

TEXAS DEPARTMENT OF HOUSING AND  
COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

8:40 a.m.  
Thursday,  
April 7, 2005

Room 437  
Waller Creek Office Building  
507 Sabine  
Austin, Texas 78701

PRESENT:

AUDIT COMMITTEE:

Shadrick Bogany, Chairman  
Norberto Salinas  
Patrick Gordon

TDHCA STAFF:

Edwina Carrington  
David Gaines  
Eddie Fariss

I N D E X

<u>AGENDA</u>	<u>PAGE</u>
Call to Order, Roll Call	3
Certification of Quorum	3
Public Comment	
ACTION ITEMS	
Item 1      Presentation, Discussion and Possible Approval of Minutes of Audit Committee Meeting of October 14, 2004	3
REPORT ITEMS	
Item 2      Presentation and Discussion of Audit Results from the Statewide Federal Single Audit for Fiscal Year Ended August 31, 2004	3
Item 3      Status of Prior Audit Issues	22
Item 4      Enterprise Risk Management - An Executive Summary	27
Item 5      Status of TDHCA's Risk Management Program	44
EXECUTIVE SESSION (None held)	45
ADJOURN	46

P R O C E E D I N G S

MR. BOGANY: We're going to call this Audit Committee Meeting to order. We're going to -- the first order of the Agenda, we're going to call the roll call and make sure we have a quorum. Shad Bogany, here. Dr. Gordon?

MR. GORDON: Here.

MR. BOGANY: Mayor Salinas?

MR. SALINAS: Here.

MR. BOGANY: We do have a quorum. We need -- an action item we need to -- make sure that everybody has reviewed the minutes. And so any need for any corrections? Or discussion on the minutes? Did everybody get an opportunity to do that?

So the minutes were okay, I'm assuming? Okay. Can I get a motion from the floor to approve the minutes from the last meeting, October 14?

MR. GORDON: Motion to approve the minutes.

MR. SALINAS: Second.

MR. BOGANY: All those in favor, say aye.

(A chorus of ayes.)

MR. BOGANY: Great. We are now going to do a presentation with discussion on Audit Results from the Statewide Federal Single Audit Fiscal Year 2004, August

31. And David Gaines is going to do that presentation.

MR. GAINES: Good morning, Chairman, members of the committee, Ms. Carrington. As Chad mentioned, the first Agenda Item behind Tab 7(a) is the Results of the Federal Single Audit for the 2004 Year.

The actual report itself was over 280 pages, and what I've done is extracted the portions relevant just for the department. That exceeds 40 pages. So the materials immediately behind the tab is a summary of those 40 pages. It's a six-page summary that discusses -- which are summaries of the findings and recommendations identified by the Audit. And that's where I'm going to focus my attention and discussion this morning.

So if you will turn to the first page behind the tab, and the background is that the Non-Federal entities that expend over \$500,000 a year are required to have this Federal Single Audit. And the non-Federal entity in this case is the State of Texas.

And so all state agencies were included in the consideration of the audit. The single audit was conducted by KPMG, who was in contract with the State Auditor's Office to conduct the audit.

Agencies and programs selected for the audit are based on the significance of the dollars, and/or risks

associated with the programs as perceived by the auditors.

The TDHCA program selected for audit was limited to the Section 8 program, and this was selected by the auditors based on its perception of the risks associated with that program.

The next section provides you definitions of the types of findings. I'm not going to read that for you. There is also findings relating to Noncompliance for Federal rules and regulations.

The audit results will be nine findings for the Section 8 program. There is five reportable conditions, three noncompliance issues, two material weaknesses, and two material noncompliance findings.

You'll notice the type of findings exceeds the number of findings, and that's because some of the findings had more than one type of issue in it.

Several of the issues noted by the auditors fall in the category of the department's control systems that it had in place, but they just weren't operating as intended by management. That was four of the nine findings. And it related to a checklist that the Section 8 program uses to ensure completeness and accuracy of the processing Section 8 adaptation and processing of payments, and such as that.

The checklist, the auditors found, was either missing, incomplete, or unsigned. Management responded that it would enhance controls over this checklist and ensure that these errors not reoccur. Three of the enhancements to the checklist were expected by mid-March.

The last enhancement was not going to be completed until the end of April, because it required coordination with Information Systems Services Division.

Of the remaining five findings, one of them related to several Housing Assistance Program contracts that were either missing or unsigned. And on this particular issue, the auditors questioned \$5,351 relating to the dollars expended into those contracts.

One of the issues related to instances where criminal history certifications or acknowledgment forms were either missing or incomplete. And one of the issues related to non-life-threatening deficiencies noted during inspections that were not corrected within the required time frame.

There was also the requirement that if these deficiencies were not corrected, you stop the payments to the landlords within a certain time frame.

There were several instances noted where those payments did not cease. And the auditors questioned those

amounts, which equated to \$1,800 -- 1,842.

In these cases, managements responded that they were going to complement their checklist, add to it, and ensure that these considerations are addressed to preclude repeat of these types of occurrences. And they responded that this would be completed by March 15.

The remaining two findings relate to material weaknesses, which means that the auditors basically -- their conclusions were that the control systems were not adequate to ensure instances of noncompliance that may occur would be detected in a timely manner by employees during the normal course of their business responsibilities in fulfilling their responsibilities.

And we'll discuss these issues in a little greater detail.

At the bottom of page two of six is a summary of reference finding, 05-72. This finding relates to reinspections. The Section 8 program requires that all housing units be inspected and reinspected based on specific criteria.

The auditors noted that several of the reinspection forms were incomplete. They also noted a significant number of reinspection forms with deficiencies of such nature that they caused the auditors to believe

that the original inspections were deficient. And those deficiencies weren't identified in the original inspections.

The auditors recommended training for the inspectors to ensure consistency and quality of the inspections. And then they also recommended quality assurance reviews over the forms documenting the inspections. And management has agreed with these recommendations and intends to provide an inspection training program to its local operators by June 1, 2005.

The last issue I wanted to specifically discuss was 05-22, on the bottom of page three of six. It -- the auditors' concern here is that there is not a transaction approval process to ensure that all transactions entered into the system for payment under the Section 8 program undergo a review and approval after they're entered into the system but before they are released for payment.

This concern is exacerbated by a lack of separation of duties, whereby the program regional coordinators are able to process a contract, process contract source documents, enter transactions into the Section 8 system, and also establish vendor payment data.

These abilities allow the coordinator the ability or the possibility to generate errors, or even



worse, commit fraud within the normal course of their business duties, allows an ability -- certainly no instant in that sort of thing, but however, no instances of such activities were noted by the auditors.

The SAO recommended a review and approval of transactions after they are entered into the system, and separating duties so that personnel who are not -- who are responsible for entering contracts into the Section 8 system cannot also establish vendors in the department's accounting system.

Management responded that it would divide the duties of the Section 8 staff leading up to the entry of data into the automated systems. And that's a review and approval of the data to be entered into the systems. And while this does provide additional controls leading up to the entry of data into the systems, it doesn't address the risk that inaccurate or improper data can be accidentally or intentionally entered into the system and be detected within the normal course of business.

So that particular address -- concerns not addressed by our response at this point. I believe that this condition will lead to a repeat comment in future years.

MR. SALINAS: So what are they doing to --

MR. BOGANY: What is management doing to --

MR. SALINAS: -- correct all these deficiencies?

MR. GAINES: I believe there's ongoing discussions on how to best resolve this, and maybe move beyond that response. I'm not sure the status of those discussions. There may be people in audience who can speak to that.

MR. SALINAS: So what would be the -- our duties as far as -- how is it -- how are we going to find out when they've corrected this deficiency?

MR. GAINES: The way I see what I would call the residual risk, after these controls to remaining risks, in my mind would be the possibility that errors or worse -- irregularities or -- another word for fraud, could be committed by an employee within the normal course of their duties, and there is not controls to detect that.

So that's the remaining risk. And the question for management and the board is is that a risk we're willing to accept? Or is that something we need to do something about? Those --

MR. BOGANY: What's your suggestion?

MR. GAINES: I'm sorry?

MR. BOGANY: What's your suggestion?

MR. GAINES: Well, my discussions with management is that there was significant resource requirements to look at transactions after they are entered into the system to ensure that they were accurate, complete, and properly supported. That was the biggest obstacle in my mind in moving forward with that.

Short of that, I would -- I'm having a little bit of a difficult time understanding why you couldn't separate the responsibilities for setting up the contract, or setting up vendors.

I'm not sure I'm -- I don't know the volume of that. I'm not recognizing it as being so significant where those duties couldn't be separated. That would provide controls over the entry of data. It still wouldn't address accidental errors being entered into the system.

So that would -- the accidental errors being entered into the system is a lesser risk that maybe is acceptable.

MR. BOGANY: Ms. Carrington, can you address any of that on David's suggestion on why we can't do it that way, or somebody in the audience can't? Is that going to slow us down? Because it seemed like the risk is -- could accumulate and accumulate and put us in a bad

position with the State Auditor, or HUD, exactly. So can anybody give us some --

MS. CARRINGTON: I'd like to ask Mr. Fariss, who is the Director of that division, to talk about that, Mr. Bogany.

MR. BOGANY: Okay.

MR. FARISS: Good morning.

MR. BOGANY: Good morning.

MR. FARISS: When we responded to this finding, we -- what we suggested was that we would separate the duties of entering the contract amendments. We -- because the Section 8 waiting lists have been closed for a long time, the main workload is amending contracts.

We amend anywhere from 100 to 250 contracts on a monthly basis. The risk of fraud that David was talking about was increased because each regional coordinator had the access to set up the amendment, enter the amount of contract, and to finish the work on that contract individually.

What we have proposed to do is that one regional coordinator will prepare the paperwork, and then another regional coordinator will enter the contract information, so there is a check and balance there in the -- even before that happens, there is quality control

review. So we have three reviews of that.

David's concern, and I guess the State Auditor's concern, is that even after those three reviews, there may be an opportunity for someone to enter inaccurate information.

MR. BOGANY: Okay.

MR. FARISS: If -- and we haven't heard from the State Auditor's Office whether they have accepted our response. However, if they don't accept the response, or if it's the Board's wishes to investigate some other further check and balance, we'll look for the opportunity to do that.

MR. BOGANY: Well, from my standpoint, I would probably like to see what they -- how they respond to your suggestion. But if they don't respond, then we need to fix it, whatever satisfies David and I, let's do it.

MR. FARISS: Right?

MR. BOGANY: Mayor?

MR. SALINAS: Yes. The findings that you have -- and I didn't understand him when he said that the stop-payments of the vouchers, when they did not sign them, were unsigned, and they were going to stop payment as soon as they --

MR. FARISS: Are you referring to --

MR. SALINAS: -- as soon as 3/15/05? Or  
3/15/06?

MR. FARISS: I'm not sure. Were you referring  
to the finding --

MR. SALINAS: Of the stop-payments, where  
people had not signed their vouchers, or -- and you were  
still paying?

MR. FARISS: Well, one of the issues that he  
talked about was the -- was paying when the landlord  
didn't address the non-threatening condition of the unit  
within a given period of time.

And that --

MR. SALINAS: Then you had to stop the payment.

MR. FARISS: You know, that payment should --  
if they don't meet the 30-day requirement, we should not  
pay until they're in -- until they've done that. And our  
quality control checklist did not have a place for the  
quality control inspector to look at that.

So we've added that to our checklist, to make  
sure that we don't pay when they're -- when the landlord  
hasn't addressed the non-life-threatening, and the life-  
threatening condition.

MR. SALINAS: Can that be put in place as a --

MR. FARISS: It's already -- we've already

put --

MR. SALINAS: -- as of March 15?

MR. FARISS: Yes. We've already changed the quality control checklist, and yes, we've already addressed that.

MR. SALINAS: Okay. Good.

MR. FARISS: In fact, we've addressed all of these issues, except working with IS, which will take us to the end of this month.

MR. BOGANY: Okay. So our goal is to have everything addressed, say, by May -- by the next board meeting we should have everything addressed.

MR. FARISS: And we should have -- I guess we will have a response from the State auditors on responses, so we'll know whether this is acceptable, and --

MR. SALINAS: What if it's not acceptable by the State auditor?

MR. FARISS: Well, there is a couple of options that we have. And one of them is to draw a sample of the contract amendments that have been entered on a monthly basis, and have another person review what went into the computer -- what was entered into the database, as opposed to what's in the file in the tenant file.

That's one option. We have one or two other

options that we just talked about yesterday. But we have two or three things that we can do, I believe, that will satisfy them further. But at this point, our response to the SAO indicated that we believed that we had reduced the risk by suggesting what -- by implementing the change that we've done.

MR. SALINAS: Okay. What how about 05-72, the inspected of -- and the reinspections of the apartments?

MR. FARISS: We --

MR. SALINAS: For -- on the form that you --

MR. FARISS: Some of those -- well, first of all, the reinspections that they mentioned in their finding is a Section 8 management and -- I forget what the acronym is for. But every year, HUD tells us -- gives us a sample size of units to reinspect. And the point of that is to look at how well the initial inspection was done.

Each year when our contract is amended, we have to reinspect the unit, and we have to redo all the eligibility information, reverify everything.

The way that we administer this program is through -- we have local operators that we contract with.

They do the inspections. So if, indeed, this finding is pointing out to us that some of them are not --



MR. SALINAS: Doing it.

MR. FARISS: -- doing it as well as they could, then what we have suggested -- our response is that we will do some additional training for the LOs. And we --

MR. SALINAS: Or find somebody else to do them, no? I mean, that we're finding local people to do them, they're not doing their job, then just find somebody else who is going to do it right.

MR. FARISS: Sometime -- yes. Right?

MR. SALINAS: Why spend money on somebody else? Why spend money on the same individuals that are not really doing their job? That's my --

MR. FARISS: I haven't analyzed this, but my suspicion is that these 36 may be limited to only a few --

MR. BOGANY: One or two local --

MR. FARISS: -- local -- yes, one or two local operators. In addition, while it's not all of -- while it's not every place, there -- you know, when an initial inspection is done, and then a follow-up inspection occurs, there is up to 90 days where something could have happened that maybe was okay in the initial inspection, but wasn't okay in the follow-up inspection.

MR. SALINAS: But it's showing up in our audit report here at -- when it comes up in our audit report,

you know, it's very problematic for us to see it in our audit report because by the time it gets to us, that means you have a lot of problems, I would think.

MR. FARISS: Except there is 1,800 inspections done --

MR. SALINAS: Well --

MR. FARISS: -- and you know, I think we can address it with some -- with doing some training and continuing to train our local operators. For the most part, they do a good job, and want to do a good job. Yes, sir?

MR. SALINAS: But when they show up here, then that means they're not doing a good job. That's the problem. I mean, you know, I don't care what they do out there. But the problem is to keep it away from us, and for us not to see it in the audit. And for the State auditors not to see it. But that's beside the big problem.

And knowing some of those problems come from what area, and you know, some of them are not really doing their job. And you know, more training is not going to help, because how long have they been doing it? And they did just --

MR. FARISS: There is a lot of turnover in --

MR. SALINAS: I know.

MR. FARISS: -- and you know, they could -- we could have been contracting with a local operator for years, but it might not be the same person who is --

MR. SALINAS: But the people that run those apartments, or those -- that run those vouchers over -- in their sections, they should really be taking care of those vouchers, because the only way they're going to straighten this out is by just taking away those vouchers, and putting them somewhere else where they're going to really do the inspections that will really take care of it.

MS. CARRINGTON: Mayor, we know that it is a problem. And it is our intent to make sure that the local operators are either properly trained and can do the inspections, or we will find other local operators.

MR. SALINAS: Well, I think that's the answer. No training at all. I mean, find somebody else --

MR. BOGANY: Well --

MR. SALINAS: -- that is not going to give us these problems and have to talk about it here at the committee meetings.

MS. CARRINGTON: Because it is our goal to minimize our audit findings. You will see a little bit later on in the Audit Committee agenda that we have had

audit findings -- we have multiple audit findings that have been cleared by HUD in our HOME program and in our Section 8 program that we're very pleased that we're going to be reporting to you in the next few minutes.

MR. SALINAS: But did you have to go --

MS. CARRINGTON: And so it's our --

MR. SALINAS: -- and spend some time and go up to the HUD and try and convince them that it has been taken care of, or we could take care of it from the very beginning.

MS. CARRINGTON: We are going to put the systems in place that minimize our audit findings.

MR. SALINAS: Uh-huh.

MS. CARRINGTON: And this is one of my -- Mr. Bogany, you had said something about are we going to be able to have our systems in place, and have corrective action by the next board meeting? This was -- this one in particular, 05-72, is one that we are looking to have the training completed -- the training completed or the training beginning on June 1.

MR. FARISS: The target date was June 1.

MS. CARRINGTON: For completion or for beginning?

MR. FARISS: Yes.

MS. CARRINGTON: Okay. So that will run us into June.

MR. BOGANY: Okay. A question. You said briefly that you could isolate where 36 of these issues --

MR. FARISS: No, I said I didn't know -- I don't know where those 36 are.

MR. BOGANY: Okay.

MR. FARISS: Or were.

MR. BOGANY: Okay. Because I agree with the mayor. If its' coming from one area, you go in and eliminate that person, and start all over.

MR. FARISS: I would agree.

MR. BOGANY: Okay. All right. Any other questions?

MR. GORDON: So I guess, is there a going to be a follow-up to these, to make sure that these have been addressed and --

MR. BOGANY: Absolutely..

MR. GORDON: -- at the next board meeting?  
Okay.

MR. SALINAS: The next board meeting they'll probably give us a report.

MS. CARRINGTON: The next -- at -- well, at the next Audit Committee meeting.

MR. BOGANY: Audit Committee meeting. Okay.

MR. SALINAS: They'll give us a report.

MS. CARRINGTON: Yes.

MR. BOGANY: Fine. Thank you.

MR. FARISS: You're welcome.

MR. BOGANY: David, is that all of Item 2?

MR. GAINES: Yes. And I'd just like to clarify a little bit. The separation of duties that Mr. Fariss was referring to, while that does enhance the controls leading up to entry, while those duties are separated, the ability to do those activities still remains.

The coordinator still has the abilities to get into the system and initiate those transactions. But that's something, as you suggested, we'll work with the state auditors until we come to a satisfactory conclusion.

MR. BOGANY: Okay. So we'll at least see what the state auditor says, and then we go to Plan D if that does not work.

MR. GAINES: Yes, sir.

MR. BOGANY: Or C, or whatever. Okay.

MR. GAINES: Any audit report, as it's presented initially, and it will be exactly like the presentation, and in subsequent follow-ups, those -- these issues will be carried to the State's Prior Audit Issue's

report. Which leads us into our next agenda item.

MR. BOGANY: Item three.

MR. GAINES: This is behind Tab 7(b), the Status of Prior Audit Issues. The first -- there was a lot of good news kind of hidden in the materials here. I'm sorry.

MR. BOGANY: Well, let's hear the good news.

MR. GAINES: You'll notice behind Tab 7(b) is the summary schedule findings that you typically see in such prior audit issues. There is three letters from HUD immediately prior to Tab 7(b), which is behind the first tab, 7(a). So if you'll turn to those letters -- it's like the last five or six pages of Tab 7(a).

Excuse the confusion. These letters should be behind Tab 7(b). But I do believe these are -- it's information we'd like to acknowledge. Each of these letters clears audit issues of the department by HUD. Three -- there is three letters clearing 13 findings in 2001, 2002 and 2003 Federal Single Audits.

There has been discussions in the past about well, management says these are cleared, and those are cleared. How do we know for sure?

And the way I've chosen, because I know they'll follow it up in prior years, is generally I'll rely on

management's representation that they've done this and that, fully recognizing they'll be followed up on during subsequent audits as those audits relate to those particular findings.

So with these letters, the department believes that all the findings associated with these three years have been closed. And that's good news. And hats off to management for their hard work in clearing those issues.

Now, back to the summary report that you're used to seeing. All I really want to focus on here is the fact that there is four issues. Three of them -- excuse me, two of them have been reported as implemented. Those are the remaining two. One is anticipated for completion in May. And the last issue relates to the Family Self-Sufficiency Program.

This is still in the -- the department continues to work with HUD. These vouchers have been approved by the board to be transferred to Brazoria County. The department continues to work with HUD to see if it's possible to transfer the responsibilities relating to the family's self-sufficiency program in Brazoria County also.

MR. BOGANY: So have you -- have they decided that they don't want to do it yet? Or -- it seemed like



that would go along with transferring the vouchers out to your responsibility, but --

MR. SALINAS: They're still messing around with that?

MS. CARRINGTON: Yes, sir.

MR. SALINAS: What's going to be -- how are we going to get rid of that problem? When are they going to take care of it?

MS. CARRINGTON: We -- it actually is moving. When I was in Washington a month ago at meetings with HUD officials, we did discuss it. And probably the week after I got back to Austin, we did receive a call, and we were asked to tell the regional HUD office how many vouchers we wanted to transfer.

And so we gave them really about three numbers and said, sort of, You decide. This is how many are allocated to Brazoria County, but these are how many are leased in Brazoria County. So it really is between HUD and Brazoria County at this point.

The department has done what we need to do in relinquishing those vouchers back to HUD, and it is up to HUD to determine how many of those vouchers will go to Brazoria County along with the administrative dollars.

MR. BOGANY: Okay. So is it possible to take

off the Family Self-Sufficient Program since HUD is now talking to Brazoria, or do we have to continue to report on this every audit committee meeting?

MS. CARRINGTON: You know, I think it's reasonable that it will come off. But that we're not comfortable in doing it until HUD has definitively said to us, You are not responsible for the Self-Sufficiency program in Brazoria County.

MR. BOGANY: Okay. All right.

MR. SALINAS: And they're not?

MS. CARRINGTON: No. We'll wait. We would be wanting HUD to tell us that, that we no longer have that responsibility.

MR. SALINAS: Okay.

MS. CARRINGTON: And they just haven't told us yet.

MR. SALINAS: But as of now we still are?

MS. CARRINGTON: As of now, we still are. Even though the vouchers are gone, we still have the responsibility for the Self-Sufficiency Program We think they'll catch up.

MR. SALINAS: One of these days.

MR. BOGANY: Okay. Any other questions on that? Well, I'd like to say I'm glad to see the

department -- we've got these three letters that tells us we're making some progress in the Audit Committee reports.

And management -- senior management and staff is really taking this very seriously to clear it up.

David, you want to present the Enterprise Risk Management framework?

MR. GAINES: Yes. And then the next two agenda items relate to the department's Risk Management Program.

And I believe it's important for the Board to recognize the program and the efforts by management in trying to identify fires before they are started, and to control them up front.

As you know, the Governor's office issued an executive order last June or July that requires each agency to implement a risk management program and report to the Governor's office last October on the status of that program.

In our report to the Governor's office, the department provided a high-level risk assessment of the department, based on a questionnaire that we put together.

The report also included the department's plan for fully developing its risk management program.

It turns out that the Governor's office liked the questionnaire so well that they've adopted it as a

standard that's going to be used by other agencies going forward. This will be helpful to us, because in the future we'll merely need to update that questionnaire for current conditions.

As far as management's plans to develop this risk assessment program, considerable progress has been made in that respect. The executive office has adopted a risk management methodology that we're fixing to walk through. It has issued a standard operating procedure defining the responsibilities for all levels of staff relating to the risk management program.

It's issued directives that the responsibilities associated with the program are included in each person's job description. And as those job descriptions are actually updated, that they need to incorporate language to that effect.

The employee evaluation system is currently under revisions. And one of the planned revisions is to incorporate consideration of an employee's performance under the program. These -- the risk assessment processes of the department are currently in process. They're well underway. All of these elements are essential elements, I believe, to the architecture of the program, and are essential for the success of the program to move forward.

The agenda items before you relate to the department's methodology that's been adopted. And I'll go through this. I came in about seven o'clock this morning to do a trial run, make sure the equipment is working. But we finally got it turned on about 15 minutes into the Audit Committee. So hopefully I'll know all the right buttons to push here.

The first section is a high-level summary that provides background of the methodology, which is based on a report by COSO, Enterprise Risk Management, and Integrated Framework.

Well, the first question is, is probably, what is COSO? And COSO is the Committee of Sponsoring Organizations. It was formed in 1985. It was created to express a single voice in the financial business community on issues raised with problems of financial reporting.

It was formed to sponsor the National Commission on Fraudulent Financial Reporting, otherwise known as the Treadway Commission. Some of you may be familiar with that. The sponsoring organizations consist of Financial Executives International, American Accounting Association, American Institute of Certified Public Accountants, American Institute of Internal Auditors, and Institute Management Accountants.

I'm sure you recognize some of these organizations, because they're all powerhouses in their respective fields. The support and backing of these groups and reports, the advisories and reports have pretty much become generally-accepted standards.

One of the first reports, Internal Control - Integrated Framework, has become the gold standard when it comes to evaluating controls. It's directed towards the needs of management. And so it affects needs of management and has been incorporated into policy rules and regulations.

It's also become the broadly accepted standard for satisfying the reporting requirement -- some of the reporting requirements relating to Sarbanes-Oxley Act, which among other things requires management to certify the effectiveness of the control systems.

Well, how does management attest to the effectiveness of control systems? We do not appreciate the challenge someone in Ms. Carrington's position would have with gaining that comfort. This framework is the basis for providing that comfort.

COSO initiated another project in 2001 that engaged PricewaterhouseCoopers to develop a framework that would be readily usable by management to evaluate and

improve their organization's enterprise risk management or ERM. And this framework was developed as the basis for the methodology that has been adopted by the department.

Well, let's talk about ERM. Enterprise Risk Management. "A process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, and provide reasonable assurance regarding the achievement of entity objectives."

There are multiple reasons why Enterprise Risk Management is important. But in summary, a viable program merely allows management to deal effectively with potential events that create uncertainty.

The COSO/ERM framework defines essential components. The framework defines essential components, suggests a common language, and provides clear direction and guidance for an enterprise risk management.

All entities have objectives, of course, and COSO believes that they can generally fall in one of these four categories, Strategic, Operating, Reporting, and Compliance.

Each of these objectives, strategic, operating,

reporting and compliance, affects all levels of the organization, their subsidiary, business unit divisions, entity-level, or however you're organized, whatever you call your sections of your organization.

COSO has identified eight frameworks of the component, that it crosses all objectives, strategic, operating, reporting. It crosses all units of the organization, and these are the internal environment, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring.

The department's methodology adopted considers all of these elements, all of the different theses of this QVC. However, our focus to-date, at least, has not been focused on the strategic objectives. We're focused on operations, recording and compliance.

Considerations of risk have been limited to these areas, because for the most part, the strategic considerations were taken into account by the department in connecting with its legislative and appropriations process.

And I'm not going to go into the different factors taken into consideration within each of these components, like the internal environments, management's



attitude towards controls, who set objectives, what are the events or activities that relate to those objectives?

What's necessary to be done? Each time you take on a new event, you're assuming new risks.

Or event identification -- your risk assessment -- that's figuring out what are the obstacles that may preclude you from being successful. What's your risk response? Are you going to establish controls? Are you going to accept risks? Some of the same things we were just speaking of.

You have your control activities for those risks that you're not willing to accept, and you want to control or reduce or mitigate. There is information and communication going on between divisions, up and down the organization, across the individual process.

And then you have to monitor your controls that you put in place. We ran across that earlier. We had the controls. We weren't, maybe, monitoring them as well as we should have been to make sure they were operating as we intended them to. So we need to monitor those controls and be sure that they're operating as we intend for them to.

MR. BOGANY: Are we implementing this now?

MR. GAINES: This is well underway. Yes, sir.

MR. BOGANY: Okay. Now, I noticed that we've only had a few that have gone through, so this should pick up where we're low right now, but maybe we will pick up --

MR. GAINES: Yes. Right. And I'll touch on that. Very good point and observation that we'll get into here momentarily.

Management has their roles and responsibilities. They've pretty much been defined in the chain of operating procedure that come out of the executive office. The board has its responsibilities, selecting the executive director of the agency, and defining what it expects in integrity and ethics, and periodically revisiting that to be satisfied that expectations are being met.

Providing oversight of the program itself, being comfortable with the risk management program. And that's the purpose of what we're doing right now.

The board can achieve that by working through the Audit Committee. And -- but it's important for the board to appreciate that it's got a viable methodology, knowing to the extent that management's accepting risk, knowing management's risk thresholds. And of course, a lot of that I try to contribute to on a monthly or as we meet, discussing prior audit issues relating to audit.

The risk officers' responsibilities -- well, let me explain what has been identified by Ms. Carrington as the risk coordinator, I really believe these responsibilities, the responsibilities typically associated with this role has been assumed by the risk management team. You can appreciate the importance Ms. Carrington has placed on this team by the composition of the team, of the members she's assigned to it, which includes herself, Tim Irvine, Executive Director of the Manufactured Housing Division, Ruth Cedillo, Deputy Executive Director.

Bill Dally, the Chief of Agency Administration, John Gonzales, Director of Administrative Support, Anne Reynolds, Ethics Officer, and Leonard Stearman [phonetic] special assistant. The internal audit's also on the team serving in an advisory and a facilitation capacity.

The only thing I wanted to touch on with Internal Audit -- we can advise and facilitate and play an important role. However, for this thing to be successful, it has to be the responsibilities of management and staff moving forward.

Then I want to back up, if I can. How about that? In mentioning the Internal Audit responsibilities, I'd be a little bit remiss if I didn't mention the

contributions of Kelly Crawford. And I believe you have all met Kelly here? She's been front and center in getting this program off the ground. And we wouldn't be anywhere near as far along in implementing the program without her. Thanks, Kelly, could you wave to everybody? Okay.

Now, also Lorrie Lopez -- is Lorrie here today? Yes, there's Lorrie. She's really rolled up her sleeves, has figured this out, and has been working real hard to help me with the program.

Now, at this time I'd like to just briefly walk through an actual assessment that we've done, so you can see this thing in action. If someone can come help me. And I'm getting back to the main page. There we go. And this is an actual live example. There we go.

This might be a little small in instances. It is in your materials. This Risk Assessment was volunteered as an example by Curtis Howe and his staff. It's a staff that is directly responsible for performing job duties that should be sitting in on the risk assessment and actually doing this work. And I'd just like to offer my highest regards to Curtis and his staff for volunteering this assessment, which is over the Information Systems user accounts.

The staff that are participating include Chad Hartman, Minda Jackson, Larry Mercadel, Anthony Gatica. I don't know if Anthony is here, but I just commend all these folks for their aggressiveness and willingness to embrace this program in its infancy, and then on top of that, sharing with you what some people might call dirty laundry.

I want to say I don't believe this is dirty laundry at all. Not in those cases where management and staff are willing to discuss their challenges, willing to discuss their problems in a constructive manner with the intent of improving operations.

And I'd suggest just the opposite. It's dirty laundry when management and staff are not willing to do this, not willing to address and elevate, if necessary, your challenges. And I believe this is the message that just needs to filter through the entire agency. Again, all these folks deserve the highest recognition.

The first page is an executive summary. It's provided with each assessment. Note that in this particular one, we've had three inadequate controlled High level risks and one inadequately controlled Medium level risk that were identified.

Remember this summary right here, three and

one, because I'll refer back to those momentarily. With this information, management and staff were in the position to take control of these risks, or to consciously accept them if appropriate.

You will also note strategies at the bottom of the page for moving forward. Action plans are going to be necessary for the uncontrolled risks, and monitoring plans are necessary for any control that management wants to ensure itself that it's operating.

If it's a control over a significant risk that they're trying to protect against, they need to periodically be monitoring that and ensuring its effectiveness.

The next slide -- this is merely a project management tool to track the status of completion on a particular project. Notice the tasks in the two left-hand columns here. These are broad categories of tasks that the party goes through in performing its risk assessment.

We know one task -- one through five are 100 percent complete. Task seven, controlling risks, is an ongoing activity. We're never through with that. Task eight relates to developing action plans for those risks we've identified that aren't adequately controlled.

The next slide we start up by identifying the

mission and objectives of the area under review. This is important to help staff focus on the activities necessary to accomplish their objectives and the risks relating to those activities.

At this point, we started out -- staff starts out and they brainstorm all the activities that they do to accomplish their objectives relating to this process. Once they feel like their brainstorming -- they've pretty much identified all the different activities, they consolidate those activities in logical groupings to help further consideration of those activities.

After they consolidate the activities, they prioritize them as to what they believe are the most important, so they'll be sure they're focusing on the right ones.

For each of those consolidated activities -- there is about four or five, I think, out of, you know, 40 individual activities consolidated in four or five -- for each of those consolidated activities, the risks right here are brainstormed. What's the risk associated with that?

Once they feel like they've adequately controlled all the risks, a conclusion is reached whether it's going to have a high, medium or low impact on the

objectives trying to be accomplished. High impact is a big problem.

Each of these ratings have been defined to help promote consistency within the assessment and between assessments.

The next, a decision is made regarding a likelihood that a risk is going to materialize. What's the probability? Again, if a conclusion is reached at the time meeting, low probability, and then defined to promote consistency.

This results in the ranking before controls. This is a useful tool in determining the level of monitoring you want to apply. And we'll speak about that again here momentarily.

Next thing is a discussion of mitigation of control strategies relating to each of these risks. And after considering the controls that are currently in place, we'll also cite with these controls what's the probability this can happen? Is it high, medium or low?

You notice some of these controls that are listed here are in parentheses. This is to designate controls that are not actually in place, but controls staff believes would be useful.

This exercise of assessing risks for this



particular activity is done for each activity. And there is a second consolidated activity, and again, within a consolidated activity, each of these numbers will represent a lower-level detailed activity. So that exercise is done for each of those areas.

Okay. Upon completing an assessment of all activities relating to a particular process, two risk matrices are generated based upon the information that was just developed in connection with assessing risks associated with the activities.

This first assessment, I know you can't see it at all, but the colors are pretty much what we want to speak to.

The first matrix summarizes each of the activities, one, two, three, four major significant activities, summarizes the activities, their associated risks, the other risk, and the risk ranking before controls. That's HH and K [phonetic].

This -- I previously mentioned, this information is assessed whether controls should be established over a particular process or not, and if so, the appropriate level of monitoring that should be applied. Now, the high risks, you might imagine, are the red ones, medium, yellow; green, low.

If high risk, management needs some -- to manage these controls -- and controls to be sure those controls are in place, to address them.

The very high risk, you have high level of monitoring. The higher you want to monitor controls for the operating, audit the controls. We do them again to ensure they're operating as intended, management, staff, supervisors, they're all over these high risk controls.

On lower-level risk, a lower-level monitoring can be performed by a lower-level staff. On the very low risk, way out here in green, these are risks the management should just be accepting, and relying really on their staff to follow policies and procedures that have been established over those risks.

This matrix is the risk matrix after controls.

It serves a different purpose than the one we just talked about. This has previously -- we went through a moment ago, information that's useful to assess whether controls that are in place are adequate to reduce the threat of a risk to an acceptable level.

In this instance, you will notice that there are three high-level risks that are not adequately controlled and one medium-level risk not adequately controlled. These are the results that appeared in that

executive summary I referred to earlier.

For these risks, management needs to develop and implement controls. For all the lower-ranked risks, they're all green, looking good. The level of control over those risks is acceptable.

The next several slides relate to monitoring plans, which are plans relating to who is responsible for a control and who is responsible for monitoring that control to ensure it's operating as it should.

The first page merely summarizes and lists the control mitigation strategies that are in place or those that are proposed, those in parentheses. And this is all for high risk. All that is is a high-level summary, the summary continued.

This page in your materials -- and it goes on -- I know it's difficult to see here. It lists all the key activities -- key consolidated activities. It lists them multiple times because they have multiple risks.

The consolidated activities -- excuse me, the associated risks with those activities, the mitigations in place to control those risks, and it provides for management different columns so they can designate who is responsible for the controls, the necessary documentation to document evidence of the control, and the date of the

control, which may be more appropriately classified as frequency. Is the control applied to every event, every transaction? Or if it's applied daily, weekly, monthly, yearly? Or maybe it's applied on some other basis.

The next several pages here is the same thing, monitoring plans. Who is going to control and who is going to monitor? There is one for medium risk, there is one for high risk, there is one for low risk.

The last page in the materials relates to a tool to assist management in developing action plans to address the unacceptable risks. Note that there is many action plans listed here. Actually there is over 20 of them. However, we've already concluded there is only four unacceptable risks, three high and one medium.

Well, those four risks are listed here on individual rows. They're within this 20-plus. All the other risks and mitigation strategies listed here are the results of staff's suggesting strategies to address risk that were already assessed as being adequately controlled.

So in most cases, either the risk assessment was not appropriately rated -- those risks were not appropriately rated, and they're really riskier than that that staff rated -- or we've concluded by definition they're adequately controlled. And so management needs to

make that determination. Are these risks adequately controlled? Or do we really need these additional controls over them? They only apply to controls either staff thinks of, if it's already adequately controlled. Any questions relating to the methodology? That was quick and dirty, and just scraping the surface.

MR. BOGANY: Thanks, Dave.

MR. GAINES: Maybe not quick to you all, but I've been working on this since August. It's pretty quick.

MR. BOGANY: I think you did a good job. I think staff and you guys put this together, and maybe this will shorten our Audit Committee meetings once we get this in place.

MR. GAINES: After today. The last slide I'm just going to touch on real quick, is the status of our actual assessment. You'll notice that we have 117 high impact and 151 medium impact processes. We've completed eleven to date.

This is not the progress we were hoping for at this point in time. I'm not sure I have that on there.

MS. CARRINGTON: We don't have it.

MR. GAINES: This is not the progress we intended to have at this point in time. The risk

management team has recently met with the strategies to move the program forward on a particular basis. I think we got several good ideas to do that.

Let's take someone that's knowledgeable of how the program works -- a general background of risks and controls. We're training facilitators throughout the department. As we get more and more people trained in this, people will be able to move forward on a quicker basis.

MS. CARRINGTON: One comment, Dave, if I might.

MR. GAINES: Yes, ma'am.

MS. CARRINGTON: I think you all can see that the amount of detail that goes into evaluating not only identifying the risks, which we've done, but then the mitigation.

And while we are behind, we wish we were farther along, I think you can see how much work goes into doing what needs to be done to addressing the risk. And we're not offering excuses, but we are in the legislative session, and we're getting them done as fast as we can.

MR. GAINES: No excuses at all. The only excuse I might have is we didn't have any idea what was involved in getting this coordinated. There are several agencies that we really piggy-backed on, and maybe even

helped us leapfrog over some of the startup costs. UT Systems have been doing this for close to seven years. The Comptroller's Office has been doing it for five years.

They have their challenges over in the Comptroller's office this week, doing a peer review on their internal audit function. In part of my interviews, I always slip in something about how's your risk management program going, and stuff like that. And so I'm real pleased with where we're at, and I know it's going to be a great program going forward.

MR. BOGANY: Any questions of David? Patrick?

MR. GORDON: No.

MR. BOGANY: Okay.

MR. GORDON: Good job.

MR. BOGANY: Excellent job.

MR. GAINES: Thank you.

MR. BOGANY: Ms. Carrington, do we have a need for an executive session?

MS. CARRINGTON: No, sir.

MR. BOGANY: If no objection, then we will call this meeting adjourned.

MR. GORDON: So moved. Motion to adjourn.

MR. SALINAS: Second.

MR. BOGANY: The meeting is now adjourned.

(Whereupon, at 9:45 a.m., the meeting was concluded.)



C E R T I F I C A T E

MEETING OF: TDHCA Audit Committee

LOCATION: Austin, Texas

DATE: April 7, 2005

I do hereby certify that the foregoing pages, numbers 1 through 49, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Penny Bynum before the Texas Department of Housing and Community Affairs.

\_\_\_\_\_  
(Transcriber) 04/15/2005  
(Date)

On the Record Reporting, Inc.  
3307 Northland, Suite 315  
Austin, Texas 78731