management can choose to implement them or not based on their assessment of the Program's needs.

The scope of this audit was expenditures, participant eligibility and program operations for program years 2010 through June 2012. An application controls review of the Housing Pro software was also included. We conducted this audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was also conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

If you have any questions about this audit report, please contact me at (512) 475-3813. We appreciate the assistance and cooperation we received from management and staff during this audit.

Sincerely,

S. Q. Donoho

Sandra Q. Donoho, MPA,CIA, CISA, CFE, CICA
Director of Internal Audit

cc: Tim Irvine, Executive Director
Brooke Boston, Deputy Executive Director
Michael DeYoung, Assistant Deputy Executive Director

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TEXAS DEPARTMENT OF HOUSING & COMMUNITY AFFAIRS

Building Homes. Strengthening Communities.

An Internal Audit of the Housing Choice Voucher Program

(Audit # 12-1048)

July 11, 2012

Background

- The Housing Choice Voucher Program (Program) is also referred to as Section 8.

- HUD provides funds in the form of vouchers so that very low-income families, the elderly, and the disabled can afford decent, safe, and sanitary housing in the private market.

- The vouchers are administered by public housing agencies (PHAs).The Texas Department of Housing and Community Affairs (the Department) is designated as a PHA and serves 22 counties across the state.

Audit Information

This was a performance audit on the economy and efficiency of the Housing Choice Voucher Program.

The objectives of this audit were:

- to determine if the Department's Housing Choice Voucher Program:
  - accurately determines participant eligibility, and
  - expends HUD funds according to rules and regulations, and
- to identify opportunities for efficiencies in the Program.

Results

- Expenditures – The Program expends funds according to HUD rules and regulations. We tested a random sample of 38 expenditures and found no errors.

- Eligibility – The Program accurately determines participant eligibility. We tested a random sample of 34 files and found that all participants were eligible.

- Efficiencies – There are opportunities to reduce costs and increase efficiencies in the Program. These opportunities include eliminating or reducing the use of local operators, reducing the fees paid to local operators, using time more efficiently, moving to a paperless environment, improving communication and information sharing, eliminating unnecessary reports and revising the quality assurance process.

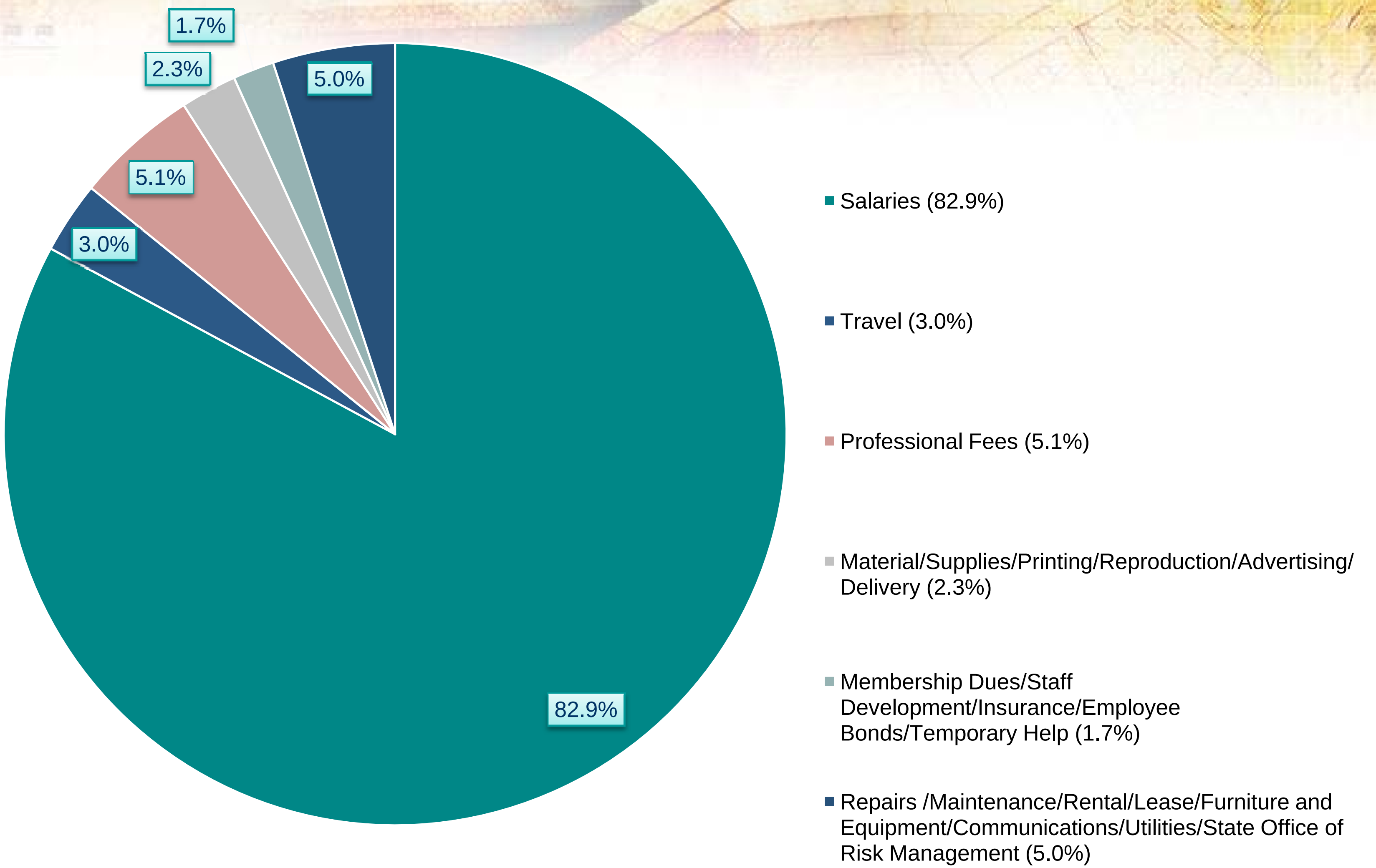
- Housing Pro Software – Application controls over the Housing Pro software are working correctly.

(Auditor's Note: The recommendations in this report are merely suggestions for making the Program more efficient and financially self-supporting. It is up to management to choose whether to implement them or not, based on their assessment of the Program's needs.)

Financial Challenges

- The Program has 7 full-time equivalent staff members.
- In fiscal year 2012, the Program's operating budget was $478,411. This is approximately $39,868 per month.
- Of the Program's annual operating budget, $396,458 (82.9%) is made up of salaries and benefits for the 7 program staff. Other items in the Program's budget are either fixed costs or are not significant enough to impact the overall budget.
- For program year 2012, the Program is eligible to receive $5,735,830 in renewal funding from HUD to cover the approximately 900 Section 8 vouchers they administer each month.
- Administrative expenditures have exceeded the amount budgeted for 27 of the past 29 months.
- The average monthly deficit of administrative funds for program years 2010, 2011 and 2012 to date is approximately $10,150. This is about 25% of the Program's current monthly budget.

Program Operating Budget



Possible Financial Solutions

- To reduce the Program's deficit, the Department must increase revenue or reduce expenditures. The Department's Accounting Operations Division performed an analysis to illustrate the various scenarios of increases in revenue and decreases in cost in order to identify a break even point.

- For example:
  - To increase revenue, the Program would have to increase the number of vouchers issued by increasing lease-ups.
  - To decrease expenditures, the Program would have to reduce costs. One way to reduce costs is to eliminate or reduce the use of local operators and to reduce the fees paid to local operators.

Use of Local Operators

- Eliminate or reduce the use of local operators by shifting more of the tasks of the local operators to the Department.
  - Local operators perform housing quality inspections, collect required documentation, and assist with applicant and participant briefings. Beginning in January 2012, many of the responsibilities of the local operators were shifted to the Department, but the fees paid to the local operators did not change.
- If some local operators are retained, reduce and standardize the fees paid to local operators.
  - Local operators receive an administrative fee for each voucher they process.
  - Administrative fees paid to local operators vary and can range from $15.00 to $25.00 per voucher administered. There is no consistency in how these fees are determined.
- The following table illustrates the amounts paid to local operators monthly.

Program Year (PY)	Average Monthly Payments Made to Local Operators	Average Monthly Vouchers	Average Monthly Payment per Voucher
PY2012 (through June 14, 2012)	$17,119.17	913	$18.75
PY2011	$14,310.00	857	$16.70
PY2010	$11,901.50	797	$14.93

- The payments per voucher increased since PY2010, but the burden on the local operators decreased as the Program staff assumed more of the responsibilities.

Use of Local Operators (Cont'd)

- For the month of May 2012, the Program paid 24 local operators fees ranging from $15 to $25 per voucher to administer 832 vouchers.

Administrative Fee Paid	Number of Vouchers Paid	Total Amount Paid
$25.00	278	$6,950.00
$20.00	348	$6,960.00
$15.00	206	$3,090.00
Totals	832	$17,000.00

- If the amount paid per voucher was reduced to $10, the total amount paid would be $8,320, resulting in a savings of $8,680.
- If the amount paid per voucher was reduced to $15, the total amount paid would be $12,480, resulting in a savings of $4,520.
- Neither of these two scenarios is sufficient to make up the $10,150 monthly shortfall.
- If the local operators were eliminated, the Program could save approximately $17,000.00 per month. However, the increased workload may require additional staff.
- If only the four largest local operators (City of Ennis, Galveston County Community Action, Waller County, and City of Waxahachie) are retained and reimbursed a fee of $10 per voucher, the total amount paid would be $5,170 (517 vouchers x $10), resulting in a savings of $11,830.

Opportunities for Efficiencies

- In addition to reducing costs by reducing or eliminating the fees paid to local operators, the Program should consider implementing other opportunities for efficiencies.

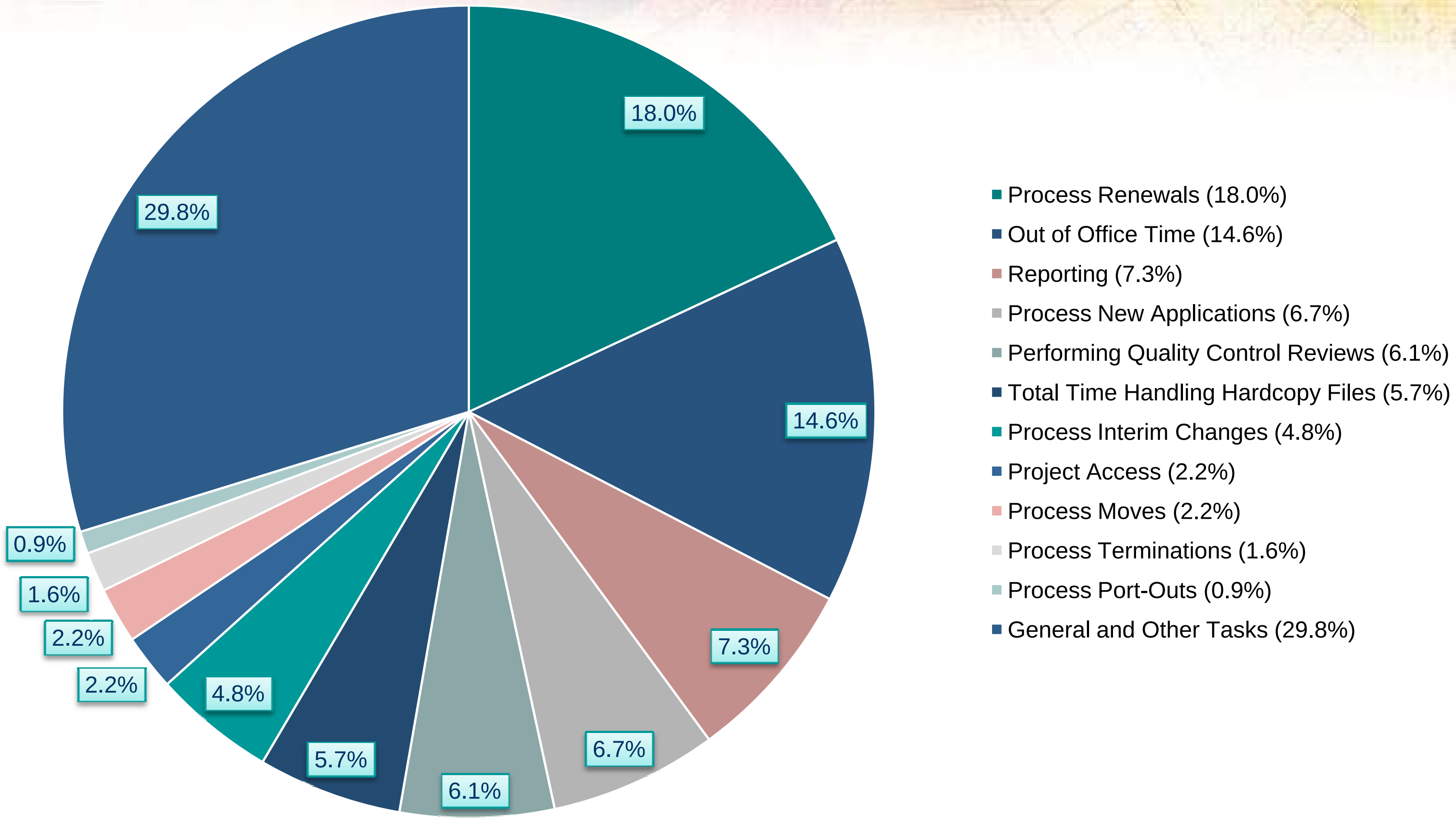
- For example:
  - Use time more efficiently
  - Go paperless
  - Increase information and communication
  - Eliminate the creation and retention of unnecessary reports
  - Decrease the time spent on quality assurance review

Use Time More Efficiently

- We conducted a time study to determine how the Program staff spend their time.

  - We analyzed the results of the time study according to transaction type such as processing new applications and processing renewals and also according to task type such as faxing, filing, and scanning.
  - Program staff spend the majority of their time processing annual renewals, preparing reports, processing new applications and performing quality assurance reviews.
  - As much time is spent processing the annual renewals as is spent processing new applications, interim adjustments, moves, terminations and Project Access combined.
  - 7.3% of their time is spent generating or reviewing reports. Time may be saved by eliminating the creation and retention of unnecessary reports.
  - 6.1% percent of their time is spent performing quality assurance reviews. This time could be decreased by reviewing only a sample of the files.
  - 5.7% percent of their time is spent dealing with hard copy files. This time could be reduced by going paperless.

Results of the Time Study



Transaction Types

- New Applications - the point of entry into the Program. When a new application is processed, documentation is collected to certify participant eligibility (income, background history, citizenship status), rent reasonableness and that the unit passes the housing quality standards inspection.

- Renewals - also known as reexamination or recertification, renewal is the process of securing documentation of total family income used to determine the rent the tenant will pay for the next twelve months if there are no changes reported. There are annual and interim certifications.

- Interim Adjustments - an interim change and a rental adjustment are the same activity. Interim adjustments may occur if there is a change in income or family composition between renewals. Income is verified when there is an interim adjustment.

- Moves - relocation from one unit to another within the same PHA jurisdiction.

- Terminations - discontinuance of tenancy or program assistance.

- Port-out and Port-in – when a tenant with a valid voucher requests to move from an area serviced by the Department's Section 8 Program to another PHA's service area, or from another PHA to the Department.

- Project Access - an initiative which provides vouchers to low-income persons with disabilities in order to assist them with the transition from institutions into the community by offering access to affordable housing.

- Other Tasks - contact with program participants, applicants and other PHAs, phone calls, email, travel, training, team meetings, obtaining information from HUD and administrative tasks.

Go Paperless

- The Program can increase its use of technology and migrate toward a paperless environment.

- For example:
  - Encourage payees to receive their monthly payments via direct deposit.
    - For the month of May 2012, 617 housing assistance and utility reimbursement payments were distributed to payees. Of those 617 monthly payments:
      - 239 (38.7%) were made via direct deposit.
      - 378 (61.3%) were made via actual checks.

  - Send statement cards electronically. For each housing assistance and utility reimbursement payment, a payment statement card is generated and mailed to each payee monthly. The Department could gain efficiencies by sending these via email.

Go Paperless

- Reduce the use of hard copy documents.
  - The time study showed that Program staff spend 5.7% of their time handling hard copy files.
  - Tasks related to handling hard copy files include scanning, filing, and compiling paperwork into the actual file folders. Hard copy files are cumbersome and require more physical storage space than electronic files.
  - The Financial Services Facilitator spent 30 minutes of one day scanning documents, although these electronic files are not utilized.

- Eliminate unnecessary documentation.
  - Participant files often contain unnecessary documentation. For example, a file could include a copy of the fax cover sheet, the fax confirmation sheet and the document requested via the original fax. Once the requested information is obtained, retaining and filing the original fax cover page and confirmation sheet is unnecessary.

Improve Information and Communication

- Provide as much information as possible via the Department’s website and ensure the information on the Department’s website is complete, accurate and timely.
  - The Section 8 information available on the Department’s website is minimal. Some of the information posted on the website is out of date.
  - Program staff spend a great deal of time communicating with the various program stakeholders. Approximately 16.6% of their time is spent communicating with program participants, landlords, public housing authorities and local operators.
  - Ensuring the information on the website is complete, accurate and timely may minimize the time spent communicating with stakeholders.

Eliminate Unnecessary Reports

- Eliminate the production and retention of reports that are not useful, not used or no longer required.
  - The “Multi” report is comprised of several reports. It is generated monthly by the Program staff. Of the 13 reports that are created and saved when preparing the “Multi” report, six (46%) are no longer used.
  - Program staff spend 7.3% of their time generating and reviewing reports.
  - Eliminating the creation and retention of unnecessary reports could save staff time.

Decrease Quality Assurance Review

- Perform quality assurance reviews on a sample of program files instead of reviewing 100% of the files.
  - With the exception of the interim changes that are processed, a quality assurance review is performed on 100% of the files processed. This includes the annual renewals and any new applications.
  - 6.1% of staff time is expended on quality assurance reviews.
  - In addition to the quality assurance review, the Section 8 manager signs off on every participant file.
  - Performing the review on a sample basis would allow additional time for other tasks.

Summary of Recommendations

- Eliminate or reduce the use of local operators.
- Reduce and standardize the fees paid to local operators.
- Use time more efficiently.
- Go paperless.
- Increase information and communication.
- Eliminate unnecessary reports.
- Decrease the time spent on quality assurance reviews.

Management's Response

"Management is very pleased with the finding of no errors on expenditures and 100% accuracy of eligibility. Management thanks the auditors for the efficiency review and will consider their suggestions in making future program decisions."

Scope and Methodology

- The scope of this audit was expenditures, participant eligibility and program operations for program years 2010 through June 2012. An application controls review of the Housing Pro software was also included.
- Methodology:
  - We interviewed responsible individuals to gain an understanding of the program area, the process for determining eligibility and the process for expending funds.
  - We reviewed background information, including information available on the Department's and HUD's website, program goals and objectives, organizational charts, policies and procedures, applicable laws, rules and regulations.
  - We identified processes, critical points and activities directly related to the Program and identified risks and controls associated with those processes.
  - We tested a random sample of expenditures to determine if they complied with HUD rules and regulations.
  - We selected a random sample of Housing Assistance Payment (HAP) expenditures. We tested the eligibility of the program participants for which those HAP funds were expended.
  - We performed a time study to determine how Program staff spend their time.
  - We analyzed budget information provided by the Accounting Operations Division.
  - We evaluated application controls for the Housing Pro software used by Program staff.

Audit Standards

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Appreciation

We would like to extend our sincere appreciation to the management and staff of the Section 8 Division for their cooperation and assistance during the course of this audit.

The following staff performed this audit:
Betsy Schwing, CPA, CFE (Project Manager)
Derrick Miller

Contact Information

Texas Department of Housing and Community Affairs

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Sandra Q. Donoho, MPA, CISA, CIA, CFE, CICA

Director of Internal Audit

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TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.state.tx.us

Rick Perry
GOVERNOR

August 16, 2012

Writer's direct phone # (512) 475-3813
Email: sandy.donoho@tdhca.state.tx.us

RE: AN INTERNAL AUDIT OF THE HOMELESS HOUSING AND SERVICES PROGRAM (REPORT #12-1050)

To the Audit Committee and the Governing Board of the Texas Department of Housing and Community Affairs:

Attached is the Internal Audit Division's report on the Texas Department of Housing and Community Affairs' (Department's) Homeless Housing and Services Program (HHSP). The HHSP generally disburses funds in accordance with subrecipient contracts and has a process in place for its subrecipients to submit monthly performance reports. In addition, the subrecipients indicate that they track and maintain the supporting documentation necessary to ensure their compliance with their contract requirements. However, the Department should improve its processes for disbursing funds, verifying matching funds and monitoring subrecipients in order to more effectively predict, identify, and prevent problems at the subrecipient level.

The HHSP provides funding to the eight largest cities in Texas for services to homeless individuals and families, including services such as case management and housing placement and retention. The Legislature appropriated $20 million for HHSP in fiscal years 2010 and 2011. For fiscal year 2012, they did not appropriate any direct funding for HHSP but allowed the Department to apply available funds to the program. The Department allocated $5 million for HHSP in fiscal year 2012.

The Department does not review the draw requests for compliance with the subrecipient contracts. Two (25.0%) of the eight HHSP contracts had funds disbursed in one of the first four draws which exceeded 25.0% draw limit set out in the contract. Matching funds required by the contract are not verified to ensure that they are adjusted when the contracts are amended. In addition, not all of the subrecipients were monitored by the Department. Three of the eight subrecipients have never been monitored by the Department and the other five were monitored only once.

Management generally agrees with the recommendations outlined in this audit report and indicated that they are taking steps to implement them.

The objectives of this audit were to determine how the Department is ensuring that subrecipients meet their performance metrics, if funds are disbursed in accordance with the subrecipient contracts, and how the HHSP predicts, identifies, and prevents weaknesses at the subrecipient level. The scope of this audit was fiscal years 2010, 2011, and 2012 to June 8, 2012. Fieldwork was conducted from June through July 2012. We conducted this audit in accordance with *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was also conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

If you have any questions about this audit report, please contact me at (512) 475-3813. We appreciate the assistance and cooperation we received from management and staff during the audit.

Sincerely,

Sandra Q. Donoho, MPA,CIA, CISA, CFE, CICA
Director of Internal Audit

cc: Tim Irvine, Executive Director
Brooke Boston, Deputy Executive Director
Michael DeYoung, Assistant Deputy Executive Director

Executive Summary

The Texas Department of Housing and Community Affairs' (Department) Homeless Housing and Services Program (HHSP) generally disburses funds in accordance with subrecipient contracts and has a process in place for its subrecipients to submit monthly performance reports. In addition, the subrecipients indicate that they track and maintain the supporting documentation necessary to ensure their compliance with the requirements of their contracts. However, the Department should improve its processes for disbursing funds, verifying matching funds and monitoring subrecipients in order to more effectively predict, identify, and prevent problems at the subrecipient level.

The HHSP was developed without the benefit of detailed legislative requirements. In addition, the Department only recently developed and approved the program rules. All eight original HHSP contracts were executed between January and April 2010. As a result, the contracts between the Department and the subrecipients are the principal source for program requirements and the primary criteria we used to evaluate the program.

The Homeless Housing and Services Program

The Homeless Housing and Services Program (HHSP) provides funding to the eight largest cities in Texas for services to homeless individuals and families, including services such as case management and housing placement and retention.

The Legislature appropriated $20 million for HHSP in fiscal years 2010 and 2011. For fiscal year 2012, they did not appropriate any direct funding for HHSP but allowed the Department to apply available funds to the program. The Department allocated $5 million for HHSP in fiscal year 2012.

The Department does not review the draw requests for compliance with the subrecipient contracts. The HHSP subrecipient contract sets a draw limit on the first four draws of 25% of the total available contract amount per draw. Two (25.0%) of the eight HHSP contracts had funds disbursed in one of the first four draws which exceeded the limit. The Department should ensure the draws are consistent with the contract terms prior to payment.

The *Policy on the HHSP 2010-2011 General Revenue*, states that each subrecipient is required to provide matching funds that equal or exceed 10% of their final allocation. Six (33.3%) of 18 total budget amendments to HHSP contracts resulted in an increase in the final allocation, however none of the amendments included a corresponding increase to the matching funds. The matching funds requirement is not verified in either the draw approval process or the program monitoring process. The Department should develop a process to ensure that subrecipients comply with the matching funds requirement in their contracts. The matching funds requirement should be adjusted when contract amendments are made which result in an increase in the final contract amount.

Other Key Points

- The HHSP contracts require subrecipients to submit monthly performance reports to support their progress, but the performance reports do not always capture performance metrics regarding the delivery of activities and services agreed to by the subrecipients.
- For the eight subrecipient contracts, there were 18 amendments that affected the subrecipient's contract budget and/or the final allocation award. None of the 18 amendments

included revisions to the subrecipient's performance metrics to account for any new service levels resulting from these changes.

- The monitoring instrument was developed for HHSP prior to the development of program rules or proposed activities. Therefore, the monitoring instrument does not capture all of the intended uses of the funds.
- The Department has not monitored all of the subrecipients. Three of the eight subrecipients have never been monitored by the Department and the other five were monitored only once. However, all seven of the subrecipients who responded to our questionnaire indicated that they were subjected to single audits or other types of audits.

Summary of Management Responses

Management generally agrees with the recommendations outlined in this report and indicated that they are taking steps to implement them.

Table of Contents

Detailed Results

Chapter 1

The Department Should Ensure Compliance with the Subrecipient Contracts for Disbursement of Funds and Match Funds

The Texas Department of Housing and Community Affairs' (Department) Homeless Housing and Services Program (HHSP) is governed by the contracts between the Department and the eight subrecipients. The Department generally disburses funds in accordance with the subrecipient contracts. However, improvements can be made to the disbursement process by following the guidelines outlined in the contracts. In addition, the Department should develop a process to ensure compliance with the matching funds requirement in the contracts.

The contracts require that subrecipients draw funds in amounts that do not exceed 25% of the total contract amount for the first four draws. Funds for two (25.0%) of the eight contracts had one of the first four draws which exceeded the 25% limit.

The *Policy on the HHSP 2010-2011 General Revenue* requires that each subrecipient provide matching funds that equal or exceed 10% of their final allocation. The match can be made in the form of cash or in-kind contributions and can include administrative costs. Exhibit A of the HHSP contract outlines the required match funds. However, this requirement is not verified during the draw approval process or the program monitoring process.

In addition, there were 18 amendments to the eight subrecipient contracts that affected the contract budget. Six (33.3%) of the 18 amendments resulted in an increase in the final allocation of funds. As a result, the matching funds requirement should also have increased. However, none of the contract amendments included an increase to the matching funds requirement.

Chapter 1-A

The Department Should Ensure that Funds are Disbursed in Accordance with the Subrecipient Contracts

The Department generally paid out HHSP funds in accordance with subrecipient contracts. However, some improvements can be made to the process used to review the draws prior to payment. Funds for two (25.0%) of the eight subrecipients were not paid in accordance with their contracts. Their contracts with the Department require that each of the first four draws not exceed 25% of the total amount of the contract. Both of these subrecipients submitted draws that exceeded the 25% limit. One of these draws was for 72.5% of the subrecipient's total contract and the other was for 28.1% of the subrecipient's total contract. However, none of the subrecipients exceeded the 50% limit prior to September 1, 2010, which was also a requirement of their contracts. Section 4 of the subrecipient contracts, Disbursement of Funds, (A) states:

> "Eligible Entity, upon contract execution by both parties, may request from the Department a first draw of HHSP funds for eligible costs that does not exceed 25% of the Eligible Entity's total allocation. Upon the provision of satisfactory expenditure reports,

invoices, and appropriate construction documentation (if construction or rehabilitation is applicable), Eligible Entity may request a second draw not to exceed 25% of Eligible Entity's total allocation. Total HHSP funds released by the department to the Eligible Entity prior to September 1, 2010 may not exceed 50% of the Eligible Entity's total allocation. On or after September 1, 2010, the Eligible Entity may request the third draw not to exceed 25% of the total allocation, provided that the Department has determined that it is among the eligible entities in full compliance with the terms of the contract. The Eligible Entity may request its fourth draw within six months subsequent to September 1, 2010 or when appropriate expenditure reports have been submitted to the Department, whichever occurs first."

The Department did not review the draw requests for compliance with the subrecipients' contracts prior to paying the draws. It is important that the Department review the requirements of the contracts in order to ensure that the subrecipients comply with their contracts.

Recommendation

The Department should ensure that draws comply with the subrecipient contracts prior to payment.

Management's Response

The Department acknowledges the need to improve oversight of the draw management process. The Department is currently exploring the feasibility of adding expenditure limit validations into the contract system. These validations would not allow Subrecipients to request amounts over the maximum allowed by contract requirements.

Person Responsible: *Michael De Young* Target Date: *September 15, 2012*

Chapter 1-B

The Department Should Verify that Subrecipients are in Compliance with the Matching Funds Requirement

The Department does not have a process in place to ensure subrecipients comply with the matching funds requirement outlined in the subrecipient contracts. The *Policy on the HHSP 2010-2011 General Revenue* states that each subrecipient is required to provide matching funds that equal or exceed 10% of their final award. The match can be made in the form of cash or in-kind contributions and can include administrative costs. Exhibit A of the HHSP contract outlines the match funds that should be provided by the subrecipient as part of the award received from the Department. However, the Department does not verify that the matching funds requirement is met during the draw approval process or the program monitoring process.

In addition, for the eight subrecipients there were a total of 18 contract amendments that impacted the contract budget. Six (33.3%) of the 18 resulted in an increase in the final allocation, which meant that the matching funds requirement should have also increased. However, none of these six contract amendments included an increase to the matching funds required by the contracts. It is important that the Department verify compliance with the matching funds requirement in order to ensure that the subrecipients comply with the contract.

Recommendation

The Department should develop a process to ensure that subrecipients comply with the matching funds requirement in their contract. The matching funds requirement should be adjusted when contract amendments are made which result in an increase in the final contract amount.

Management's Response

The Department acknowledges that adjustments to the match requirement in the contracts were not sufficiently adjusted. Future HHSP contracts will not include a match requirement as the governing statute does not include language regarding match, as the original rider did. Staff assures that in the future contract requirements, for match or otherwise, will be more thoroughly tracked.

Person Responsible: *Michael De Young* Target Date: *September 15, 2012*

Chapter 2

The Department Should Review the Performance Metrics Requirements in the Subrecipient Contracts

The Department has a process in place for the subrecipients to report the results of their performance metrics each month. However, the required monthly performance reports are not consistent with all of the performance metrics outlined in the subrecipient contracts.

The HHSP contracts require that the subrecipients submit monthly performance reports to the Department to document their performance progress in accordance with the performance statement in the contracts. The Department's *Policy on 2010-2011 HHSP General Revenue* states that "performance and outcome measures will be based on the specific approved Funding Request Packet from each Subgrantee."

The monthly performance reports capture data on the agreed-upon activities and services provided by the subrecipients, however these performance measures are not always specific to the activities and services outlined in the subrecipient contracts.

There are 49 HHSP services in the subrecipient contracts which the subrecipients agreed to provide to a targeted number of clients. The *HHSP Monthly Performance Report* tracks all performance metrics for 27 (55.1%) HHSP services, some but not all performance metrics for 19 (38.8%) HHSP services, and does not track any performance metrics for three (6.1%) HHSP services.

The table below describes some examples of HHSP services for which the performance report tracks some but not all of the performance measures from the contracts.

Table 1

HHSP Service Stated in the Contract Performance Statement	Performance Metric Tracked by the Performance Report	Performance Metric Not Tracked by the Performance Report
24 hour shelter providing immediate safety to families experiencing domestic violence, 1,200 clients to be served.	Number of persons and households in shelters.	Number of persons and households experiencing domestic violence.
45% of persons exiting the case management program will move into safe and stable housing.	Number of persons provided with case management services.	Living conditions of persons who have exited the case management program.
500 homeless will receive job training and 500 will obtain employment.	Number of persons receiving employment services.	Number of clients who successfully obtained employment.

In addition, for the eight subrecipient contracts, there were 18 amendments that affected the subrecipient's contract budget and/or the final allocation award. None of the 18 amendments included revisions to the contract's performance metrics to account for the new service levels that might result from the change in funding.

We asked the eight HHSP subrecipients to complete a questionnaire in order to determine what performance measures the subrecipients tracked and submitted to the Department to demonstrate their compliance with the contract. We received responses, supporting documents, and monthly performance report information from seven of the eight subrecipients. The responses and supporting documents we received indicated that the subrecipients track and maintain the supporting documentation necessary to ensure their compliance with the contract.

The contract states that the subrecipient "shall provide reports to [the] Department regarding program activities to evidence progress of performance in accordance with the requirements of the Texas Homeless Housing and Services Program and contained in Exhibit A—Performance Statement and Budget." The performance reports which the Department is requesting do not provide consistent evidence of subrecipients' progress towards meeting contract requirements. It is important that the Department ensure that the subrecipients are in compliance with the performance metrics required in the contract in order to verify that the funding is used as intended.

Recommendation

The Department should ensure that the performance metrics reported by the subrecipient accurately measure the subrecipients' progress towards meeting the goals outlined in their contracts.

Management's Response

The Department acknowledges the need to improve oversight in this area. In future contracts, the Performance Measures exhibit to the contract will include items that more consistently reflect the metrics to be achieved, and monthly reporting will include submission relating to all contract measures. Further, the contracts will include benchmarks setting the rate at which Subrecipients must meet their performance targets; if not successfully achieved, deobligation will be considered. Finally, the Monthly Performance Report will track items that more consistently reflect the metrics included in the contract.

The CAD Planning Section will review progress to meeting the benchmarks on a quarterly basis to ensure that benchmarks are adhered to. If review shows that a Subrecipient is consistently unable to satisfy contract requirements regarding benchmarks, the Subrecipient will be required to submit a plan of action to meet the benchmarks and follow through with that plan.

This effort to ensure metrics accurately measure progress toward goals outlined in their contracts is already underway and manifest in the HHSP rules. This will also be reflected in the final version of future HHSP contracts.

Person Responsible: *Michael De Young* Target Date: *September 15, 2012*

Chapter 3

Monitoring Procedures Should be Improved

The Department does not have effective monitoring procedures in place to predict, identify, and prevent weaknesses at the subrecipient level. As part of the monitoring process, a monitoring instrument was created for HHSP but it was developed prior to the development of program rules or proposed activities for the use of the funds. As a result, the monitoring instrument does not capture information on many of the requirements in the subrecipient contracts. For example, the monitoring instrument heavily emphasizes construction activities but only two of the eight subrecipients used their funds for construction.

Although the monitoring instrument includes a review of expenditures and construction progress, it does not:

- identify any set criteria or benchmarks in order to evaluate the subrecipient's expenditure rate,
- include procedures to review the subrecipient's use of match funds or compliance with fund disbursements, or
- evaluate whether the methodology used by the subrecipients to measure the number of services provided or persons assisted accurately reflects these performance metrics.

In addition, the Department has not monitored three of the eight subrecipients and the other five were monitored only once since 2010. However, all seven of the subrecipients who responded to our questionnaire indicated that they were subjected to single audits or other types of audits. The monitoring process is important to the overall success of the program and should occur on a regular basis for all subrecipients.

Recommendation

The Department should improve its monitoring procedures and periodically monitor all of the subrecipients to ensure compliance with their contracts.

Management's Response

The Department's Compliance Division is responsible for monitoring the HHSP program. The Compliance Division understands that the Department has yet to formally adopt specific rules on the administration of the HHSP program. Currently, the Department has a general HHSP rule (§5.1003) that provides an overview of the intent of the program. The HHSP program is currently funded through GR, HTF and BMIR funds. The multiple sources of funds require the Compliance Division take into account specific requirements from each of the GR, BMIR and HTF funds. The Compliance Division intends on utilizing the BMIR requirements and HTF funding source requirements (in addition to Rule §5.1003), to develop a monitoring instrument that will ensure program funds are expended in accordance with the contract provisions and applicable State and Federal rules, regulations, policies and related Statutes.

The Compliance Division intends on completing the HHSP Monitoring Instrument by September 31, 2012 and intends on performing a desk monitoring or an on-site monitoring of all HHSP entities, between October 2012 and February 2013.

Until the Department is able to adopt the HHSP rules, the Compliance Division will utilize the monitoring instrument to determine the effectiveness of the subrecipient's performance and program compliance.

Person Responsible: *Patricia Murphy* Target Date: *February 28, 2013*

Appendix A

Objectives

The objectives of the audit were to determine:

- how the Department is ensuring that subrecipients meet their performance metrics,
- if funds are disbursed in accordance with the subrecipient contracts, and
- how the Homeless Housing and Services Program predicts, identifies, and prevents weaknesses at the subrecipient level.

Scope

The scope of this audit was fiscal years 2010, 2011, and 2012 to June 8, 2012.

Methodology

- We conducted interviews of Department staff involved in the HHSP.
- We performed background research on the HHSP.
- We reviewed the eight subrecipient contracts. We reviewed subrecipient monitoring reports, monthly performance reports, and monthly financial reports.
- We developed an Internal Control Questionnaire and distributed it to the eight subrecipients.
- We reviewed the completed Internal Control Questionnaires and the supporting documentation for performance metrics provided by the subrecipients.
- We tested all draws for compliance with the disbursement of funds requirements and the performance metrics as outlined in each subrecipient contract.

Criteria

- HHSP contracts between the Department and the eight subrecipients
- Uniform Grant Management Standards
- HHSP monitoring instrument
- *Policy on the HHSP 2010-2011 General Revenue*

Type of Audit

This audit was a performance audit of the Homeless Housing and Services Program (HHSP).

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

We conducted audit fieldwork from June 8, 2012 through July 27, 2012. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was also conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

The following staff performed this audit:
Nicole Elizondo, CFE, CICA, Project Manager
Derrick Miller

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the Homeless Housing and Services Program for their cooperation and assistance during the course of this audit.

Appendix B

Background

The Homeless Housing and Services Program (HHSP) was established during the 81st Texas Legislature through an appropriations rider and codified during the 82nd Texas Legislature. The Legislature appropriated $20 million for the HHSP for fiscal years 2010 and 2011. For fiscal year 2012, the Legislature made no direct appropriations for HHSP but allowed the Department to apply available funds to the program. The Department identified $5 million dollars for HHSP for fiscal year 2012.

Through HHSP, the state provides funding to the eight largest cities with populations greater than 285,000 people. Cities currently served through HHSP include Arlington, Austin, Corpus Christi, Dallas, El Paso, Fort Worth, Houston, and San Antonio.

The Legislature provided latitude with respect to the types of services and activities that are allowable under this program in support of services to homeless individuals and families. Allowable activities include construction and rehabilitation of structures targeted to serving homeless or at-risk individuals; operations of direct services; case management; housing retention; homelessness prevention; rental assistance; or other homelessness-related activity as approved by the Department.

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BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of the Status of External Audits.

REPORT ITEM

There have been fourteen external audits or monitoring visits so far this fiscal year.

BACKGROUND

Of the fourteen external audits of monitoring visits in fiscal year 2012, ten are complete and four are still in the reporting phase. The Department has received draft reports on three of these:

- a technical assistance and monitoring review of the Uniform Relocation Act,
- a close out audit of the Alternative Housing Pilot Project (AHHP), and
- a technical assistance and monitoring review of the HOME Program.

The Department is waiting for the draft report on the final external audit of fiscal year 2012:

- The Comptroller's post-payment audit of the Department's purchasing, travel and payroll.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
INTERNAL AUDIT DIVISION – STATUS OF FY 2012 EXTERNAL AUDITS
September 6, 2012

External Audits/Activities	Scope/Description	Stage	Comments
KPMG	The scope of the financial portion of the Statewide Single Audit includes an audit of the state's basic financial statements for fiscal year 2011 and a review of significant controls over financial reporting and compliance with applicable requirements.	Completed	The final report was released in March 2012.
SAO	Annual opinion audits: • Basic Financial Statements for the FYE August 31, 2010. • Revenue Bond Program Audit for the FYE August 31, 2010. • FY 2010 Unencumbered Fund Balances.	Completed	Final reports were released on December 20, 2011.
HUD-OIG	An audit of the Neighborhood Stabilization Program (NSP1). Scope includes subrecipient monitoring and status of program requirements (obligation, procurement, expenditure and program income.)	Completed	Final report was released on August 2, 2012.
HUD	A remote monitoring review of NSP obligations for selected subrecipients.	Completed	A report was received on May 9, 2012.
DOE	On-site monitoring of the financial and programmatic aspects of the Weatherization Assistance Program (WAP.) Monitoring was completed in October 2011. Scope included on-site visits to subrecipients in Waco and College Station.	Completed	Report was received November 14, 2011.
NeighborWorks America	Compliance monitoring for grantees that received assistance under the National Foreclosure Mitigation Counseling Program. This grant is administered under the Texas State Affordable Housing Corporation.	Completed	Close-out report was received July 23, 2012.
DOE	Financial monitoring of ARRA Weatherization Assistance Program (WAP.)	Completed	Report was received March 15, 2012.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
INTERNAL AUDIT DIVISION – STATUS OF FY 2012 EXTERNAL AUDITS
September 6, 2012

External Audits/Activities	Scope/Description	Stage	Comments
DPS	A review of driver's license records requests for the Human Resources Division.	Completed	A report is not expected.
HUD	Section 8 Management Assessment Program (SEMAP) Review.	Completed	Report received April 16, 2012.
SAO	An audit of compliance with the Public Funds Investment Act.	Completed	A report was received May 25, 2012.
HUD	Technical assistance and monitoring review of the HOME Program. HUD will be reviewing Community Housing Development Organizations (CHDOs).	**Reporting**	A draft report was received and management responses are due on September 17, 2012.
HUD	Technical assistance and monitoring review of the Uniform Relocation Act	**Reporting**	A draft report was received and management responses were due September 2, 2012. The Department has requested an extension.
FEMA	Close out audit of the Alternative Housing Pilot Project (AHHP).	**Reporting**	A draft report was received and management responses are due September 26, 2012.
Comptroller	A post-payment audit of the Department's purchasing, travel and payroll for June 1, 2011 to May 31, 2012.	**Reporting**	A draft report has not yet been received.

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BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of Recent External Audit Reports.

REPORT ITEM

Reports were recently received for two of the fourteen external audits or monitoring visits that occurred in fiscal year 2012.

BACKGROUND

NeighborWorks' Review of the National Foreclosure Mitigation Counseling Program

NeighborWorks contracted with Mayer Hoffman McCann, P.C. to perform agreed-upon procedures to evaluate participants of the National Foreclosure Mitigation Counseling Program. They tested compliance with requirements outlined in the Funding Announcements and Grant Agreements. The Department is the grantee for this program. The auditors selected the North Texas Housing Coalition for review. They initially identified 4 findings and 3 additional recommendations. However, based on their review of documentation provided during the management response period, all of the findings were cured.

HUD-OIG Audit of the Neighborhood Stabilization Program

HUD-OIG concluded that the Department did not adequately manage its obligations for the Neighborhood Stabilization Program (NSP) because it did not maintain sufficient records to support the obligations reported to HUD. The Department did not effectively and efficiently implement its planned program and incurred questioned obligations and costs totaling more than $25 million.

- The Department did not have valid contracts or other obligating documentation for $631,402 in reported obligations.
- The Department entered into agreements with subrecipients that did not complete their activities, resulting in $8,767 in unsupported costs.
- More than $24.6 million of the Department's reported obligations did not match subrecipient agreements.
- The Department improperly obligated $42,182.
- The Department did not report its progress to HUD in a timely manner and did not appear to be on track to spend NSP funds by the statutory deadline.
- The Department lacked adequate resources and effective controls to operate the program.

HUD-OIG recommended that HUD:

- recapture and reallocate $42,182 in ineligible obligations,

- require the Department to support that $589,220 in obligations existed as of the September 3, 2010 obligation deadline or repay HUD for funds drawn down,
- require the Department to provide supporting documentation for $8,767 in unsupported costs or repay HUD,
- require the Department to support that $24.7 million in obligations existed as of September 3, 2010 or repay HUD for funds drawn down,
- require the Department to implement adequate procedures and internal controls, and
- monitor the Department's progress toward meeting the March 2, 2013 expenditure deadline.

Update to the May 9, 2012 HUD NSP Monitoring Report

The Remote Monitoring Review of Neighborhood Stabilization Program (NSP) Obligations resulted in a decrease in the NSP grant of $10,673,574.72.

Mayer Hoffman McCann P.C.
An Independent CPA Firm

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June 4, 2012

Albert Martin
North Texas Housing Coalition
Sub Grantee of: Texas Department of Housing and Community Affairs
2900 Live Oak, 2nd Floor
Dallas, TX 75204

Dear Albert Martin:

Mayer Hoffman McCann P.C. was selected by NeighborWorks® America (NeighborWorks) to apply agreed-upon procedures in evaluating the participants of the National Foreclosure Mitigation Counseling (NFMC) programs performance of the NFMC Rounds 4, 5 and Legal Assistance grant awards. The testing follows the requirements outlined in the Funding Announcements and Grant Agreements. NeighborWorks is accountable to Congress and is responsible for ensuring that Grantees are in compliance with the terms and conditions of the NFMC program; therefore, these reviews are a high priority.

The procedures consisted of a review of both programmatic and client files testing. As a **sub-grantee**, your organization is responsible for compliance with the terms and conditions of the NFMC program and should consult with your direct grantee if the requirements listed in this letter differ from your grant agreement or contract to provide NFMC counseling. Findings must be addressed as failure to do so may result in de-obligation, recapture and/or other corrective action measures for the direct grantee and could result in a termination of your contract to provide NFMC services as a sub-grantee. Recommendations do not require a response but should be addressed as it may impact future compliance testing.

The direct grantee will receive a copy of this compliance letter and may request all documented evidence submitted by its sub-grantee during compliance testing.

We appreciate the assistance we received from your staff in providing the documents requested and being available for our reviewers during the course of our engagement.

During our engagement we noted the following Findings:

Programmatic Findings

Finding 1: **Counselor Training:** Per the NFMC Round 5 Grant Agreement, "Grantee(s) must certify (a) that it will adhere to the National Industry Standards Code of Ethics and Conduct as appropriate for the level(s) of counseling it plans to provide; (b) that all counselors performing work in NFMC Round 5 have signed the National Industry Standards Code of Ethics and Conduct and that Grantee will retain those signed copies as evidence of compliance; and (c) that all work performed under this grant will meet the Minimum Standard Activities for Foreclosure Intervention and Default Counseling."

No training policy or other documentation was provided to indicate that counselors receive on-the-job training for the first 90 days of employment in accordance with National Industry Standards. *(This requirement can be found in the NFMC Round 5 Grant Agreement, page 6).*

Please provide documented evidence that counselors providing NFMC counseling received on-the-job training within the first 90 days of employment and an updated training policy to cure this Finding.

Finding 2: **Counselor Training:** Per the NFMC Round 5 Grant Agreement, "Grantee(s) must certify (a) that it will adhere to the National Industry Standards Code of Ethics and Conduct as appropriate for the level(s) of counseling it plans to provide; (b) that all counselors performing work in NFMC Round 5 have signed the National Industry Standards Code of Ethics and Conduct and that Grantee will retain those signed copies as evidence of compliance; and (c) that all work performed under this grant will meet the Minimum Standard Activities for Foreclosure Intervention and Default Counseling."

No training policy was provided that outlines the on-boarding and on-going training process in accordance with National Industry Standards. *(This requirement can be found in the NFMC Round 5 Grant Agreement, page 6).*

Please provide a training policy that outlines the on-boarding process as well as the process for ensuring counselors receive on-going training to cure this Finding.

Finding 3: **Foreclosure Program Budget:** We noted during our review that your agency did not provide documented evidence that a separate budget was maintained. Per the NFMC Funding Announcement, "All Grantees will maintain a separate budget for their foreclosure program, and all NFMC Program funding will be used to fund Grantees' foreclosure counseling program and related expenses. Intermediaries and State HFAs are responsible for monitoring the expenditure reports of its Sub-grantees or Branches. In the final report, all Grantees will report on expenditure of NFMC Program funds. Intermediaries and State HFAs will report in the aggregate for its Sub-grantees or Branches but should collect and maintain on file expenditure reports from Sub-grantees and Branches and be able to furnish such during the course of the NFMC Program's planned quality control and compliance measures." *(This requirement can be found in the NFMC Round 5 Funding Announcement, page 24, bullet 1).*

Please submit documented evidence that your agency is maintaining a separate budget for the foreclosure program to cure this Finding.

Finding 4: **Expenditure Tracking:** We noted during our review that your agency did not provide documented evidence that it is tracking its NFMC expenditures separately. Per the NFMC Funding Announcement, "Grantees must be able to maintain separate accounts for their NFMC Program grant funds and track their expenditures." *(This requirement can be found in the NFMC Round 5 Grant Agreement, page 23, item 2).*

Please submit documented evidence that your agency is tracking its NFMC expenditures separately. This can be in the form of a general ledger.

Recommendations

The following are recommendations that do not require responses; however, if the recommended changes are not put in place, it may affect future compliance testing.

1. Please note that one or more documents for the client files were not clearly identified as belonging to the Client ID requested by NFMC. This will not be considered a Finding at this time. Going forward, please include the Client ID number on all client file pages. This includes (but is not limited to) Budget, Action Plan, MHA Eligibility Determination, Steps Taken on the Action Plan, and Close-out Documentation. This will ensure that NFMC Quality Control and Compliance staff can verify that the files belong to the correct client. A failure to clearly label each document may result in a Finding in future reviews. We noted all of the client files submitted had the same concern.

2. We noted the authorization language allowing NFMC to follow-up with clients for purposes of program evaluation limited the time for NFMC to follow-up with the client after the funding round was completed. A NFMC authorization form template can be found on the NFMC Members' Website (*www.nfmcmembers.org/*). Please update the program evaluation language to allow the appropriate time for follow-up. We noted all of the authorization forms submitted had the same concern.

3. We noted that your organization provided steps taken on the action plan as evidence of Close-Out. While this is in accordance with the Round 4 & 5 Funding Announcements and is not a Finding, we recommend that going forward your organization indicate in the file that for NFMC purposes the file is closed-out (the file has been billed to NFMC and the appropriate documentation is in the file). A template for Close-Out is available on the NFMC Members' Website (*www.nfmcmembers.org/*). The following files had this concern:

Client ID	Round	Level
4256	5	2
4133	5	2
4260	5	2

Your organization has 10 business days from the date of this letter to provide a written response to the Findings noted in this letter. Please submit your written response, a signed copy of this Findings letter and any additional documented evidence to the secure File Transfer Protocol (FTP) site https://secure-ftp.cbiz.com/.

Please use the cover sheets previously provided to separate the documents for any client file Findings noted. For any programmatic Findings noted in this letter, please provide a similar cover sheet to separate the documents related to programmatic Findings noted in this letter.

In addition, please find attached to this letter a table containing the results of the client file testing.

If you have questions or concerns, please contact Holly Perez at mhmcr@cbiz.com.

Sincerely,

Holly Perez

Helen M. "Holly" Perez, CPA
Manager

We acknowledge receipt of this letter. Please see our response attached.

Signature: ______________________________

Name Printed: ___________________________

Title: _________________________________

Date: _________________________________

pcode:	5041		Texas Department of Housing and Community Affairs Sub-grantee: North Texas Housing Coalition														
								All Client Files			Level 1				Level 2		
Grantee/ Subgrantee Name	Client ID	Round	Counseling Level	Have All Required Documents?	Have All Service Related Documents?	Number of Missing Documents	Number of Missing Service Related Documents	Authorization Form	Disclosure Statement	Privacy Policy	Intake	Budget	Action Plan	MHA Eligibility	Budget Verification	Steps Taken Upon Action Plan	Close Out Documentation
North Texas Housing Coalition	4040	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4053	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	3894	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4024	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	3887	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4044	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4164	5	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4256	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4185	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4133	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4260	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4110	5	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
					TOTAL	0	0										

July 23, 2012

Albert Martin
North Texas Housing Coalition
Sub Grantee of: Texas Department of Housing and Community Affairs
2900 Live Oak, 2nd Floor
Dallas, TX 75204

Dear Albert Martin,

NeighborWorks® America would like to thank you for your response to its Quality Control and Compliance Review for Rounds 4 and 5 conducted by Mayer Hoffman McCann P.C. (MHM) on behalf of the National Foreclosure Mitigation Counseling (NFMC) Program. As a recipient of NFMC funding, your organization, as a sub-grantee, branch, and/or affiliate office, is subject to site visits, file audits, and other measures to ensure program compliance conducted by NeighborWorks America and its authorized representatives.

MHM conducted an on-site or remote review of your organization based on NFMC program guidelines stated in the Rounds 4 and 5 Funding Announcement, Grant Agreement, and subsequent program announcements. As a **sub-grantee, branch, or affiliate**, your organization is responsible for compliance with the terms and conditions of the NFMC program and should consult with your direct grantee if the requirements listed in this letter differ from your grant agreement or contract to provide NFMC counseling.

This will be your final letter regarding the Quality Control and Compliance Review for Rounds 4 and 5. Based on Findings here, your direct grantee may take corrective measures that could result in a termination of your contract to provide NFMC services as a sub-grantee. Recommendations by MHM were encouraged, but not required, to be responded to as they may impact future compliance testing of the direct grantee. NFMC staff has reviewed your response and determined the following:

> **Your Finding(s) have been cured based on the documented evidence provided in your response.**

The information on the following pages detail the results of the Quality Control and Compliance Review for Rounds 4 and 5:

Programmatic Findings

Finding 1: **CURED:** The documented evidence submitted met the requirements as stated in the NFMC Grant Agreement and/or Funding Announcement. **Original Finding:**

Counselor Training: Per the NFMC Round 5 Grant Agreement, "Grantee(s) must certify (a) that it will adhere to the National Industry Standards Code of Ethics and Conduct as appropriate for the level(s) of counseling it plans to provide; (b) that all counselors performing work in NFMC Round 5 have signed the National Industry Standards Code of Ethics and Conduct and that Grantee will retain those signed copies as evidence of compliance; and (c) that all work performed under this grant will meet the Minimum Standard Activities for Foreclosure Intervention and Default Counseling."

No training policy or other documentation was provided to indicate that counselors receive on-the-job training for the first 90 days of employment in accordance with National Industry Standards. *(This requirement can be found in the NFMC Round 5 Grant Agreement, page 6).*

Finding 2: **CURED:** The documented evidence submitted met the requirements as stated in the NFMC Grant Agreement and/or Funding Announcement. **Original Finding:**

Counselor Training: Per the NFMC Round 5 Grant Agreement, "Grantee(s) must certify (a) that it will adhere to the National Industry Standards Code of Ethics and Conduct as appropriate for the level(s) of counseling it plans to provide; (b) that all counselors performing work in NFMC Round 5 have signed the National Industry Standards Code of Ethics and Conduct and that Grantee will retain those signed copies as evidence of compliance; and (c) that all work performed under this grant will meet the Minimum Standard Activities for Foreclosure Intervention and Default Counseling."

No training policy was provided that outlines the on-boarding and on-going training process in accordance with National Industry Standards. *(This requirement can be found in the NFMC Round 5 Grant Agreement, page 6).*

Finding 3: **CURED:** The documented evidence submitted met the requirements as stated in the NFMC Grant Agreement and/or Funding Announcement. **Original Finding:**

Foreclosure Program Budget: We noted during our review that your agency did not provide documented evidence that a separate budget was maintained. Per the NFMC Funding Announcement, "All Grantees will maintain a separate budget for their foreclosure program, and all NFMC Program funding will be used to fund Grantees' foreclosure counseling program and related expenses. Intermediaries and State HFAs are responsible for monitoring the expenditure reports of its Sub-grantees or Branches. In the final report, all Grantees will report on expenditure of NFMC Program funds. Intermediaries and State HFAs will report in the aggregate for its Sub-grantees or Branches but should collect and maintain on file expenditure reports from Sub-grantees and Branches and be able to furnish such during the course of the NFMC Program's planned quality control and compliance measures." (*This requirement can be found in the NFMC Round 5 Funding Announcement, page 24, bullet 1)*.

Finding 4: **CURED:** The documented evidence submitted met the requirements as stated in the NFMC Grant Agreement and/or Funding Announcement. **Original Finding:**

Expenditure Tracking: We noted during our review that your agency did not provide documented evidence that it is tracking its NFMC expenditures separately. Per the NFMC Funding Announcement, "Grantees must be able to maintain separate accounts for their NFMC Program grant funds and track their expenditures." (*This requirement can be found in the NFMC Round 5 Grant Agreement, page 23, item 2)*.

Thank you for your participation in the NFMC Program. We appreciate all of the work you do for foreclosure counseling and education. If you have questions regarding Quality Control and Compliance or would like NFMC to provide a WebEx or other instructional material regarding NFMC Quality Control and Compliance, please contact us at nfmc@nw.org. The subject line should read "Round 4 & 5 Standard Compliance Reviews".

Thank you for your time and consideration.

Sincerely,

Tonya Sims

Tonya Sims
Senior Program Manager, National Foreclosure Mitigation Counseling Program

Attachment: Client File Findings worksheet

pcode:	5041		Texas Department of Housing and Community Affairs Sub-grantee: North Texas Housing Coalition															
								All Client Files			Level 1				Level 2		
Grantee/ Subgrantee Name	Client ID	Round	Counseling Level	Have All Required Documents?	Have All Service Related Documents?	Number of Missing Documents	Number of Missing Service Related Documents	Authorization Form	Disclosure Statement	Privacy Policy	Intake	Budget	Action Plan	MHA Eligibility	Budget Verification	Steps Taken Upon Action Plan	Close Out Documentation
North Texas Housing Coalition	4040	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4053	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	3894	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4024	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	3887	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4044	4	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4164	5	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
North Texas Housing Coalition	4256	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4185	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4133	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4260	5	2	Yes	Yes	0	0	Yes	Yes	Yes	N/A	N/A	N/A	N/A	Yes	Yes	Yes
North Texas Housing Coalition	4110	5	1	Yes	Yes	0	0	Yes	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
					TOTAL	0	0										

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OFFICE OF AUDIT
REGION VI
FORT WORTH, TX

The Texas Department of Housing and Community Affairs, Austin, TX

Did Not Always Comply with Neighborhood Stabilization Program Requirements

2012-FW-1013

AUGUST 22, 2012

Issue Date: August 22, 2012

Audit Report Number: 2012-FW-1013

TO: Shirley J. Henley
Director, Office of Community Planning and Development, 6AD

//signed//

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Texas Department of Housing and Community Affairs, Austin, TX, Did Not Always Comply with Neighborhood Stabilization Program Requirements

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the Texas Department of Housing and Community Affairs' Neighborhood Stabilization Program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 817-978-9309.

August 22, 2012

The Texas Department of Housing and Community Affairs, Austin, TX, Did Not Always Comply with Neighborhood Stabilization Program Requirements

Highlights

Audit Report 2012-FW-0013

What We Audited and Why

We audited the U. S. Department of Housing and Urban Development (HUD) Neighborhood Stabilization Program (NSP1) administered by the Texas Department of Housing and Community Affairs. We selected the Department based upon the large amount of NSP1 funding that it received, more than $101 million. Our objective was to determine whether the Department complied with NSP1 requirements for obligations, expenditures, program income, monitoring, and reporting.

What We Recommend

We recommend that the Fort Worth Director of HUD’s Office of Community Planning and Development recapture $42,182 that the Department obligated improperly, and require the Department to provide support for more than $25 million in unsupported obligations and costs.

What We Found

The Department improperly obligated $42,182. In addition, it could not support more than $25 million in obligations made by the deadline and $8,767 in expenditures. Further, it did not report on its progress as required and did not appear to be on schedule to spend funds within required timeframes. As a result, the Department could not assure HUD that it properly managed its more than $101 million program.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

Under the Housing and Economic Recovery Act of 2008, the U. S. Department of Housing and Urban Development (HUD) distributed, through a prescribed formula, $3.92 billion in Neighborhood Stabilization Program (NSP1) funds to States and local governments. While NSP1 had similarities to existing HUD programs, it was a newly created program that required recipients to create or modify procedures and systems to manage and comply with requirements. On March 3, 2009, HUD awarded more than $101 million in NSP1 funds to the State of Texas. The State was to use its NSP1 funds to assist in the rehabilitation of abandoned and foreclosed-upon homes and residential properties.

The governor of Texas selected the Department of Housing and Community Affairs as the lead agency for its $101 million program. The Department provides for the public service and housing needs of low- to moderate-income families in Texas. The Department established a multilevel approach for the distribution of the NSP1 funds to communities with the greatest need. For the first level, it directly allocated $76.9 million to local governments and nonprofit agencies in counties identified as having the greatest need. For the second level, the Department competitively awarded $19.9 million to entities in counties with significant needs, referred to as the "select pool" counties.[1] It entered into a memorandum of understanding with the Texas Department of Rural Affairs, authorizing it to oversee the "select pool" activities.[2] However, as lead agency, the Department maintained overall responsibility for the entire program.

NSP1 required the Department to obligate its funds within 18 months after HUD signed the grant agreement on March 3, 2009.[3] The requirements defined obligations as when the Department placed orders, awarded contracts, received services, and conducted similar transactions.[4] The Department could not obligate funds simply by awarding NSP1 grants to its subrecipients. As table 1 shows, the NSP1 also required the Department to spend its funds within 4 years. As of May 29, 2012, the Department had drawn down only $52 million, which was about 52 percent of its grant, although its grant period for expending the funds was 81 percent completed.

Table 1: Statutory deadlines for the Department's NSP1 grant

Grant number	Date funds available	Obligation deadline set by HUD	Expenditure deadline
B-08-DN-48-0001	March 3, 2009	September 3, 2010	March 2, 2013

Our objective was to determine whether the Department complied with NSP1 requirements for obligations, expenditures, program income, monitoring, and reporting.

1 The remaining $5.1 million was for administrative costs.
2 This memorandum of understanding was for the period September 25, 2009, through August 31, 2011.
3 Federal Register Docket Number FR-5255-N-01, section II.B
4 Federal Register Docket Number FR-5255-N-01, section II.A

RESULTS OF AUDIT

Finding: The Department Did Not Always Comply with Neighborhood Stabilization Program Requirements

The Department did not adequately manage its NSP1 obligations by not maintaining sufficient records to support obligations reported to HUD. Federal regulations required the Department to establish and maintain sufficient records to support that it complied with requirements.[5] Based on a review of a statistical sample of obligations, the Department did not have valid contracts or other obligating documentation for $631,402 in reported obligations. Also, it entered into agreements with subrecipients that did not complete their activities, resulting in $8,767 of unsupported costs. Further, more than $24.7 million of its reported obligations did not match the subrecipient agreements. In addition, the Department did not report its progress to HUD in a timely manner as required and did not appear to be on track to spend funds by the statutory deadline. These conditions occurred because the Department did not allocate enough resources or establish the effective controls to operate its program. Therefore, the Department did not effectively and efficiently implement its planned program and incurred questioned obligations and costs totaling more than $25 million.

The Department Could Not Support the Obligation Amounts That It Reported to HUD

The Department did not create and maintain adequate records to support its meeting of the September 3, 2010, statutory obligation deadline. This deficiency occurred because the Department did not allocate the staff and resources necessary to establish the control environment to track and monitor its NSP1 obligations as required by its grant agreement.[6] Further, it could not effectively support its current obligations, which impaired its ability to manage its program.

In accepting its NSP1 grant, dated March 3, 2009, the Department certified to HUD that it would obligate its NSP1 funds within 18 months, or by the September 3, 2010, deadline. HUD emphasized the importance to all NSP1 recipients of meeting this deadline so they would not need to return funds. On September 4, 2010, the Department reported in HUD's Disaster Recovery Grant

5 24 CFR (Code of Federal Regulations) 570.506
6 Ibid.

Reporting (DRGR) system[7] that it had obligated 100 percent of its grant, thus meeting the obligation deadline.

However, the Department did not establish systems and controls for the obligation of NSP1 funds, which significantly hindered its ability to support its reported obligations. In response to several requests for support of its September 4, 2010, reported obligations, the Department provided a spreadsheet, dated October 17, 2011. It prepared the spreadsheet specifically for this audit using spreadsheets maintained by its program services division.[8] Department staff explained that the data in the program services' spreadsheets included information through February 2011, 5 months after the deadline. However, the Department could not substantiate the obligations it reported to HUD as meeting the September 3, 2010, deadline. Specifically, the Department could not provide a contemporaneously prepared or verifiable list of obligation amounts by specific NSP1 activities that equaled its obligations reported in the DRGR system.

In attempting to draw an obligation sample, we compared the Department's spreadsheet to the obligations it reported to HUD.[9] For 28 of 38 (74 percent) Department contracts, the amounts did not reconcile. As table 2 shows, the aggregate discrepancy between the Department's records totaled more than $9.4 million.

Table 2: Aggregate discrepancy between obligations the Department reported to HUD and its October 17, 2011, spreadsheet supporting the reported amounts

Contract comparison	Reported in the DRGR system on 09/04/2010	Department's spreadsheet 10/17/2011	Aggregate discrepancy
17 overstated contracts	$30,098,073	$ 34,385,120	$ 4,287,047
11 understated contracts	(16,898,251)	(11,759,273)	5,138,978
Total of 28 incorrectly reported contracts	**$13,199,822**	**$ 22,625,847**	**$ 9,426,025**

The Department was responsible for maintaining the information supporting what it reported to HUD through the DRGR system. The Department must reconcile its records and resolve the more than $9.4 million in aggregate discrepancies that its records showed. As further evidence that its records were inaccurate, table 3 demonstrates the fluctuations in amounts the Department reported to HUD and

7 HUD's Office of Community Planning and Development designed the DRGR system for its Disaster Recovery program and other special appropriations. Grantees use the system to report their NSP1 obligations and expenditures. HUD uses data from the system to review activities and required reports.

8 The Department provided the program services division's source spreadsheets on January 19, 2012, 4 months after our initial request.

9 This comparison did not include the Texas Department of Rural Affairs' agreements.

the amounts it reported on its Web site for its June 30, 2010, quarterly performance report, which it didn't report until June 22, 2011, almost 1 year late.

Table 3: Fluctuations between amounts the Department reported in the DRGR system and on its Web site for its June 30, 2010, quarterly performance report

Description	DRGR system as of 10/31/2011	DRGR system as of 11/16/2011	Department's Web site on 11/21/2011
Total NSP1 funds budgeted	$100,873,093	$84,569,796	$97,974,744
Program funds obligated	25,864,303	24,986,774	25,864,303
National objective NSP1 only – 25 percent set aside[10]	$65,369,757	$51,851,920	$62,524,020

None of the Department's budgeted amounts equaled the grant amount of more than $101 million as they should have. In discussions, Department staff attributed the discrepancies to the DRGR system. However, the DRGR system served as a repository for information that the Department submitted, and HUD used to monitor the Department's program.[11] Therefore, the Department was responsible for allocating the resources to accurately record information into the system.

The Department Did Not Obligate NSP1 Grant Funds by the Obligation Deadline

The Department could not support that it obligated all NSP1 grant funds within 18 months of the grant award as required.[12] For 20 of 56 (36 percent) grant activities reviewed, the Department incorrectly reported in the DRGR system that it met its obligation deadline for the grant funds awarded.[13] For 3 of the 20 activities, it reported that it obligated $42,182, although there were no executed agreements obligating the funds. For the remaining 17 activities, the Department's system did not contain documentation to support $589,220 in obligations.[14] This condition occurred because the Department did not effectively manage its NSP1 obligations. It did not allocate sufficient staff to implement policies and procedures for processing obligations. As a result, it did not ensure that its subrecipients entered into agreements that clearly obligated the funds by September 3, 2010.

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10 Federal Register Docket Number FR-5255-N-01, section II.E, required that the Department spend 25 percent of the funds for the purchase and redevelopment of abandoned or foreclosed-upon residential properties to be used to house individuals or families whose incomes did not exceed 50 percent of area median income.

11 HUD reviewed the DRGR system to analyze risk and find anomalies or performance problems that suggested fraud, waste, or abuse of funds. HUD reconciled budgets, obligations, fund draws, and expenditures to the DRGR system.

12 Federal Register Docket Number FR-5255-N-01, section II.B

13 The Department certified that it would obligate the $101 million NSP1 grant amount by September 3, 2010.

14 For example, some subrecipients did not date the signatures on the documents supporting the obligations.

Further, the Department did not establish and maintain a system for recording NSP1 obligations as required.[15] As a result, it could not provide a reliable list of obligations. The 56 sample grant activities were selected from records that the Department and the Texas Department of Rural Affairs provided.[16] The Texas Department of Rural Affairs provided several spreadsheets showing obligations for "select pool" subrecipients, which it prepared about September 3, 2010, when it entered obligations into the DRGR system. For the remaining obligations, the Department used various sources and took more than a year after the obligation deadline to create a spreadsheet that listed the obligations. The Department did not maintain an accurate obligation record, as more than half of the 56 samples did not match the obligations reported in its housing contract system. In total, its system underreported the sample amount for 34 activities (61 percent) by more than $4.8 million.[17] The sample listing contained 25 activities that exceeded its system's obligations and 9 activities for which the listed obligations were less than those reported in its system.[18] This condition occurred because the Department did not have effective systems for reconciling its obligating documents to its system and correcting discrepancies. As a result, it could not support that it obligated its funds by September 3, 2010.

The Department Deobligated More Than $21 Million for Activities That It Could Not Complete

Of 44 subrecipients, 15 (34 percent) did not complete the planned activities for 24 of 58 (41 percent) grant agreements. This condition occurred because the Department lacked systems and controls for selecting and helping subrecipients complete grant activities within guidelines.[19] As a result, the Department deobligated more than $21 million for activities that it could not complete.[20] The deobligations appear to show that the Department was more interested in meeting the obligation deadline than obligating funds for activities that it could complete. The deobligations may deter its ability to spend funds by March 2, 2013, as required. Table 4 is a summary of deobligated agreements.

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15 Under 24 CFR 570.506, the Department was required to maintain a historical record of funds obligated to meet the deadline.

16 The Department managed 43, and the Texas Department of Rural Affairs oversaw the remaining 13.

17 The sample amount showed total obligations of $35.3 million, while the Department's system reported a total of $30.4 million. The Department had taken one sample item in the amount of $106,315 out of its housing contract system. As a result, we did not compare that sample amount to the system.

18 The total absolute variance was more than $5.3 million.

19 Common business practice would require the Department to select only those subrecipients that could complete the proposed work while complying with Federal regulations.

20 HUD had not deobligated those funds from the Department's award.

Table 4: Funds deobligated by the Department from its subrecipients

Reason for deobligations	Number of agreements	Funds drawn down for lapsed contracts	Amount deobligated
Agreement terminated	9	$ 41,621	$11,597,964
Agreement expired	11	801,070	6,189,830
Amended agreement reduced the amount	4		3,595,891
Totals	**24**	**$842,691**	**$21,383,685**

The Department deobligated more than $12.3 of the $101 million that HUD awarded (12 percent) within 27 days following the September 3, 2010, obligation deadline. On September 4, 2010, the Department reported in the DRGR system that it had obligated all the awarded funds. However, its quarterly performance report for the quarter ended September 30, 2010, 26 days later,[21] showed obligations of only $89.6 million. The Department explained that there are many fluctuations in real estate transactions and the amounts obligated were only estimates that changed upon closing. It also explained that there was no existing requirement that the Department maintain its obligations after the obligation deadline. However, this did not clearly explain what happened to the reported obligations in such a short time period. The $12.3 million in deobligated funds are shown in the following table.

Table 5: Funds deobligated in 26 days following the obligation reporting

Type of activity	NSP1 funds deobligated
Renovations-new construction	($9,466,215)
Land banks	(2,874,858)
Acquisitions	1,024,762
Administrative fees (about 8%)	(955,464)
Demolitions	(143,839)
Rehabilitation	28,809
Total	**($12,386,805)**

HUD regulations specified the documents the Department must have when it obligated NSP1 funds.[22] Those documents had to be signed and dated. For instance, under NSP1 the Department could report an obligation when;

- a subrecipient had a signed purchase offer accepted by the seller for an acquisition of real property,

[21] The Department did not submit this report until November 15, 2011.
[22] NSP Policy Alert dated April 23, 2010

- a subrecipient had either a construction contract or other action that was legally binding for rehabilitation of property owned by the subrecipient,

- a subrecipient awarded a construction contract for new housing construction on vacant or demolished property, or

- a subrecipient awarded a demolition contract for a specific property.

All of the required documents mentioned above were legally binding to a subrecipient. Thus, it was unclear why the amounts obligated for these transactions would change so much and often during the short time period without the activities being completed or written amendments to the documents.

Before the Department deobligated NSP1 funds from the remaining balances of two subrecipient agreements, it paid the subrecipients for questionable costs. As a result, the Department spent $8,767 on unsupported payroll and administrative costs for those agreements that it cancelled.

- **Unsupported Payroll Costs**
  Timesheets did not reflect total activity required in fulfillment of the employees' responsibilities to the subrecipients, and there was nothing to indicate that the employees only worked on NSP1 activities. As a result, employees did not report their total activities as required.[23]

- **Unsupported Administrative Costs**
  Two subrecipients charged indirect costs to NSP1 based on a calculated percentage. When using the direct allocation method for allocating indirect costs under 2 CFR 230, subrecipients were required to prorate costs individually as direct costs to each activity using a base most appropriate to the particular cost being prorated. The base used must accurately measure the benefits provided to each activity and must be supported by current data. However, the Department's housing contract system did not have documentation to support that its subrecipients complied with the regulations. Further, in one instance, a subrecipient did not have a hotel receipt supporting more than $300.

The Department's Subrecipient Agreements Did Not Support the Obligations

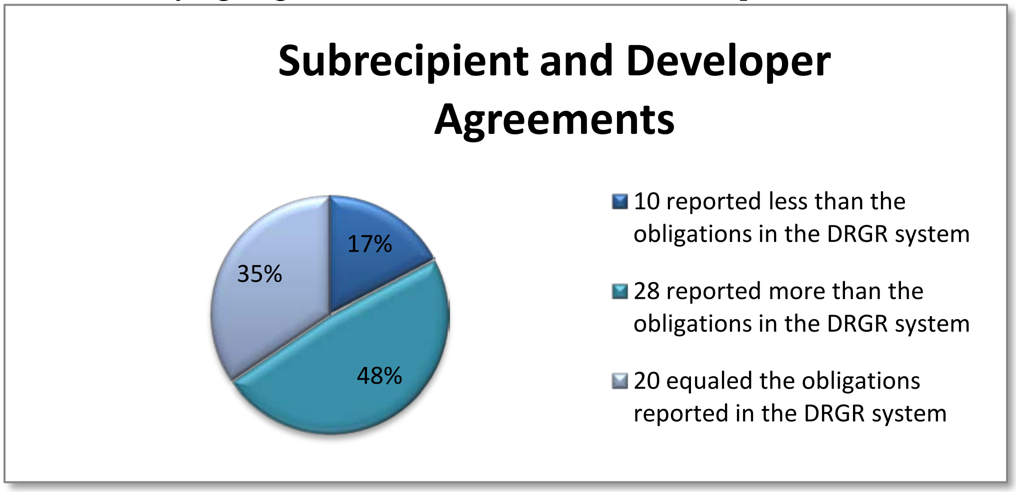
As previously noted, the Department did not maintain adequate records to support its September 3, 2010, obligations. In an attempt to determine which, if any, funds were not properly obligated by September 3, 2010, we compared the

[23] Under 2 CFR 230, each time report account for the total activity for which employees were compensated. The time report must show the total time required in fulfillment of their obligations to the organization.

obligations reported in the DRGR system to the individual subrecipient and developer agreements that were effective on that day. The agreements would help the Department ensure that it spent funds in accordance with program requirements.[24] However, the agreements did not support the obligations reported in the DRGR system and the Department could not reconcile the differences.

For instance, of the 58 obligations reported, 38 did not agree with the amounts in the subrecipient grant agreements. Ten agreements, 17 percent, were for less, and 28 agreements, 48 percent, were for more than the reported obligations. In addition, the Department entered into a developer agreement that it did not report. The aggregate amount of the obligation differences totaled more than $24.7 million, which was unsupported.

Chart 1: Thirty-eight agreements had different amounts than reported in DRGR



To worsen the situation, 22 of the 58 agreements showed that planned grant activities did not match the obligated activities. These differences gave the appearance that the Department did not know what activities it was going to pursue.

The variances occurred because the Department did not allocate the staff and resources necessary to create systems and controls for processing, tracking, and reconciling obligations. As a result, it did not ensure that its grant agreements matched the obligation information it reported. Since the agreements differed from the information submitted to HUD, the Department could not effectively monitor its performance under the submitted plans[25] or support that it met the obligation deadline.

[24] 24 CFR 570.501(b)

[25] Before the Department gave funds to its subrecipients, 24 CFR 570.503 required that the Department enter into subrecipient agreements with its subrecipients. The agreements were required to include a detailed description of the planned work, a schedule for completing the work, and a budget. The subrecipients were also required to provide adequate information for the Department to monitor performance under the agreements.

HUD cautioned grantees that adequate subrecipient agreements, which are "required," are "essential management tools" for measuring the subrecipients' performance and "verifying regulatory compliance." HUD explained that the Department should amend its written agreement when there was an unwritten agreement to change the scope of work. "Neglecting to amend" an agreement places the Department "at risk" because the "agreement is no longer an effective tool for monitoring and enforcing performance standards." For agreements that have more activities than obligated, the agreement "may continue to legally bind" the subrecipient to the activities that both parties agreed were no longer a responsibility of the subrecipient. According to the guidance, "[c]larifying or correcting these misunderstandings after the fact can be both disruptive and costly."[26] Since the Department did not amend its 38 agreements, it could not support $24.7 million obligated.

The Department Did Not Report on Its Progress as Required

The Department did not report its progress toward meeting its NSP1 goals as required. HUD required the Department to submit quarterly performance reports using its DRGR system within 30 days following the end of each quarter. It also required the Department to post prominently the quarterly performance report on the State's official Web site at the time of submission.[27] As table 6 shows, only 2 of the Department's 12 quarterly performance reports met the reporting requirement.

Table 6: Status of required quarterly performance report submissions as of July 12, 2012

Status	Quarterly performance report	Due date	Date submitted to HUD	Number of days late	Report submitted on time?
Submitted timely (2 reports)	06/30/2009	07/30/2009	07/28/2009	0	Yes
	03/31/2012	04/30/2012	04/26/2012	0	Yes
Submitted late (10 reports)	09/30/2009	10/30/2009	11/12/2009	13	No
	12/31/2009	01/30/2010	02/02/2010	3	No
	03/31/2010	04/30/2010	06/11/2010	42	No
	06/30/2010	07/30/2010	06/22/2011	327	No
	09/30/2010	10/30/2010	11/15/2011	381	No
	12/31/2010	01/30/2011	11/22/2011	296	No
	03/31/2011	04/30/2011	01/17/2012	262	No
	06/30/2011	07/30/2011	03/19/2012	233	No
	09/30/2011	10/30/2011	03/28/2012	150	No
	12/31/2011	01/30/2012	04/03/2012	64	No

26 Managing CDBG: A Guidebook for Grantees on Subrecipient Oversight
27 Federal Register Docket Number FR-5255-N-01, section II.O

The Department submitted acceptable June and September 2010, quarterly performance reports nearly 1 year late. However, it did not maintain records or implement a system for summarizing its progress. This condition occurred because the Department did not effectively plan to manage its NSP1 by implementing systems to properly record obligations thereby allowing it to accurately report its performance to HUD in a timely manner. It did not assign enough staff members to run the program and it did not adequately prioritize the requirement for accurate and timely reporting of results. As a result, the NSP1 manager submitted the quarterly performance reports whenever time allowed. The September 2010 quarterly performance report would have informed the public of the Department's obligation status.

The Department did not report its obligations to HUD monthly as it should have. HUD required grantees that were not 100 percent obligated by June 30, 2010, to report monthly on their progress.[28] Specifically, HUD required the Department to submit monthly reports until HUD accepted a report demonstrating 100 percent obligation. The Department's September 2010 quarterly performance report established obligations as of the obligation deadline. However, the Department did not submit the September 2010 quarterly performance report until November 15, 2011. Therefore, the Department should have submitted monthly reports on its obligations from June 30, 2010, through October 30, 2011.

In addition, the Department could not support that it met its performance goals that it reported in the DRGR system. The Department's housing contract system showed detailed information on each grant activity. However, it did not summarize the information for easy reporting. Additionally, the Department did not have a system for reconciling its data with the DRGR system; thus, it did not reconcile its actual activities shown in its housing contract system to the activities that it reported in the DRGR system. As a result, it did not have readily available records to support that it met its performance goals, including the requirement to spend at least 25 percent of its funds to benefit individuals and families whose incomes did not exceed 50 percent of the area median income. The Department also did not have records to show that its subrecipients met their milestones and thresholds as required by their grant agreements.

In August 2011, the Department implemented policies and procedures for monitoring subrecipient progress toward meeting program goals, and it had created a database to track subrecipient performance as of January 31, 2012.[29] However, it had not implemented policies and procedures for summarizing its total progress. HUD required the Department to meet grant performance goals for several years after expending grant funds. If the Department does not keep

28 Federal Register Docket Number FR-5255-N-01, section II.O.1(b)(i). HUD awarded the funds on March 3, 2009. The end of the 15th month following that date was June 30, 2010.

29 Since the Department had just begun using the database, we did not review the system's effectiveness for tracking performance measures.

records supporting its accomplishments, HUD has no assurance that the Department will comply with these requirements.

In addition, the Department's program division did not have written procedures for tracking and reporting program income. According to the NSP1 manager, the Department had unwritten procedures. When the financial administration division received program income, it notified program staff by email. After receiving notification, one loan specialist entered the information into the DRGR system; another entered the information into the Department's system. According to management, staff continually reconciled the entries. Without formalized program income policies and procedures, the Department could not support that it tracked program income as required.

The Department Had Incomplete Guidelines To Verify Eligibility

The Department's policies and procedures for verifying tenant and homeowner eligibility before approving draw requests for homeowner loans were incomplete. Also, the procedures did not have a timeline for the quality assurance staff to complete their reviews. According to management, properties were set up in the Department's system to comply with the area median income requirements. The subrecipients set up activities in the system, and the specialists reviewed and approved the activity setups. As a result, specialists needed to confirm that each property met its eligibility requirements and quality assurance staff did a second review before requesting NSP1 funds for homebuyer loans. Without clear written procedures for processing setups and draws, the Department may not be able to ensure that its staff understand the requirements and that its subrecipients have the resources necessary to complete their grant activities in a timely manner.

The Department Was Not on Track To Spend Funds in a Timely Manner

Based on the expended funds and progress as of May 29, 2012, the Department did not appear to be spending its NSP1 funds in a timely manner. Federal regulations[30] required that the Department spend the total funds awarded within 4 years, or by March 2, 2013.[31] HUD would recapture all funds not expended by that date. Although it was 3.2 years (81 percent) through the grant, the Department had spent only $52 million (52 percent) of its grant funds. The Department put itself at risk of not spending the grant funds on time when it selected subrecipients that did not have the capacity to administer the program activities. At least 34 percent of the subrecipients either did not have the capacity

[30] Federal Register Docket Number FR-5255-N-01, section II.M.2
[31] The 4-year expenditure period began on March 3, 2009, when HUD signed the State's NSP1 grant agreement.

or were not willing to complete their NSP1 activities. This problem caused the Department to deobligate at least $21 million. As table 7 shows, the Department had obligated only $84 of the $101 million grant (approximately 83 percent) as of May 29, 2012.

Table 7: The Department's total drawdowns for NSP1 activities as of May 29, 2012

Activity	Obligated	Funds drawn down	Activity percentage completed
Acquisition – multifamily properties	$21,154,879	$20,288,081	96%
Land banks	8,362,291	6,531,276	78%
Demolition	2,433,838	1,666,694	68%
Acquisition – single-family properties	14,640,381	10,348,427	71%
Financing	995,566	413,482	42%
Administrative fees	8,220,142	4,898,421	60%
Rehabilitation or reconstruction – multifamily properties	8,636,639	3,368,867	39%
New construction or rehabilitation – single-family properties	20,158,340	5,357,223	27%
Totals	**$84,602,076**	**$52,872,471**	

Although the Department seemed to be completing the purchase of properties for multifamily residences and land banks in a timely manner, it was not progressing as well on the other activities. For example, the Department was slow to complete its acquisition, new construction, and rehabilitation goals for single family homes. It had spent only $15 of $34 million (approximately 45 percent) obligated for those activities. In another example, the City of Huntsville did not appear to be able to complete its activities. As of May 24, 2012, Huntsville had drawn down only $155,490 (10 percent) of its $1.5 million in obligated funds. Funds were not drawn down in a timely manner because there seemed to be delays in receiving guidance to carry out the programs, entering information into the system, getting timely approvals to carry out program activities, and obtaining funds for expenses. The Department's inability to use its funds could make funds unavailable for capable entities that could complete viable NSP1 activities.

Conclusion

The Department did not always follow requirements when obligating and reporting on its NSP1 funds. It did not keep reliable records to support that it met the statutory obligation deadline. The Department obligated $42,182 without valid agreements and $589,220 without complete obligating documents. In addition, the Department entered into grant agreements with subrecipients that could not complete their NSP1 activities, resulting in $8,767 in unsupported expenditures. Also, it entered into subrecipient grant agreements that were not the same as the obligations reported in the DRGR system. The aggregate amount of the obligation differences totaled more than $24.7 million. Further, the Department needs to strengthen its written policies and procedures for program specialists and quality assurance staff during the homebuyer loan process. Also, the Department did not appear to be spending its NSP1 funds in a timely manner. As a result, it did not carry out its activities as planned and could not adequately monitor the activities that it reported to HUD. In addition, the Department did not report on its progress as required. This condition occurred because the Department did not allocate sufficient staff and resources to implement adequate policies and procedures for its NSP1 obligations, thereby putting the program at risk of misappropriated funds.

Recommendations

We recommend that the Fort Worth Director of the Office of Community Planning and Development

1A. Recapture and reallocate $42,182 in ineligible obligations and require the Department to reimburse HUD from non-Federal funds for any NSP1 proceeds spent on these obligations.[32]

1B. Require the Department to support that $589,220 in obligations existed as of September 3, 2010, or repay HUD for funds drawn down. The Director should take additional corrective action as appropriate.[33] These were obligations that we reviewed for which the Department's system did not have the required obligating documents.

1C. Require the Department to provide documentation to support $8,767 in unsupported costs or repay any unsupported amounts to HUD.

1D. Require the Department to support that $24.7 million in obligations existed as of September 3, 2010, or repay HUD for funds drawn down. Further, the Director should take additional corrective action as appropriate.[34] These were developer and subrecipient agreements that did not agree with the amounts and activities the Department obligated in the DRGR system.

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32 According to Federal Register Volume 75, Number 201, section I.B.2, HUD is required to recapture and reallocate up to $19.6 million in improper obligations. HUD may take other corrective action for funds in excess of $19.6 million.

33 Ibid.

34 Ibid.

1E. Require the Department to implement adequate procedures and controls

- For processing, documenting, tracking, and reconciling its obligations to its subrecipient grant agreements and information reported to HUD and tracking and reporting its program income.

- For selecting subrecipients that have the capacity to complete grant programs.

- For tracking its progress toward meeting its NSP1 performance goals and completing and submitting quarterly performance reports to the DRGR system so that HUD knows the program's status.

1F. Require the Department to revise its standard operating procedures for its performance specialists and quality assurance staff to ensure loans and drawdowns are processed in a timely manner and to clearly explain the procedures for approving homebuyer activities for loans and drawdowns. The procedures should include the types of supporting documentation that must be reviewed, incorporating the NSP Homebuyer Workbook,[35] and clarifying what checklist(s) will be used and when to determine eligibility. The procedures for quality assurance staff should include a timeline for completing the review.

1G. Monitor the Department's progress toward meeting its March 2, 2013, expenditure deadline and follow up on any delays.

[35] According to the Department, subrecipients submit this workbook, along with source documentation, when sending household information to the Department for review and approval.

SCOPE AND METHODOLOGY

We performed our fieldwork at the Department's office located in Austin, TX, and our office in Oklahoma City, OK, from July 2011 through May 2012. Our audit scope was January 2009 through July 2011. We expanded our scope to July 12, 2012, for DRGR system reporting progress and May 29, 2012, for expenditure progress.

To accomplish our objectives, we performed the following related to the Department's NSP1 grant funds:

- Reviewed relevant laws, regulations, and HUD guidance;
- Reviewed the Department's policies and procedures;
- Reviewed and analyzed the Department's NSP1 grant agreement and the State's substantial amendment to its annual action plan for Federal fiscal year 2008;
- Reviewed internal audit reports and the February 15, 2011, NSP1 needs assessment report prepared by Training and Development Associates, an independent contractor for HUD;
- Reviewed the Department's monitoring reports of its subrecipients and the Texas Department of Rural Affairs;
- Reviewed the expenditures of 10 subrecipient grant agreements that either expired or were terminated;
- Reviewed 35 percent of the Department's NSP1 obligations as of September 3, 2010, to ensure that the Authority met its obligation requirements;
- Reviewed 13 NSP1 expenditures to determine whether the Department met expenditure requirements;
- Reviewed the status of the Department's NSP1 quarterly performance reports as of November 1, 2011, and the April 2011 annual Section 3 reports[36] for timely reporting;
- Interviewed HUD, Department, and Texas Department of Rural Affairs staff and NSP1 subrecipients; and
- Conducted 26 site visits to properties (5 multifamily properties and 21 single family homes) financed with NSP1 funds.

For the obligation sample review of approximately $75 million in obligations directly overseen by the Department, we used a spreadsheet prepared by the Department more than 1 year following the obligations. The spreadsheet apparently showed the obligations, listed by subrecipient grant activity, which existed as of September 3, 2010, the obligation deadline. For the approximate $19 million in obligations initially administered by the Texas Department of Rural Affairs, we used spreadsheets prepared by its staff when it entered the September 3, 2010, obligations into the DRGR system. Using the spreadsheets, we identified and reviewed a statistical sample of 56 activities. The sample amount was more than $35.3 million. The sample universe included 1,430 activities that totaled more than $93.7 million. These activities

[36] The Department certified that it would submit Section 3 reports to HUD showing that, to the greatest extent feasible, it provided job training, employment, and contracting opportunities for low- or very-low income residents in connection with projects and activities in their neighborhoods.

consisted of 1,203 activities administered by the Department and 227 activities initially administered by the Texas Department of Rural Affairs. Twenty-one activities, involving 4 subrecipient grant agreements, were not included in the universe because the information provided by the Department designated them as “cancelled.” The spreadsheet that the Department prepared was not reliable. There were many discrepancies between the contract amounts and activities shown on the spreadsheet and those shown in the DRGR system. As a result, we did not project the results of the review.

We selected a nonstatistical, representative sample of 52 of the Department’s 1,136 NSP1 administrative draws and expenditures. The 52 samples, valued at almost $1 million, represented almost 3 percent of the more than $37 million in administrative draws and expenditures. For the survey, we tested 13 of the 52 expenditures with no exceptions. As a result, we did not review the remaining 39. We used a nonstatistical sample because we were evaluating whether the Department kept documentation that supported its expenditures and we were not projecting the results.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Policies and procedures that the Department's management had implemented to ensure that its program met its objectives.
- Policies and procedures that the Department's management had implemented to ensure that its subrecipients and developers complied with laws and regulations.
- Policies and procedures that the Department's management had implemented to ensure that its resource use was consistent with laws and regulations and that its resources were safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The Department did not establish systems and controls for processing, documenting, tracking, and reconciling its obligations to its subrecipient grant agreements and information reported to HUD (finding).
- The Department did not establish systems and controls for tracking and reporting its program income (finding).
- The Department did not establish systems and controls for selecting subrecipients that had the capacity to complete its NSP1 activities (finding).
- The Department did not have a system in place to ensure that it had adequate staff to oversee its NSP1 activities and its subrecipients (finding).
- The Department did not implement policies and procedures for its program specialists to verify tenant or homeowner eligibility before approving NSP1 draws (finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Unsupported 2/
1A	$42,182	
1B		$ 589,220
1C		8,767
1D		24,706,604
Totals	**$42,182**	**$25,304,591**[37]

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

[37] According to Federal Register Volume 75, Number 201, HUD is required to recapture and reallocate up to $19.6 million in improper obligations. HUD may take additional corrective actions related to any amount of unused funds greater than $19.6 million.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

www.tdhca.state.tx.us

Rick Perry
GOVERNOR

July 18, 2012

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Mr. Gerald R. Kirkland
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General, Region 6
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

RE: MANAGEMENT RESPONSE TO THE DRAFT AUDIT REPORT FOR THE TEXAS NEIGHBORHOOD STABILIZATION PROGRAM (NSP)

Dear Mr. Kirkland:

Thank you for providing the Texas Department of Housing and Community Affairs (TDHCA) with an opportunity to review the findings and recommendations of your draft audit report issued June 27, 2012, regarding the Texas NSP. We appreciate the time and effort that your audit team put into reviewing our program.

Before we respond to more specific aspects of the report, I would like to first acknowledge that TDHCA has struggled with the Texas NSP and concurs with your assessment that we did not have ideal systems in place as the program was initiated. However, our ability to administer the program was severely impacted by limited initial federal program guidance, subsequent federal changes in guidance mid-way through the program and challenges utilizing the DRGR system.

Comment 1

Mr. William Nixon, HUD Assistant Regional Inspector General for Audit, indicated in our exit conference that our main issue was "paperwork and documentation." We concur that our processes for record-keeping in the initial phases of our program left room for improvement; while we do not agree that our funds were improperly obligated (other than those obligations with which we have been corresponding with HUD over the past nine months), we do agree that they were not well organized. However, in spite of our challenges and lack of ideal systems, we believe that we have source documentation to substantiate TDHCA's commitments, obligations, and decisions. We also are deeply concerned and disappointed with the emotionally charged and pointed language in portions of your report which appear to suggest that TDHCA intentionally mismanaged its administration of the Texas NSP. In fact, TDHCA has acted in good faith and has always attempted to administer this program in a manner that complies with all applicable federal requirements and guidance.

221 East 11th Street P.O. Box 13941 Austin, Texas 78711-3941 (800) 525-0657 (512) 475-3800

In regards to concern for TDHCA's ability to utilize the remaining program funds, I would note that based on current rates of expenditures and activity, TDHCA forecasts that it will have expended ***all*** funds by the deadline.

We will continue to work through the detailed issues with HUD.

Finding One: Improper Obligation

Regarding the draft audit report findings identified in Finding One, TDHCA would like to emphasize the following:

Comment 2

- Comments throughout the draft audit report indicate that obligation amounts should not have fluctuated or that they should have equaled the individual contract amounts. However, it is not only reasonable, but fully expected, that in the vast majority of real estate transactions there will be fluctuations. The amount originally obligated to a subrecipient for numerous transactions will not be identical to the cumulative amount actually contracted or expended. It would be unrealistic to expect an exact amount in this case. Even in the most "cookie cutter" real estate transactions, everything is couched in terms of estimates up until the drawing of documents for closing.

- In cases where the documented contract amount exceeded the amount obligated, TDHCA did not exceed the obligation amount in the subrecipient agreement; as required by HUD guidance, if the obligation total was less than the agreement, only the obligation amount was permitted to be entered into DRGR, therefore creating data that would be susceptible to being viewed as a discrepancy.

- TDHCA staff has actively managed the NSP contracts by continuously re-evaluating, adjusting, and updating contract amounts to ensure that they reflect the most current facts of each real estate transaction and tracked ongoing activity that, when reported and documented, will of necessity create variations in amounts.

Comment 3
Comment 2

- Regarding many of the statements and comments in the draft audit report, TDHCA emphasizes that there is no existing HUD or NSP requirement that 100% of obligations be maintained after September 2010 or that obligations be required to match contracts after that deadline. In a webinar on August 18, 2011, Mr. John Laswick of HUD, stated: "But the fact that it's not exactly the same projects that you had listed as obligated last September, is not something that we're concerned about."

Comment 4
Comment 2

- The draft audit report indicates that some of TDHCA's obligations were unsubstantiated and that it "could not effectively support its current obligations." We believe that we have adequate support for each of our current obligations as well as the obligations made by the September 2010 obligation deadline.

- The draft audit report implies that variances in DRGR are the responsibility of TDHCA. While it is true that the Department is responsible for entry into DRGR, TDHCA is not able to make changes in DRGR after the QPR for the period in which the entries were made is reviewed. However, historical reports generated reflecting back to that quarter, or other periods of time, do not reflect what TDHCA entered on those dates. The QPR system has idiosyncrasies outside of TDHCA's control that prevent its use as a reliable snapshot report of record for this purpose.

Comment5
Comment 2

- While TDHCA acknowledges that the state is responsible for all of the NSP funds it was awarded, it should be emphasized that as soon as TDHCA assumed direct responsibility for the Texas Department of Rural Affairs' contracts (upon its dissolution by action of the Texas legislature), a thorough review was performed, TDHCA identified contracts of concern, reported them to HUD and requested guidance on how to proceed.

Comment2

- TDHCA is now fully current on its Quarterly Performance Reports.

Addendum One provides a more extensive response to the concerns noted in the draft audit report for Issue One, including back up documentation and explanation of attachments.

Finding Two: Townhomes of Bay Forest Mortgage

Comment 6

Regarding this multifamily transaction, TDHCA firmly believes that the use of these funds and structure of this partnership were not only eligible expenses but that TDHCA exercised tremendous prudence in making sure that the structure we utilized was within regulatory requirements, both for the NSP funding source and for the leveraged housing tax credits. Because the expenditures were indeed eligibly spent, the full amount of funds, including the balance of $659,443, should not be recaptured by HUD or reimbursed to HUD. Addendum Two provides a more thorough and in-depth response to the Issue Two concerns noted in the draft audit report.

Thank you for your consideration in reviewing our comments as your finalize your audit report.

Sincerely,

Timothy K. Irvine
Executive Director

TKI/bb

cc: Shirley J. Henley, HUD
Steve Eberlein, HUD
William Bedford, HUD

Addendum One
Texas NSP Management Response to Audit – Detail Regarding Finding One
July 18, 2012

Finding 1: The Department Improperly Obligated and Misspent NSP1 Funds

The Department Could Not Support its Obligations - 1A & 1B

Comment 7

The first two sections of the report text appear to refer to the same findings 1A & 1B. HUD guidance is clear that a subrecipient agreement alone does not constitute valid obligation for NSP1. Obligation is described as, "The amounts of orders placed, contracts awarded, goods and services received, and similar transactions during a given period that will require payment by the grantee (or subrecipient) during the same or a future period."[1] The Department reviewed each document provided by subrecipients and entered the corresponding aggregate obligation amounts by eligible use in DRGR within the obligation deadline requirements. Unfortunately, that work did not include creation or maintenance of a separate summary record, as found in the audit report. Lack of a separate summary does not invalidate the obligations, nor does that lack create a discrepancy between the documents themselves and the obligations as entered.

Comment 8

Additionally, the spreadsheet provided by OIG as support for the audit report amounts indicates that only Exhibit B (Budget to the subrecipient contracts) was used as a basis for calculation. Included in the absolute value of differences between the obligation amount and the subrecipient agreement are differences between the budget amount for an eligible use as it appears in Exhibit B of the contract, and the set-aside obligation amount entered in DRGR. Requirements for set-aside amounts are included as part of the Exhibit A - Performance Statement of each contract.[2] The set-aside requirements are described both in terms of dollar amounts to be expended, and unit counts in each contract, as such, the set-aside obligations entered in DRGR are appropriate and reflect the Department's requirement that subrecipients meet set-aside targets.

Comment 9

In many instances, the obligation amounts taken from documentation provided by subrecipients did not exactly total to the subrecipient agreements. It is nearly impossible to reach an exact amount with multiple individual real estate transactions that had been unknown when the subrecipient agreement was executed a year prior to the obligation deadline. In some cases, the total of subrecipient obligation documentation was more than the contract amount. In these instances the amount of obligation entered by the Department was limited to the agreement amount. If the obligation total was less than the agreement, only that amount was entered in DRGR, as required by the definition of obligation. For the 28 agreements that were more than the reported obligations, the Department believes it acted properly in reporting the true obligation amount. Entry of the full contract amount without supporting obligation documentation would have been a violation of NSP1 requirements.

Comment 10

For the agreements that were less than the obligation amount, the difference was part of an original subrecipient agreement that was amended shortly before the obligation deadline to move rental activities to a Developer Agreement. The reduction to the acquisition obligation and corresponding

[1] See attached NSP Policy Alert, Obligations, April 23, 2010
[2] See attached Texas NSP Contract, Exhibit A – Performance Statement includes requirements for expenditure of a percentage of non-administrative funds along with a corresponding number of units to benefit households at or below 50% AMI.

administrative funds was missed in the course of obligation entry. The funds have subsequently been obligated to another activity.

The remaining nine contracts that had obligations more than the contract amount were administered by TDRA. TDRA staff entered the obligation amounts for their contracts, as required by the Memorandum of Understanding. When TDRA was dissolved and the NSP1 contracts and files were transferred, the Department conducted an in-depth review of the records along with monitoring visits to all assigned contracts. In the course of review, a number of discrepancies in the TDRA obligations were identified and those concerns communicated to HUD. HUD has completed a review of 100% of the TDRA obligations, and continues to work with the Department to resolve the findings.

Comment 11

Presentation of amounts from the June 30, 2010, Quarterly Performance Reports by the auditors appear to be pulled on different dates from DRGR and their use as an example of the Departments records we believe is misleading. The report posted to the Department's website is the one reviewed and approved by HUD. Once a report is approved, grantees are not longer able to edit it, so that differing budget, obligation or set-aside amounts are the result of programming issues within DRGR.[3]

The Department Did Not Obligate NSP1 Grant Funds by the Obligation Deadline - Findings 1C and 1D

Comment 12

While NSP1 funds were required to be obligated to individual activities with appropriate supporting documentation, the obligations were reported in DRGR as a total amount per eligible use under each contract. Examining obligations at the per-activity level, rather than all the activities attributable to an eligible use within a contract, would not necessarily result in the same conclusions. It appears that for all of the NSP1 subrecipient contracts, multiple individual activity obligations were combined to total the amounts entered in DRGR. An examination of all of the activities that were used to obligate funds for a contract may have yielded different results.

Further, comparison of obligation amounts to entries in the Department's Housing Contract System is not a valid measure of accuracy. As subrecipients have moved from initial obligation to loan closing and completion of activities, amounts required for rehabilitation to meet property standards frequently change. Variances may be the result of Department staff review of additional documentation, changes in the scope of work, or changes in the cost of goods and services.

The Department Spent $8,767 of Unsupported Costs of Terminated Subrecipient Agreements

Comment 13

Unsupported Payroll Costs

The Department requires that documentation meeting OMB requirements is provided in order for salary costs to be reimbursed.[4] Documentation provided to support the draw request in question includes timesheets for a bi-monthly pay period, that reflect an after-the-fact determination of the hours worked on specific NSP1 tasks, they are signed by the employee and the supervisor, thereby meeting the requirements for salary documentation as described in OMB A-122, Appendix B, Item 8m.

[3] See attached Add/Edit QPR Screen - When a Quarterly Performance Report is submitted and approved, the "edit" button is automatically removed.

[4] See attached - NSP Administrative Draw Checklist: Only actual hours worked directly on the NSP Program are eligible for reimbursement and must be documented. Support documentation must include one of the following: payroll journal, cancelled payroll checks, or check stubs, along with the Time Sheet – Form 15.01.

Reimbursement is made on the hours reported as worked on the NSP Program; there is no requirement that subrecipient employees work full-time on NSP.

Comment 14

Unsupported Administrative Costs

Most NSP1 subrecipients use OMB A-122A D.4., Direct Allocation Method as the basis for allocation of administrative costs. An indirect cost rate is not required by OMB, it is one of several methods available to account for expenses.

Comment 15

For the specific draw mentioned that did not include a hotel receipt, the draw as originally submitted was for $6,425.44, the draw was reduced to $5,000.00 as approved.[5] The hotel charge is part of the charges that were not paid by TDHCA.

The Department Did Not Report on Its Progress as Required

Comment 16

In September 2011 an Information Specialist was added to the NSP staff, whose primary assignment is maintenance of accurate DRGR reporting. Working closely with HUD staff, seven (7) Quarterly Reports were submitted and approved between November 15, 2011, and April 26, 2012. The Department is now current for all such HUD reporting.[3]

Comment 17

Formal submission of QPRs during months 15-18 was not required, in fact the DRGR system was not set up to allow monthly submission. HUD's Policy Alert, New Monthly Reporting Requirements for NSP1 Grantees[6] includes the following instruction:

> Open the QPR for the next quarter (July-Sept), and begin reporting on expenditures right away. You should also note receipt of program income and show its disbursement. Remember that every time you enter new information you should save the QPR, and then your CPD Rep will be able to open the document at the end of the month

Comment 18

Performance reporting is required as units are occupied. All information required to report performance is captured in the NSP Homebuyer Workbook[7], and the Housing Contract System[8]. During the review period that resulted in this report, there was very little performance reporting activity, as most NSP1 subrecipients were working on acquisition and rehabilitation or construction prior to homebuyer sales. The Department now has sufficient procedures in place to accurately and timely report on performance goals.

Comment 19

Measurement of the 25% setaside requirement will occur at the expenditure deadline, at which time the expenditure per unit occupied by a household at or below 50% AMI will be reported. In addition, it should be noted that the budgets for the NSP multi-family projects, almost all of which are 100% restricted for households at or below 50% AMI, total $29,791,517.68. This amount alone exceeds the 25% requirement by $4,292,305.68 prior to addition of set-aside ownership units.

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[5] See attached - 77090000172 Administrative Draw, as approved

[3] See attached – Add/Edit QPR Screen

[6] See Attached Policy Alert - New Monthly Reporting Requirements for NSP1 Grantees

[7] See attached – NSP Homebuyer Workbook. This workbook is used by subrecipients to submit households to the Department for review and approval.

[8] See attached – NSP Household Detail Screen

The Department Had Incomplete Guidelines to Verify Eligibility

Comment 20

It is the nature of NSP that most subrecipients are engaged in speculative purchase and rehabilitation, or new construction, of properties before a homebuyer is identified. The Department provides funding for those activities through interim acquisition and construction loans, which include income eligibility of the homebuyer or tenant as a condition of release of financing.[9] Because funds are provided before the occupant household is identified, verification of income eligibility at draw is not possible.

Household Income Eligibility is verified for all transactions prior to homebuyer loan closing. NSP Program Specialists verify eligibility determinations in accordance with Standard Operating Procedures (SOP)[10] using the NSP Homebuyer Internal Review tool, [11] to include review of source documentation provided as an attachment with the NSP Homebuyer Workbook.[12] Quality Assurance staff in the Program Services division complete a secondary review of income eligibility for all homebuyer transactions.[13] Management reviews a sample of activities quarterly in accordance with the Management Oversight SOP.[14] The Program Specialists are required to complete their review and approve or disapprove the transaction within 10 business days of submission, as described in the current SOP. The same 10 business day requirement for review and approval or disapproval of draws is imposed by the current SOP for that task.[15]

The Department was Not on Track to Spend Funds in a Timely Manner

Comment 21

While HUD has not provided final guidance regarding the expenditure deadline and subsequent grant close-out, they have recently provided important information regarding the difference between expenditure and drawdown of NSP1 funds.[16] Based on this clarified guidance, the Department will begin to report subrecipient expenditure differently in future quarters.

The report equates draw down to expenditure. The draw down amount reflects funds drawn through DRGR from the NSP1 Grant or program income to reimburse expenses. The expenditure amount reflects the expenses reported by the Department as accrued by NSP1 subrecipients and developers. The deadline requires that grantees expend 100% of the NSP1 grant amount, regardless of the amount drawn so we believe the two are not the same.

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[9] See attached – NSP Interim Deed of Trust: 7.24 Low and Moderate Income Requirement. It is the intent of Beneficiary and Grantor that 100% of the funds made available under NSP are to be used to meet the low and moderate income requirement established in the Housing and Economic Recovery Act Section 2301 (f)(3)(A)(i) and (ii). The low and moderate income requirement includes individuals and families whose incomes do not exceed 120% of area median income as defined therein.
[10] See attached – NSP Setups Standard Operating Procedure
[11] See attached – NSP Homebuyer Internal Review Checklist
[12] See attached – NSP Homebuyer Workbook
[13] See attached – Quality Assurance NSP Homebuyer Review Checklist
[14] See attached – NSP Management Oversight Standard Operating Procedure
[15] See attached – NSP Drawdown Standard Operating Procedure
[16] See Attached – HUD "Life After Deadlines" presentation slides

Comment 6

Addendum Two
Texas NSP Management Response to Audit – Finding Two Detail
July 18, 2012

Finding 2: The Department Improperly Spent NSP1 Funds on a Refinanced Mortgage

Finding two indicates that the Department improperly spent $5.5M on the acquisition and rehabilitation of a 128 unit multifamily development known as the Townhomes of Bayforest because, according to the report, the acquisition of the property did not take place. The audit report correctly identifies the subgrantee, Covenant Community Capital Corporation ("Covenant"), as the developer and new owner of the property. The audit report also correctly recognizes that that Department properly obligated funding for Covenant on August 26, 2010. The audit report reflects that on December 31, 2010, the Department closed on a loan and provided funds to Covenant in order to acquire general partnership interest in the property and acknowledges that the property ownership named Townhomes of Bayforest LP, was reorganized at that time though it was not renamed as originally anticipated. The audit report does not recognize that an acquisition of the property did take place in accordance with NSP 1 requirements. On the date of the closing Covenant acquired control and equitable title to the property, rights to the partnership name, and ability to maintain other existing partnership relationships and advantages when they acquired sole controlling general partnership interest to the partnership[17]. Acquisition for NSP 1 is ultimately governed by CDBG regulations[18] which provide under 24 CFR 507.201 (a):

> "Acquisition in whole or in part by the recipient, or other public or private nonprofit entity, by purchase, long-term lease, donation, or otherwise, of real property (including air rights, water rights, rights-of-way, easements, and other interests therein) for any public purpose, subject to the limitations of § 570.207." (Underline added)

A change in the name of the ownership entity is not required, nor is acquisition of 100% of the interest in the property required to be an eligible acquisition. Control of the property through the partial acquisition in the form of the acquisition of the general partner interest does meet the requirements of an acquisition, in part, by a private nonprofit entity, by purchase, long-term lease, donation, or otherwise. Moreover, Covenant obtained equitable title to the property when the ownership structure was reorganized and they were added as the new general partner in the partnership[19].

The property in question was originally developed utilizing the tax credit program and, therefore, the original ownership was structured as a limited partnership with a controlling general partner and a limited partner who provided the equity in exchange for full use of the 10 year stream of annual tax credits. At the time of the default, initiation of foreclosure proceedings and subsequent acquisition by Covenant using the NSP funding, there were still several years of tax credits to be utilized and the original limited partner sought to participate in the foreclosure workout process. The limited partner insisted on preserving, for their benefit, the value of the remaining stream of tax credits and thus was

17 See executed settlement statement and amended partnership agreement.

18 Federal Register Volume 73, Number 194 dated October 6, 2008 page 58330, bottom of column 1 "Title III of Division B of the Housing and Economic Recovery Act, 2008 (HERA) (Pub. L. 110–289, approved July 30, 2008) appropriates $3.92 billion for emergency assistance for redevelopment of abandoned and foreclosed homes and residential properties, and provides under a rule of construction that, unless HERA states otherwise, the grants are to be considered Community Development Block Grant (CDBG) funds."

19 The Texas Supreme Court recent ruling in AHF Arbors at Huntsville I, LLC vs. Walker County Appraisal District further substantiates the well established concept of equitable title in Texas where a nonprofit corporation controlling the general partnership interest in a property and having the power to compel transfer of legal title has equitable title to the property and for tax purposes and the general partner and partnership are treated as the same.

from the outset of the intervention by Covenant, anticipated to be a limited partner in the ownership structure. Without the inclusion of the existing limited partner, the change of ownership through the acquisition by Covenant could not have been accomplished. While the reorganization of the partnership was extensive[20], maintaining the existing partnership name after the acquisition allowed many of the existing relationships with vendors and operations of the property to be continued at the discretion of Covenant without interruption and the costly need to be reestablished.

On the other hand, all of the liability associated with the ownership of the property shifted from the prior general partner to Covenant. The extent of the limited partner's liability is the investment into the partnership and the general partner indemnifies the limited partner in the partnership from any potential loss beyond their preexisting investment. Thus Covenant is fully responsible for their ownership decisions made by them as the general partner.

In addition, the acquisition through the controlling interest of the general partner in this case is analogous to the purchase through a long-term lease since the only other interest in the partnership is the limited partner and they have an agreement to convey their limited interest at the end of the initial compliance period[21]. Just like the leasor in a long term lease, the general partner has full use of the property through its controlling interest but the vesting of title remains in the name of another entity, the partnership. In this case the limited partner retains usage rights over a potion of the bundle of rights under the partnership (the low income housing tax credits) but ultimately agrees to relinquish all rights to the partnership once the value of the credits is extinguished. This is analogous to a long term lease which provides for full ownership and this too would clearly meet the definition of acquisition under 24 CFR 507.210 (a).

Finally the audit report claims that "The Department Improperly Spent NSP1 Funds on a Refinanced Mortgage" and includes in its conclusion the statement that the "funds were used to pay down the delinquent mortgage on the property" implying that this ultimate use of the funds loaned to the new owner ultimately paying the prior owners loan is improper. That conclusion does not recognize that most, if not all, NSP transactions could be construed to be doing the same thing because they are focused on identifying defaulted or foreclosed upon properties (owned by lenders as a result of a loan to another party) and providing funds to a new owner to alleviate the defaulted situation or remedy the foreclosure by paying off the lender. In fact, financing the acquisition of an existing property is almost always going to include the pay down or pay off of the financing that existed prior to the acquisition. Moreover, another element of evidence that a true change of ownership occurred at the subject property is that, like in a more conventional property acquisition, the prior mortgage was entirely eliminated and replaced by a new loan to a new entity.

In the end the reorganized partnership with the same name, controlled by a new general partner, Covenant, provided the Department with a new deed of trust in first lien position to secure the repayment of the new note made by Covenant and payable to the Department. Far from being an improper expenditure, this securitization (not, strictly speaking a securitization but the issuance of a secured promissory note by the partnership with the liability of the new GP) of the purchase of the property was properly completed and the entire $5.4M in obligation was and continues to be eligible. The $41,853 in legal fees paid for in the transaction were eligible costs which were documented and identified on the settlement statement in two line items as Attorney's Fees of $18,953.21 and $23,000 to

[20] The second amended and restated agreement of limited partnership is an extensive document that is 79 pages long
[21] See right of first refusal and option to purchase agreement

Coats, Rose, Yale, Ryman & Lee, P.C. Thus since the acquisition is eligible the attorney's fees to complete the transaction are also eligible. The $659,443 of funds remaining are eligible soft costs that have been targeted to reimburse a modest amount of rehabilitation which has now been completed. The draw request has been received by the Department. Thus the entire $5.4 million activity is or shortly will be spent on eligible NSP1 activities.

Texas NSP Management Response to Audit – Attachments
July 18, 2012

1. NSP Policy Alert, April 23, 2010
2. Exhibit A, Texas NSP Contract
3. Quarterly Performance Report
4. NSP Administrative Draw Checklist
5. Administrative Draw 77090000172
6. Policy Alert
7. NSP Homebuyer Workbook
8. NSP Household Detail Screen
9. NSP Interim Deed of Trust
10. NSP Setups Standard Operating Procedures
11. NSP Homebuyer Internal Review Checklist
12. NSP Homebuyer Workbook
13. Quality Assurance NSP Homebuyer Review Checklist
14. NSP Management Oversight Standard Operating Procedure
15. NSP Drawdown Standard Operating Procedure
16. HUD "Life After Deadlines" presentation slides
17. Settlement Statement and Amended Partnership Agreement
18. Federal Register Volume 73, Number 194
19. The Texas Supreme Court ruling in AHF Arbors at Huntsville I, LLC vs. Walker County
20. Second Amended and Restated Agreement of Limited Partnership
21. Right of First Refusal and Option to Purchase Agreement

OIG Evaluation of Auditee Comments

Comment 1 The Department questioned some of the language in the draft report as being emotionally charged and pointed; but, it did not provide any specific examples. We made several revisions to the report language to attempt to address the Department's concern.

Comment 2 The Department provided an expanded response in its Addendum One. We address these comments there.

Comment 3 The comment that HUD does not require grantees to keep the same obligations throughout the NSP1 grant period is valid. However, this was not an issue raised in the draft report. HUD required the Department to have valid obligations for its more than $101 million award by September 3, 2010. The report concluded that the Department did not have adequate support for its September 3, 2010, obligations. It also concluded that the September 3, 2010, obligations entered into the DRGR system did not match obligations that existed on that date. We provided clarification in the finding.

Comment 4 As discussed in the report, the Department did not maintain records or implement a system for summarizing its progress and reconciling its obligations to the DRGR system. HUD required the Department to establish and maintain sufficient records to enable HUD to determine whether it complied with applicable requirements.

Comment 5 The Department acknowledged that it was responsible for all of the NSP1 funds awarded. In October 2011, more than a year after the obligation deadline, the Department notified HUD that it had improperly obligated funds at September 3, 2010. If it had implemented a system for tracking and reconciling the obligations reported in the DRGR system, it would have identified 'contracts of concern' earlier in the process before it entered them as valid obligations in the DRGR system.

Comment 6 We appreciate the Department providing additional information and clarification. After reevaluation of the evidence, we removed the draft finding from the report.

Comment 7 We did not dispute the definition of an "obligation." The Department was responsible for supporting the obligations it reported to HUD at the September 3, 2010, obligation deadline. However, as detailed throughout the finding, the Department's records were inaccurate and it could not support or reconcile the obligations it reported to HUD on September 4, 2010. To date, the Department has still been unable to support those obligations in summary form or otherwise. We maintain our position.

Comment 8 We prepared the spreadsheet from information provided by the Department. Based on the Department's comments, we clarified and made changes as appropriate to the finding.

Comment 9 The Department acknowledged that it entered into 38 written agreements with its subrecipients that did not total the amounts in the subrecipient grant agreements, 28 of which exceeded the obligations. The Department entered actual obligations into the DRGR system as of September 3, 2010. However, its grant agreements and contracts with its subrecipients and developers for the same period were not for the same activities and amounts as those reported in the DRGR system. Even though the Department entered into 14 of the 38 agreements between 6 months and 1 year before the September 3, 2010, obligation deadline, it entered into 11 agreements within 5 months before the deadline and the remaining 13 agreements within 1 to 2 months before the deadline. The Department did not amend any of the agreements to match the actual obligations entered into the DRGR system.

This caused fluctuations between the agreements and information in the DRGR system. The Department did not keep records to show where the fluctuations existed. If it had been properly managing its NSP1, its records would have shown what changed in the obligations and how the changes reconciled to the DRGR system.

Under the written agreements, the Department was bound to spend NSP1 funds for the activities and amounts included in the agreements. As a result, it obligated funds that were not available when it entered into subrecipient agreements that exceeded the obligated funds reported in the DRGR system. We did not revise the finding based on the Department's comment.

Comment 10 The Department agreed that it made errors when it entered obligation information into the DRGR system. If it had a system in place that reconciled the obligations in the subrecipient agreements to the obligations reported in its housing contract system and the DRGR system it could have identified the discrepancies earlier in the process.

The regulations[38] required that the Department enter into a written agreement with each subrecipient before disbursing HUD funds. The agreement must remain in effect during the time that the subrecipient has control over the funds. The written agreement must include a description of the work to be performed, a schedule for completing the work, and a budget. The information should be in sufficient detail to provide a sound basis for the Department to effectively monitor performance under the agreement. NSP1 regulations required additional documents to obligate funds, such as purchase offers and construction contracts. In response to the Department's comments, we made no changes to the report.

[38] 24 CFR 570.503

Comment 11 The Department was responsible for maintaining the information it reported to HUD through the DRGR system. HUD required the Department to submit its June 30, 2010, quarterly performance report on July 30, 2010. As table 3 of the report showed, over a 22-day period[39] between October 31, 2011, and November 21, 2011, the amounts the Department reported to HUD fluctuated significantly. These significant fluctuations over such a short timeframe, along with the Department submitting the reports more than a year after they were due, further support the conclusion that the Department did not have adequate controls over its obligations.

Comment 12 Obligated NSP1 funds should have appropriate supporting documentation for both total obligations and individual activities. As required in the grant agreement, funds would be obligated no later than September 3, 2010. Further, the Department agreed that funds were obligated for an activity when orders were placed, contracts were awarded, services were received, and similar transactions had occurred that required payment by the Department or subrecipient during the same or a future period. The Department could not obligate funds into the DRGR system for an activity when it entered into subawards (e.g., grants to subrecipients or to units of local government). Therefore, as stated in the report, we tested sample activities the Department recorded as obligated by the deadline and concluded that the Department's system of record did not contain supporting documentation for its obligations.

HUD required the Department to establish and maintain sufficient records to enable HUD to determine whether it complied with applicable requirements.[40] The Department should record accurate obligation amounts in its system of record, which should also reconcile with the DRGR system. Therefore, it is necessary for the Department to track and record changes as needed in a timely manner in its housing contract system to ensure that a valid obligation exists. Further, the tracking of obligations and subsequent expenditures assists the Department in monitoring subrecipients' progress and should improve its ability to administer the grant.

Comment 13 We clarified the criteria in the finding.

Comment 14 We added clarification in the finding.

Comment 15 The Department did not provide support for the $6,425 in costs.

Comment 16 We updated the finding to include information provided by the Department in its comments and verified in the DRGR system. We also updated table 6 to reflect the Department's submission of its late quarterly performance reports. However, we did not test the accuracy of the information reported in these submissions.

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[39] This was more than 15 months after the quarterly performance report due date.
[40] 24 CFR 570.506

Comment 17 Monthly reporting submissions were not required for grantees for which HUD had accepted a quarterly performance report that reflected that it had met the 100 percent obligation requirement. The Department's reporting was late and when the monthly reporting requirement began, it did not have a HUD-approved quarterly performance report showing that it had obligated 100 percent of its grant funds. We made clarifying changes, as needed, to the finding.

Comment 18 We disagree that there was little performance activity during the audit. All NSP1 activities were essential to completing the program as planned. Thus, the acquisition, land banking, demolition, renovation, and construction activities were all necessary. HUD required the Department to establish and maintain sufficient records to enable HUD to determine whether it complied with applicable requirements.[41] The Department should capture the entire population in a single system or report to identify the information needed by HUD to monitor the program. We did not change the finding based on the comments.

Comment 19 The Department needs to show that it spent funds as budgeted and obligated. It should implement a system for tracking its overall progress towards meeting the 25 percent setaside requirement as budgeted. We did not change the finding based on the Department's comments.

Comment 20 We made changes, as appropriate, to the finding. After the Department provided the NSP Homebuyer Workbook, we recommended that it incorporate the workbook into its standard operating procedures.

Comment 21 While we based the audit analysis on the reported drawdowns shown in the DRGR system, the Department did not submit documentation with its response to show that it had spent more than the $52 million discussed in the report. We did not change the finding based on the Department's response.

[41] 24 CFR 570.506

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Fort Worth Regional Office, Region VI
Office of Community Planning and Development
801 Cherry Street, Unit #45, Suite 2500
Fort Worth, TX 76102
www.hud.gov

AUG 15 2012

Timothy Irvine, Executive Director
Texas Department of Housing
and Community Affairs (TDHCA)
221 East 11th
P.O. Box 13941
Austin, Texas 78711-3941

Dear Mr. Irvine:

SUBJECT: Remote Monitoring Review of Neighborhood Stabilization Program (NSP) Obligations—Grant No. B-08-DN-48-0001

We received your response dated June 6, 2012, to our remote monitoring review letter dated May 9, 2012. Our letter indicated that through HUD's monitoring review it was determined that $10,673,574.72 in NSP1 funds could not be supported by source documentation and thus, were invalid NSP obligations. In response, your letter identified three concerns that you believed would affect the amount that HUD determined were invalid obligations. We also received your July 13, 2012 letter, requesting a reduction in the grant award in an amount equal to the invalid obligations. We appreciate your letters and our response to your concerns is as follows:

State's Concern 1:
The method for determining the total [NSP1 obligations] should be calculated from obligation amounts entered in DRGR rather than those presented in the spreadsheet.

HUD Response to State's Concern 1:
In accordance with section II.G.3 of the "Notice of Formula Allocations and Program Requirements for Neighborhood Stabilization Program Formula Grants" (Unified NSP Notice), at 75 Fed. Reg. 64322, 64332, states are required to "establish and maintain such records as may be necessary to facilitate review and audit by HUD of the State's administration of funds under 24 CFR 570.493. … [T]he content of records maintained by the state shall be sufficient to :... (2) make compliance determinations for activities carried out by the state." To verify the validity of an obligation, a contract must be linked to a specific address or household. HUD could not make this determination using DRGR or the spreadsheet provided by the state; instead HUD reviewed the source documentation maintained by the state. DRGR is not a source document. Rather, it is

a reporting system used to track obligations by activity. Those activities and obligations are not tied to specific addresses or households at the time of obligation, making it impossible to connect DRGR inputs to a specific contract or to ensure that the contract constitutes an obligation. As a result, the source documentation HUD used to verify compliance with the obligation deadline was the actual contracts listed in the state's spreadsheet.

State's Concern 2:
The detailed spreadsheets accompanying [HUD's] May 9, 2012 letter include the correct amounts for the corresponding obligation documents, but budgeted amounts for activity delivery and contingency are not included.

HUD Response to State's Concern 2:
As you stated, activity delivery costs and contingency fees are eligible expenses under NSP and these costs and fees were included in HUD's calculations of your program's valid NSP obligations. However, these costs and fees cannot be included twice. Through HUD's review it was found that these expenses were included in the underlying contracts and then included again by the state on top of the total contract value. HUD subtracted any duplicate activity delivery costs and contingency fees added by the state whenever these fees were found to be included in the contract. For example, the city of San Marcos obligated a total of $36,602.24 on two rehabilitation contracts. The contracts [77099999141-B2-SA] included contingencies which brought the total to $42,001.18. HUD also factored in 20 percent in activity delivery costs which brought the grand total to $50,401.42. However, according to the state $55,555.94 in NSP1 funds were obligated. As a result, HUD reduced the obligation amount by $5,154.53 to reflect the amount that was allowed to constitute a valid obligation.

State's Concern 3:
In Texas, contracts are not required to be dated in order to be considered valid. We know the date that each document was attached in the TDHCA Housing Contract System, as each is named by the system with a convention which includes the date, therefore, we know that the documents were executed on or before the obligation deadline and were valid and existing contracts prior to that date.

HUD Response to State's Concern 3:
All NSP1 funds must be used in a manner that complies with the governing federal laws and regulations. Section 2301(c)(1) of the Housing and Economic Recovery Act of 2008, the authorizing statute for NSP1 funds, explicitly provides that all NSP1 funds must be used within 18 months of receipt. By Federal Register Notice, HUD defined "use" in section 2301(c)(1) to mean when funds are obligated by a state, unit of general local government, or any subrecipient thereof, for a specific NSP activity. Further, funds are obligated for an activity when orders are placed, contracts are awarded, services are received and similar transactions have occurred that require payment. See 75 Fed. Reg. 64322, 64326. For contractual obligations, to demonstrate compliance with section 2301(c)(1), NSP1 grantees must show that the contracts were awarded prior to the statutory 18-month obligation deadline. This may be evidenced by the execution date on the signed contract. In this instance, certain contracts that were subject to the remote monitoring review did not contain sufficient data to indicate that the award was made prior to the

statutory deadline. Your letter explains that the TDCHA Housing Contract System includes a date in its naming convention which could be used to determine compliance. However, HUD has determined that the naming convention is insufficient evidence that the contract was awarded prior to the statutory deadline as it does not require the witness or approval of the other party(ies) to the contract.

In closing, it is our determination that the $10,673,574.72 of unsupported NSP1 obligations identified in our May 9, 2012, letter are invalid obligations. Please accept this response as HUD's final determination on this matter. In accordance with the Unified NSP Notice, HUD will recapture the amount indicated above.

Enclosed you will find three copies of an amended NSP grant agreement which reflects the captured amount. To revise DRGR to reflect the recapture, modify the action plan by creating a new activity in the amount of the recapture under the Restricted Balance project (project number 9999). Once the activity is established, submit the action plan and notify HUD so adjustments can be made in IDIS. Please sign and return all three copies the amended agreement and complete the DRGR entries within 15 days of the date of this letter. We appreciate your cooperation and attention on this matter.

Sincerely,

Shirley J. Henley

Shirley J. Henley
Director

7

BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of the Status of Prior Audit Issues.

REPORT ITEM

Internal Audit tracks prior audit issues from both internal and external auditing or monitoring reports. These issues are followed up and cleared as time allows.

BACKGROUND

Of the 37 prior audit issues:

- 6 issues previously reported as "implemented" were verified and closed by internal audit. (These issues are not on the attached list.)
- 6 issues were cleared from the internal audit reports presented at the last audit committee meeting. (These issues are not on the attached list.)
- 16 issues were reported by management as "implemented" and are reflected on the attached list. These will be verified and closed by internal audit once we have reviewed the supporting documentation.
- 9 issues are "pending" and are reflected on the attached list. Internal audit will verify and close these issues once they are reported as "implemented." Of these:
    - 4 are for the Neighborhood Stabilization Program (NSP), and
    - 5 are for the HOME Multifamily Program.

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: There are no formal timing requirements or goals in place for loan closing. Based on workload estimates provided by NSP management, there is not enough staff to close all the loans by the August 31, 2011 initial closing deadline.

NSP has four staff for loan closers. However, two have additional responsibilities apart from closing loans. It is possible to process a homebuyer loan in 45 working days (or nine weeks) from underwriting to closure. This includes the 30 days required by legal for loan document preparation and review. In the private sector, it takes approximately two weeks to process a homebuyer loan and full-time loan processors can complete ten to fifteen closings each month. It is important to note that non-homebuyer transactions can be more complex and may require more time and effort for the loan processor. To assess the feasibility of meeting the August 31, 2011 deadline, we considered different staffing scenarios for processing the estimated 400 loans and concluded that it is highly unlikely that NSP will be able to meet the deadline with the current staffing level.

If NSP is unable to close the estimated number of loans by August 31, 2011, homebuyers awaiting closings could be without housing or incur additional expense in finding a temporary place to live.

Recommendation: The Department should re-evaluate the resources of the NSP and reallocate staff as necessary to ensure that there are an adequate number of loan closers to complete the anticipated influx of closings. In addition, NSP should redistribute responsibilities to ensure that employees who conduct homebuyer loan closings can focus primarily on that task.

Management Response: Management concurs and has re-allocated staff resources in order to ensure that homebuyer transactions are processed timely. Management will monitor workflow and as bottlenecks are forecast and identified, adjust resources to focus on the portion of the closing effort that is affected.

Action for this finding was previously reported as implemented on August 17, 2011, but there had not been sufficient transactions to clear the item in the January, 2012 report.

Target Implementation Date: 01/19/12

Actual Implementation Date: 01/19/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Pending

Finding: Key support, such as contracts and environmental clearance certifications, are often missing from the loan files when NSP forwards the files to legal. NSP Loan Closing Specialists attach a "Request for Preparation of Loan Documents and Closing Instructions" form to loan files provided to legal. The form provides general information on the files' contents. We compared the NSP form to the documentation that legal needs for homebuyer loan preparation. The form did not include many of the items needed by legal, including subgrantee contract information, indication of environmental clearance, and indication that the purchase discount was satisfied or waived.

NSP has been largely focused on productivity. High production appears to have an impact on the quality of work. The risk of error is heightened by the lack of mitigating controls such as formalized policies and procedures.

The responsibility for ensuring the accuracy of the information in the files lies with the NSP. If information in the loan file is not correct and the error is not caught by legal, inaccurate or incomplete homebuyer loans could be closed and funded, NSP money could fund non-compliant transactions, or NSP may unknowingly report incorrect information to HUD.

Recommendation: NSP should:

- enhance quality assurance reviews on the front end of the homebuyer loan closing process to ensure that issues are caught and corrected before files are sent to legal, and
- amend the "Request for Preparation of Loan Document and Closing Instructions" form to include a comments section and checkboxes to indicate the file includes all of the items required by legal in order to prepare homebuyer loan documents.

Management Response: Management concurs. Management will ensure the standardization of documentation to be reviewed by Legal Services and existing checklists will be reevaluated and revised in coordination with Legal Services to ensure that files are complete for each transaction. The clarifications now being finalized will clearly delineate the documents that will be required (to enable subgrantees to gather them), the review to be performed by Legal Services, and the programmatic reviews that will be performed by NSP and/or Program Services.

Target Implementation Date: 02/29/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 161

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: Although not required by HUD, the Department's NOFA set a minimum NSP contract amount of $500,000 plus $25,000 in administration fees for a total contract of $525,000. However, of the 48 randomly selected contract files tested, one original contract was written for less than $525,000. The NSP NOFA states that "In order to avoid allocating small amounts of funding that can have no meaningful impact on stabilizing of property values, the minimum award amount to an eligible entity cannot be less than $500,000, excluding administration cost."

Although the Texas Administrative Code for NSP allows the Department to issue a waiver of certain contract terms required in the 2009 NSP NOFA, the stricter requirements of the NOFA may have deterred potential subgrantees from applying for grant funds and could have resulted in fewer areas served by the NSP.

Recommendation: The Department should abide by the NOFA to ensure the subgrantees understand the Department's intent and that all subgrantees are offered an equal opportunity to participate under the dame set of rules.

Management Response: Management concurs and will ensure that any future subgrantee abides by the requirements of the applicable NOFA.

The NSP1 NOFA, which included the $525,000 minimum award, is no longer valid, and no further awards will be made under that authority. The current NSP1-PI NOFA, which allows access to the NSP Reservation System, does not include a minimum award amount.

Target Implementation Date: 02/29/12

Actual Implementation Date: 01/19/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Pending

Finding: NSP does not have an established mechanism in place to track key elements of the program including contract milestone thresholds, cumulative budget transfer amounts, and homebuyer loan files.

Although the NSP Technical Guide states that the Department will evaluate compliance with contractual obligations to ensure progress toward meeting benchmarks. NSP is not consistently tracking the subgrantee's milestones. Subgrantees are not always meeting their milestones. HUD requires grantees to obligate and expend funds in an expeditious manner and HUD has imposed a deadline for expending grant funds. In one instance, the subgrantee should have expended 30% ($600,000) of its demolition obligation by May 31, 2010 and 30% ($153,397) of its purchase and rehabilitation obligation by August 31, 2010. As of January 10, 2011, all the contract activities entered into the Housing Contract System for this subgrantee are still in pending status. The subgrantee has not drawn any funds to support meeting the 30% expended funds. This is significant because if the NSP fails to expend the grant funds within the established timelines, the funds will be recaptured by HUD, the subgrantees' geographic area will not be served, and the Department may not achieve the program objectives. NSP is also not formally tracking incremental budget transfers. The NSP contract with subgrantees indicates that there is a 10% budget transfer ceiling. Transfers above 10% require an amendment or written authorization from the Department. Transfers above 25% require approval of the Department's governing board. When the cumulative amount of budget transfers is not monitored, program specialists and management may not identify incremental budget transfers that exceed the allowable limits and may neglect to obtain the appropriate level of approval.

There is no centralized mechanism to track the progression of homebuyer loans through the inter-divisional, multi-step closing process.

NSP does not have a system or report that captures the entire population of NSP transactions. No single resource can be used to determine the status of the program or to review complete information about a specific transaction.

If NSP does not sufficiently monitor these key elements, there is an increased risk that the program may not stay on track and that the program objectives will not be completely achieved. Missed milestones could result in the loss of funding. Budget transfers could exceed the 10% ceiling, which may prevent the amendment from receiving approval as required. Homebuyer loan files could fall through the crack and result in delayed closings or unnecessary re-work.

Recommendation: NSP should:

- establish a system for tracking key program elements,
- ensure grant funds are expended within the program guidelines and within the program timeframe, and
- monitor contract milestone thresholds, cumulative budget transfer amounts, and the status of homebuyer loan files

Management Response:	Management concurs. Management will establish a system for tracking key program elements and formally incorporate the procedures into an SOP by May 31, 2011 in order to better track subrecipient performance and compliance. Management will prepare a budget transfer reconciliation report for the May 2011 TDHCA Board meeting and request, if necessary, authorization for any already identified transfers at that meeting and will establish a more uniform process to manage cumulative budget transfers by May 31, 2011.	**Target Implementation Date:** 01/31/12 **Actual Implementation Date:** N/A
Status:	Management has not yet reported this recommendation as implemented.	**Recommendation Age (in days):** 190

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: NSP does not have detailed policies and procedures. The limited number of written policies and procedures NSP does have are all in draft form and have not been formally communicated to staff including SOPs for contract amendment requests, draw requests, set-up requests, contract administration, mortgage loan financing, home buyer assistance loans, and obtaining credit reports.

Without finalizing and formally communicating policies and procedures to the NSP staff, staff may not be performing their job duties as intended by management. NSP management's finalization of the policies are necessary to ensure that all program specialists are performing their duties in accordance with standardized instructions, that program specialists perform their duties consistently and effectively, and that risks are mitigated.

Recommendation: NSP management should finalize, communicate, and monitor compliance with the program's written policies and procedures.

Management Response: Management concurs. Management will reevaluate the four existing draft SOPs, edit or create new SOPs as appropriate and finalize and communicate the SOPs to staff by May 30, 2011. Management will provide training on the SOPs for staff once they have been finalized. Management will establish a process for periodic sampling and testing to ensure compliance with written policies and procedures by August 31, 2011.

The NSP SOPs were finalized on August 17, 2011.

Target Implementation Date: 01/31/12

Actual Implementation Date: 01/18/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Pending

Finding: The Department may not be reporting accurate information to HUD. There were discrepancies in the total budgeted amounts recorded in the Department's Housing Contract System and the budgeted amounts recorded in the DRGR system. Of the 52 contracts that we compared in both the DRGR and Housing Contract System, differences were noted in 26 contracts (50.0%). Four contracts had differences of $1 million or more. One contract differed by more than $5 million. Two contracts were entered into the DRGR system but were not in the Housing Contract System and one contract was entered into the Housing Contract System but was not in DRGR. Overall, there was a total difference of $2,313,071 more in the DRGR system than in the Housing Contract System.

HUD requires each grantee to report on its NSP funds using the DRGR system. HUD uses grantee reports to monitor for anomalies or performance problems that suggest fraud, waste, and abuse of funds and to reconcile budgets, obligations, fund draws and expenditures.

A reconciliation of the data in the DRGR system, the Housing Contract System, and the contract file does not occur on a regular basis. Only two reconciliations were performed as of November 25, 2010. Both were performed in connection with an external audit by HUD. However, in both of these reconciliations, the data was not reconciled in aggregate at the program level, only at the individual contract level. Without regular reconciliations, contract information in the Department's Housing Contract System will not be consistent with HUD's DRGR system or with the hard copy files.

The program manager is responsible for submitting program reports to HUD using the DRGR system. The program manager is also responsible for entering contract budget corrections into both DRGR and the Department's Housing Contract System. Ideally, these functions should be separated. When one person has the ability to enter data into the Housing Contract System and DRGR, there is a higher risk that data entry errors go undetected. Regular and routine reconciliations should identify data entry errors.

Lack of regular reconciliations may prevent management from having accurate performance information available for decision-making and for reporting to HUD. A regular reconciliation process ensures that data is accurate and that unauthorized changes have not occurred.

Recommendation: NSP should perform regular and routine reconciliations between the data in the Housing Contract System, the data in the DRGR system and the hard copy files. At a minimum, these reconciliations should include:

- reviewing source documents,
- verifying the accuracy and recording of the transactions in the Housing Contract System,
- identifying and resolving any discrepancies in a timely manner,

- documenting the performance of reconciliations,
- reviewing the reconciliations to ensure they are performed and any discrepancies are resolved, and
- ensuring the individual performing the reconciliation does not also enter data into either of the data systems being reconciled or have the ability to process transactions.

Management Response: Management concurs. Program Services staff is currently in the process of reconciling the contract system with DRGR, and the responsibility for completing HUD reporting from the DRGR system is being assigned to a staff member in Program Services. A full reconciliation is anticipated to be complete by April 30, 2011. Management will review existing draft SOPs to edit or create a new SOP to ensure that a process exists for the two systems to be reconciled on a monthly basis thereafter; associated SOPs will be finalized by May 30, 2011.

Target Implementation Date: 03/31/12

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 130

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: The contract status in the Housing Contract System does not always reflect the actual status of the contract. We randomly selected a sample of 48 NSP contracts for testing purposes. The status of 18 of the 48 (37.5%) contracts reviewed in the Housing Contract System (and using the hard copy contract files) was inaccurate. The status should be classified as "pending", "active", "closed", or "terminated for cause" depending on the situation.

We found that of the 18 inaccurately classified contracts:

- Ten contracts expired on November 30, 2010. According to NSP management, amendments are in process. These contracts should be classified as "pending amendment" or "inactive" but were still labeled "active".
- Four files were labeled as "closed" but there was no formal documentation scanned in the Housing Contract System to support closing the project.
- Two files were labeled "terminated for cause" but should be "closed".
- One file labeled "active" should be "closed".
- One contract was not yet entered into the Housing Contract System; therefore no status was available.

The status in the Housing Contract System should agree to the actual status of the contract. When triggering events such as contract expiration or contract termination occur, the status in the Housing Contract System should be revised and the correct classification should be used. Documentation supporting the triggering event should also be entered into the Housing Contract System.

NSP staff does not always update the Housing Contract System when triggering events occurred such as contract expiration or voluntary termination. As a result, program managers who use the data in the contract file and the Housing Contract System for decision-making may not be relying on the correct data.

Recommendation: NSP should ensure that the contract status in the Housing Contract System accurately reflects the status of the contract.

Management Response: Management concurs. Management will review and amend existing draft SOPs regarding contract status in the Housing Contract System to ensure that a clear procedure exists for timely and accurate updates to HCS and implement a monthly review as part of the monthly reconciliation process discussed as part of response to recommendation 2A.

Target Implementation Date: 01/17/12

Actual Implementation Date: 04/17/12

The NSP Setups and Draws SOP was amended to include verification of contract status prior to approval of draws and activity setups. The amended SOP was effective 3/20/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: Data in the Housing Contract System is often unavailable. Documents supporting the contract setups and draws, and the actual amendments themselves were not always present in the Housing Contract System. For instance, imaged documents for the budget amendments was not available in the Housing Contract System for 17 of 28 (60.7%) sub-recipient contracts reviewed. As a result, accounting and other program personnel periodically have to track down documentation supporting executed amendments on a case-by-case basis.

Supporting documentation for setups was not available in the Housing Contract System. Examples of setup documents that were unavailable include:

- 26 of 48 files (54.2%) did not include evidence of review, (of these 26 files, 21 were TDRA files), and
- 5 of 48 files (10.4%) did not include contract termination documents, although the contracts were (or should have been) terminated.

The draft NSP procedures require that supporting documentation be entered into the Housing Contract System. Expecting program staff and other Department staff to track down documentation that should be available in the Housing contract System is time consuming and inefficient. As a result, users of the Housing Contract System may rely on incorrect data because the information in the system is incomplete or unavailable.

Recommendation: NSP should:

- ensure that all supporting documentation is submitted by both the Department and TDRA and available in the Housing Contract System, and
- finalize, communicate, and enforce the procedures that require supporting documentation to be entered into the Housing Contract System.

Management Response: Management concurs. Management will review and edit existing SOPs or create new SOPs to ensure that all required supporting documentation is submitted and available in the Housing Contract System. All checklists will be reviewed and edited, as necessary, to facilitate the process and provide clear understanding of the required documentation. Associated SOPs and checklists will be finalized and communicated to staff and subgrantees by May 31, 2011.

Management will establish a process for periodic sampling and testing of the Housing Contract System by August 31, 2011 to ensure that all required supporting documentation is present.

Target Implementation Date: 01/31/12

Actual Implementation Date: 03/20/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: NSP does not maintain a listing, outside of the Hosing Contract System, of the addresses and/or household names that were used to obligate the NSP funds by the September 3, 2010, deadline for obligations. NSP relies on the information in the Housing Contract System to record obligations. However, the Housing Contract System is constantly in flux and does not maintain a complete historical record of information. Therefore, we were unable to determine accurately the original population of awards obligated by the September 3, 2010, deadline. Because we could not determine the obligation population, we could not confirm compliance with the HUD requirements.

The Housing and Recovery Act of 2008 requires grantees to use NSP funds within 18 months of when HUD signed its NSP grant agreement. For the Department, the 18-month period ended September 3, 2010. Funds are considered used when they are obligated by a grantee. HUD requirements include ensuring each obligation can be linked to a specific address. The obligation of each eligible use must be further evidenced by a specific event. For example, acquisition and landbank costs are considered obligated when the seller has accepted the purchase offer. Demolition costs can be reported as obligated when the subrecipient awards a demolition contract. A subrecipient's rehabilitation costs can be recorded as obligated when a construction contract is awarded for a specific property. To test the evidence of obligation, the population of obligations must first be identified. Because a listing of addresses and/or household names was not maintained outside of the Housing Contract System, the population of obligations could not be easily determined.

Recommendation: NSP should ensure that the Department has documentation in place to support the obligation information reported to HUD.

Management Response: Management concurs. Management has charged Program Services with the responsibility for re-evaluating and reconciling documentation provided to recertify the obligations made as of the obligation deadline by April 30, 2011.

NSP staff has extracted copies of all obligation documents from the Housing Contract System, and saved them to an accessible network file. A summary spreadsheet describing the obligation documents and amounts is also in the file.

Target Implementation Date: 03/01/12

Actual Implementation Date: 04/15/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *04/08/2011*

Current Status: Implemented – Not Verified

Finding: The checklists used by NSP staff to process draw requests do not have enough detail to guide NSP staff on how to process these draws. There is not a checklist for every draw type, staff do not always use the checklists consistently, and the checklists are not always signed by staff. Use of NSPs draw request checklists could be improved to ensure they provide clear and detailed guidance to NSP team members. NSP developed checklists to guide subgrantees in submitting their draw requests and to serve as a reference for NSP staff as they process draws. The checklists are supposed to cite the required supporting documentation and list any verifications the NSP staff must make prior to approving a draw.The draw request checklists do not outline the specific items that NSP staff should verify within the supporting documents. The checklists also do not reference the requirements or criteria against which the requests and support should be reviewed. NSP needs a checklist for every draw type. NSP has four checklists in place to handle six types of draws. As a result, subgrantees and NSP staff do not have clear guidance as to what documents and benchmarks are required.

NSP and TDRA staff should complete the draw checklists consistently. Of the 77 judgmentally selected draws tested, 40 (51.9%) did not have completed checklists, and 16 (20.8%) checklists were not signed by the program specialist. The draft NSP procedure related to draws states that if the electronic setup is acceptable, then the program specialist will complete the draw request checklist. Without the signature of the program specialist affirming their review of the supporting documentation for the draw, NSP may be unable to determine if the supporting documentation was reviewed for accuracy and allowability prior to the approval of the draw by the program specialist. The use of checklists continually reminds staff of the job requirements. It is a systematic way to make sure the activities are completed correctly and provides written documentation to support this assertion.

Recommendation: NSP should improve the use of draw checklists by:

- modifying checklists to accurately document the draw requirements,
- developing comprehensive checklists for all draw types, and
- ensuring that all draw checklists are completed correctly.

Management Response: Management concurs. Management will re-evaluate and edit checklists as necessary to be specific for each of the following draw types: Administrative, Activity Delivery, Closing and Construction Draws.

The revised checklists will be implemented by March 31, 2011, and staff will continue to provide training and technical assistance to subgrantees in person and via webinar.

Target Implementation Date: 01/23/12

Actual Implementation Date: 01/23/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: A Follow-up Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *01/31/2012*

Current Status: Implemented – Not Verified

Finding: NSP loan files do not always include title insurance policies, which indicate that the subrecipient has clear title to the property. Of 161 properties reviewed, documentation of a title insurance policy was not available in the electronic or hard copy file for nine (5.6%) of the properties. Because NSP does not have documentation of the title insurance policy for these properties, the Department does not have assurance that the title to the property was clear when acquired by the subrecipient.

The title is the collective ownership records of a piece of property. A clear line of title makes the property owner less vulnerable to ownership claims from other parties and to any outstanding debts of the previous property owners. Title insurance policies protect the property buyer against losses arising from problems with the property title that are unknown when the property is purchased. The title insurance policy will indicate whether all liens against the property have been satisfied.

Recommendation: NSP should obtain and maintain a copy of the property's title insurance policy and ensure the policy indicates that any outstanding debts against the property have been satisfied.

Management Response: The NSP Loan Processing SOP was amended on 3/20/12 to add tracking and review for receipt of Title Policies.

Target Implementation Date: 02/29/12

Actual Implementation Date: 03/20/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: A Follow-up Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *01/31/2012*

Current Status: Implemented – Not Verified

Finding: The loan repayment date listed in the general agreement between the Department and the subrecipient does not always agree with the loan documentation for a specific property or group of properties. For example, a promissory note stated that the subrecipient's loan repayment date was August 31, 2011, while the amended NSP agreement indicated that the subrecipient's loan repayment date was July 1, 2012 - almost one year later. As a result, the subrecipient appears to be delinquent in the Department's Loan Servicing System, although their NSP agreement was extended. If the subrecipient appears delinquent in their repayment to the Department it could impact their other funding opportunities with the Department.

Recommendation: NSP should ensure that the property loan documents are consistent with the NSP agreement between the Department and the subrecipient.

Management Response: The NSP Contract Amendment SOP has been amended to add review of loan documents for potential impact of the Contract Amendment as part of the documentation maintenance process

Target Implementation Date: 02/29/12

Actual Implementation Date: 03/20/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: A Follow-up Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *01/31/2012*

Current Status: Implemented – Not Verified

Finding: NSP did not always obtain documentation that the deed to a property was properly recorded. We tested files related to 161 NSP properties. Documentation demonstrating the property deed was recorded was not available for twenty-one (13.0%) of 161 properties reviewed. Failing to record the deed increases the risk that someone else may have a higher priority claim to the property.

A deed should be recorded in the appropriate county to indicate that ownership has been transferred from the grantor to the grantee. Although the Texas Property Code does not require that a property deed be recorded, recording a property deed publicly indicates who owns the property. The first person who records the deed, (as evidenced by the stamp on the deed and filing at the county's property records office), and does not have notice of any other deeds relating to the property, holds legal title to the property.

Recommendation: NSP should obtain and maintain documentation indicating that the deed to each property has been properly recorded and that the subrecipient is listed on the recorded deed as the grantee.

Management Response: The NSP Loan Processing SOP was amended on March 20, 2012, to include tracking and review for copies of recorded Warranty Deeds. A request was made to Legal Services on March 16, 2012 to add a requirement to closing instructions that copies of the recorded Warranty Deeds be required as part of the documents to be returned to TDHCA.

Target Implementation Date: 02/29/12

Actual Implementation Date: 03/20/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: A Follow-up Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *01/31/2012*

Current Status: Implemented – Not Verified

Finding: NSP is not providing timely information to HUD as required. HUD requires NSP to report program performance to HUD on a quarterly basis using HUD's DRGR system. The reports contain both current and historical information and are due to HUD no later than thirty days after the completion of the quarter. The most recent report submitted to HUD was for the fourth quarter of 2010. Accurate performance information is critical to stakeholders who use it for decision-making purposes. HUD requires regular reporting to ensure it receives sufficient management information to follow up promptly if a grantee lags in implementation and is at risk of recapture of grant funds. HUD also uses these reports to determine compliance with federal regulations and to identify and prevent fraud, waste and abuse.

Recommendation: NSP should provide HUD with required information on a timely basis and continue to submit past due reports.

Management Response: The 1st Quarter 2012 QPR was submitted to HUD in advance of the April 30, 2012 due date, on April 26, 2012

Target Implementation Date: 04/30/12

Actual Implementation Date: 04/26/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: A Follow-up Audit of the Neighborhood Stabilization Program

Division: Neighborhood Stabilization Program

Report Date: *01/31/2012*

Current Status: Implemented – Not Verified

Finding: Section 3 of the Housing and Urban Development Act of 1968 requires the Department and its subgrantees to give priority consideration in awarding jobs, training and contracting opportunities to low- and very-low income persons who live in the community in which the funds are spent. HUD requires that grant recipients report cumulative Section 3 activities within their jurisdiction on an annual basis. The Department collects Section 3 data from the subrecipients using the Subrecipient Activity Reports and then reports the Section 3 data to HUD annually as required. However, NSP does not verify the accuracy of the data reported by its subrecipients.

Recommendation: NSP should verify the Section 3 data reported by the subrecipients.

Management Response: The Monitoring and Compliance Division is including Section 3 for current quarter risk assessment and monitoring.

Target Implementation Date: 02/29/12

Actual Implementation Date: 04/09/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the HOME Multifamily Program

Division: Multifamily Allocation Division

Report Date: *05/16/2012*

Current Status: Pending

Finding: HOME Multifamily does not always process draws within five to ten business days as required by the HOME Performance Management Standard Operating Procedure. Five (14.3%) of the 35 judgmentally selected project draws and six (20.7%) of the 29 judgmentally selected CHDO operating draws were not processed within 10 business days. The longest processing time noted for these draws was 24 business days for project draws and 16 business days for CHDO operating draws.

Recommendation: The Department should ensure that draws are processed within the timeframe required by HOME Multifamily.

Management Response: Staff concurs with the recommendation and will ensure that draws are processed within the timeframe required. Management notes that part of the resolution to this finding may include amending the process to include a more realistic timeframe for draw completion; draw processing for multifamily is often more time-consuming because of factors related to the final construction inspection and because of the complexity and volume of the invoices submitted.

Target Implementation Date: 05/31/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 69

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the HOME Multifamily Program

Division: Multifamily Allocation Division

Report Date: *05/16/2012*

Current Status: Pending

Finding: The HOME Multifamily Standard Operating Procedures (SOP) for Application Intake and Award Process; Contract Generation; Setups, Disbursements, and Loan Closings; and Performance Management are not finalized as of January 27, 2012.

The Application Intake and Award Process; Contract Generation; Setups Disbursements, and Loan Closings; and Performance Management SOPs are not signed or dated.

Furthermore, the Application Intake and Award Process and Contract Generation SOPs do not have an effective date indicated and the Application Intake and Award Process additionally has comments and corrections throughout.

Recommendation: The Department Should finalize, sign, date and distribute the HOME Performance Management policies and procedures.

The Department should ensure that policies and procedures are finalized, signed and dated, and distributed to the Department's staff.

The Department should ensure that the HOME Multifamily policies and procedures are finalized, signed, dated and distributed to the Department's staff.

Management Response: Staff will also ensure that the appropriate processes for Performance Management will be finalized, signed and dated.

All existing HOME procedures are under review and management is committed to finalizing and signing SOPs by the end of May. All of the information contained in this audit will be considered as modifications are made to the SOPs.

As stated above, existing HOME procedures are under review and management is committed to finalizing and signing SOPs by the end of May.

Target Implementation Date: 05/31/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 69

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the HOME Multifamily Program

Division: Multifamily Allocation Division

Report Date: *05/16/2012*

Current Status: Pending

Finding: The supporting documentation for the draws was not always available or did not always adequately support draws for both the project draws and the CHDO operating draws we tested. The HOME Program Specialists use draw checklists which are contained in the HOME Access database to review the requests and the supporting documentation, and to approve or disapprove the draw request. We tested a judgmentally selected sample of 35 project draws and found that 18 (51.4%) did not have adequate or complete supporting documentation available in the Housing Contract System, the HOME Program electronic files, or the hard copy file. We also tested 29 CHDO operating draws and found that 23 (79.3%) did not have sufficient supporting documentation available in the Housing Contract System, hardcopy contract files, or the HOME Program's electronic files as required.

Recommendation: The Department should:

- ensure that draw requests are not approved until all items required by the draw checklist are verified, and
- ensure that draw documentation is sufficient to adequately support costs.

Management Response: Internal Audit's recommendations speak to ensuring adequate support for costs paid. Although this supporting documentation may come in multiple forms due to the limited Federal guidance simply requiring that CHDO draw support prove CHDO costs are "necessary and reasonable," staff will work to ensure that a timesheet, paystub or other appropriate documentation of pay (at the determination of division management) is included with every CHDO draw that is claiming staff time as a cost. Checklists will be updated as necessary, the SOP will be revised to provide further clarity and management will continue to work to make sure that program guidelines are consistently applied by all staff processing draws.

Target Implementation Date: 05/31/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 69

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the HOME Multifamily Program

Division: Multifamily Allocation Division

Report Date: *05/16/2012*

Current Status: Pending

Finding: There were two of eighteen contracts (13.3%) that had contract start and end dates in the Housing Contract System which did not agree with the effective dates and the termination dates of the executed contracts. One contract was listed in the Housing Contract System to start and end 6 days earlier than the executed contract, and one contract was listed to start and end 2 days later than the executed contract.

Recommendation: The Department should ensure that contract information is accurately entered into the Housing Contract System during contract setup.

Management Response: Management understands, and fully agrees with, the importance of accuracy of information input in the Housing Contract System. An additional step will be added to the current procedure to confirm the contract system data against the actual executed contract.

Target Implementation Date: 05/31/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 69

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: An Internal Audit of the HOME Multifamily Program

Division: Multifamily Allocation Division

Report Date: *05/16/2012*

Current Status: Pending

Finding: HOME Multifamily is not always tracking contract amendments or maintaining supporting documentation for amendments. We judgmentally selected a sample of 15 amended contracts from an incomplete population of 37 amended contracts which were amended from September 1, 2010 to February 1, 2012. Amended contracts were sampled rather than individual amendments because the complete population of amendments for HOME Multifamily contracts could not be determined. We were unable to determine the complete population of amendments because this information has not been consistently tracked.

Recommendation: The Department should ensure that all amendments are tracked and the supporting documentation is maintained as required.

Management Response: The Multifamily Finance Division is currently building a pipeline management database in Microsoft Access to track and manage all multifamily programs. The amendments will be tracked in this new system, which is expected to be implemented in the fall. In the meantime, staff will track all multifamily Contract amendments in a spreadsheet. Additionally, documentation of the amendment request will be saved in the Division's electronic files.

Target Implementation Date: 05/31/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 69

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: HUD On-Site Monitoring of Homelessness Prevention and Rapid Re-Housing Program ***Division:*** Community Affairs Division

Report Date: *08/16/2011* ***Current Status:*** Implemented –Not Verified

Finding: Of the 9 recipients that were monitored, only five monitored letters had been completed and mailed to the subrecipients. The first three monitoring visits exceeded the 45 day deadline by an average of 71 days. Subsequent monitoring letters took approximately 2 additional weeks to be finalized.

(*Note: This issue was listed as a concern in the HUD monitoring report. However, Community Services - CSBG had a prior audit finding (PAI #44) from 6/11/2008 that also identified monitoring reports being submitted late. Due to the new concern from the HUD report we closed PAI #44 and elevated HUD's concern to a finding which will be tracked and followed up on by Internal Audit.)*

Recommendation: Management should review its standard and if necessary make adjustments to the monitoring review time.

Management Response: Management has reviewed the 45-day response period and remains committed to the timely release of monitoring reports. The implementation of a new program, combined with new regulations, as well as new staff members contributed to the delays in issuing reports within 45 days. Management will continue to assess the timeline and make adjustments to the 45 day period if staff is unable to meet the 45 day deadline.

Target Implementation Date: 10/31/11

Actual Implementation Date: 08/15/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): 282

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: DOE Financial Management and Administration Monitoring Report

Division: Community Affairs Division

Report Date: *3/1/2012*

Current Status: Implemented –Not Verified

Finding: In the course of this review it was noted that labor categories presented against Annual funds were consistent; however, the time being charged was substantially inconsistent with the approved budget. Specifically, the charges reviewed were approximately 63 percent below the approved budgeted personnel costs. The degree of inconsistency is extreme in comparison to other WAP grant recipients who presented lower than estimated payroll expenditures. The Project Officer's Technical Monitoring Report also noted this issue.

When this issue was discussed with the Grantee, they stated that it is anticipated that labor charges will become more in line as there are more expenditures to the grant as described in the "Uncosted Balances" section of this report, which shoes the remaining balance of the Annual grant as $8,653,924.44.

Recommendation: TDHCA should submit a Corrective Action Plan within 60 days of receipt of this report that illustrates a path forward to expend the remaining uncosted balances and distribute spending more consistently across both WAP grants, considering the ramping down of the ARRA award, throughout the remaining grant period.

Management Response: During the ARRA weatherization grant period, Texas Subrecipients produced ARRA units at an unprecedented rate. The Department charged costs at a rate that was in proportion to the amount of activity observed through monitoring at the Subrecipient level and the amount of staff time spent supporting the grant. The Department has already experienced an increase in formula grant activity at the Subrecipient level. As the Department successfully winds down the ARRA grant, we expect that weatherization activity for the formula grant will return to its pre-ARRA level. In turn, Department staff will spend more time and resources supporting the grant, expending all grant funds by the end of the grant period. Under regular operation of our program, the Department will always strive to expend 100% of grant funds in accordance with Department of Energy requirements within the grant period.

Target Implementation Date: 03/31/13

Actual Implementation Date: 08/21/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: KPMG 2010 Statewide Single Audit

Division: Financial Administration Division

Report Date: *2/29/2012*

Current Status: Implemented –Not Verified

Finding: The Texas Department of Housing and Community Affairs (TDHCA) used a modified direct cost methodology to receive cost reimbursement under their Federal awards for select agency wide type expenses. The modified direct cost methodology allocates expenses among various federal programs based on full time employees (FTEs) assigned to each respective federal program. The modified direct cost methodology has not been submitted to their cognizant agent for approval. Therefore, these expenses should have been allocated to the various federal programs based on their approved Indirect Cost Rate Agreement dated August 24, 2011. The approved rate is 43% with a base of direct salaries.

For one specific sample item, the agency wide type expense was for disaster recovery information technology issues. TDHCA prepared an analysis of the allocation based on the Indirect Cost Rate Agreement as compared to their modified direct cost methodology. The variances between federal programs were less than $1,000 per program. The total drawn from the federal programs was less than the 43% that would have been allowable under the Indirect Cost Rate Agreement. Therefore there are no questioned costs.

Recommendation: TDHCA should seek approval for their modified direct cost methodology or use the approved Indirect Cost Rate Agreement.

Management Response: The Department will review its methodology for allocating agency wide type expenses and will either seek approval for continued use of the modified direct cost methodology or use the approved Indirect Cost Rate Agreement. Using the approved Indirect Cost Rate Agreement for all agency wide type expenses will ensure that draws are consistent with the approved rate.

Target Implementation Date: 08/31/12

Actual Implementation Date: 08/17/12

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Recommendation Age (in days): N/A

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: KPMG 2010 Statewide Single Audit

Division: Compliance Division

Report Date: *2/29/2012*

Current Status: Implemented –Not Verified

Finding: The HUD 60002 Report for NSP was submitted timely for the fiscal year ending January 31, 2011. However, no supporting documentation was maintained to verify the completeness and accuracy of the amounts being reported.

Recommendation: TDHCA should maintain documentation to support the HUD 60002 Reports filed.

Management Response: TDHCA Compliance and Monitoring Division is drafting a monitoring plan and tool for review and verification of Section 3 data submitted by all subgrantees. It is anticipated that data provided for the 2011 Program Year Section 3 report will be subject to monitoring in accordance with Compliance and Asset Monitoring's established protocols.

Status: Management reports that this recommendation has been implemented. Internal Audit has not yet verified this assertion.

Target Implementation Date: 07/24/12

Actual Implementation Date: 07/24/12

Recommendation Age (in days): 15

Texas Department of Housing and Community Affairs
Detailed Audit Findings

Report Name: KPMG 2010 Statewide Single Audit

Division: Neighborhood Stabilization Program

Report Date: *2/29/2012*

Current Status: Pending

Finding: Per review of the DRGR system, the September 30, 2010 report was the only Quarterly Performance Report (QPR) that was submitted for NSP as of September 2011. It was submitted approximately one hundred ninety-five days late and subsequently rejected awaiting modifications. All other required DRGR reports for NSP had not been submitted as of September 2011; therefore, none of these reports could be tested for completeness and accuracy.

Recommendation: TDHCA should establish a process for filing the required NSP reports.

Management Response: The Texas Department of Housing and Community Affairs (TDHCA), as the state agency charged with administration of the Neighborhood Stabilization Program (NSP) in Texas, is required to file quarterly progress reports (QPRs and each a QPR) with the US Department of Housing and Urban Development (HUD). At the outset of NSP TDHCA failed to organize and staff to be able to file QPRs on a proper timely basis. Efforts to utilize non-NSP staff to assist in addressing QPR requirements were not successful, and in August 2011 TDHCA hired an NSP Information Specialist to assume responsibility for the QPRs. The NSP Information Specialist has received the training on the HUD systems used to file QPRs and on the requirements of NSP. It is necessary to submit QPRs in sequential order and to have each QPR accepted by HUD before filing the next QPR. Since the effective date of the audit TDHCA has submitted, received requests for corrections, corrected, and resubmitted successfully its QPR for 3rd quarter 2010, 4th quarter 2010, and 1st quarter 2011. TDHCA has submitted its QPR for the 2nd quarter of 2011 and is awaiting HUD approval. The 3rd quarter QPR is ready to submit as soon as 2nd quarter is approved. The 4th quarter QPR is due January 31, 2012. TDHCA believes, assuming no unanticipated issues are raised in the HUD review process, it will be current on its QPR filings by February 2012 and that it will be able to remain current. Due to HUD review and approval timing, it is anticipated that the 1st quarter, 2012 report will be timely submitted on or before April 30, 2012. Throughout this process HUD staff has been kept apprised on a current basis. because the corrective work has continued into fiscal year 2012, it is anticipated this will, however, be a recurring finding in that year.

Target Implementation Date: 07/24/12

Actual Implementation Date: N/A

Status: Management has not yet reported this recommendation as implemented.

Recommendation Age (in days): 15

8

BOARD REPORT

INTERNAL AUDIT

SEPTEMBER 6, 2012

Presentation and Discussion of the Status of the Fraud Hotline and Fraud Complaints.

REPORT ITEM

The Internal Audit Division handled 78 complaints of fraud, waste or abuse in fiscal year 2012.

BACKGROUND

In fiscal year 2012, internal audit handled a total of 78 fraud complaints. Of these:

- 51 calls were received on our hotline:
  - 5 were related to the Department's programs or staff:
    - Multifamily - 2
    - Weatherization - 2
    - Tax Credit - 1
  - 46 were related to other agency's or housing authority's programs. These callers were referred to the appropriate agency for assistance.
- 27 complaints were received from other sources. These complaints included:
  - Weatherization/CEAP - 12
  - Tax Credits - 9
  - CDBG - 2
  - CSBG - 1
  - HOME - 1
  - First Time Homebuyer - 1
  - Section 8 - 1

  The sources for these complaints were:
  - TDHCA Staff - 8
  - Public - 7
  - Sub-recipient - 5
  - SAO Hotline - 4
  - Law Enforcement - 1
  - Other agency - 2
- 47 of the 78 complaints (60.0%) were not under the Department's jurisdiction.
- Resolution of the 31 TDHCA complaints:
  - Unfounded - 23
  - Pending - 2
  - Referred to SAO and/or other oversight agencies - 6