

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

8:30 a.m.
Thursday,
February 5, 2009

Robert E. Johnson Building
Central Conference Room
1501 North Congress
Austin, Texas 78701

COMMITTEE MEMBERS:

GLORIA RAY, Chair
LESLIE BINGHAM-ESCARREÑO
TOM CARDENAS

STAFF:

MICHAEL GERBER, Executive Director

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P R O C E E D I N G S

MS. RAY: I'll call to order the meeting of the Audit Committee, and we'll start with the roll call.

Mr. Cardenas?

MR. CARDENAS: Here.

MS. RAY: Ms. Bingham?

MS. BINGHAM: Here.

MS. RAY: The Audit Committee has a quorum.

I do not have any requests for public comment at this time. Are there any requests for public comment?

(No response.)

MS. RAY: Hearing none, we will move to report item 1, to be presented by Sandy Donaho, director of Internal Audit.

And Ms. Donaho, if you would please just go through your items sequentially.

MS. DONAHO: Good morning. Item 1 is the presentation, discussion and possible approval of the revised internal audit charter and board resolutions. The Institute for Internal Audit just recently revised the international standards for professional practice of internal auditing.

MS. RAY: Ms. Donaho, if you'd hold just a minute.

Is there a technical person who could turn the volume up on the microphone? It's a little difficult to hear.

MS. DONAHO: Is that better?

MS. RAY: Yes.

MS. DONAHO: Okay. Item 1 is the presentation, discussion and possible approval of the internal audit charter and board resolutions. The Institute for Internal Auditors recently revised the international standards for the professional practice of internal auditing. This requires revisions to the Internal Audit Division's charter and the board's resolutions for internal audit. They've been revised to comply with the standards and require approval by the audit committee.

A copy of the charter and board resolutions is included in your board packet. Deletions are lined through and revisions are underlined. The major changes to the charter include the definition of internal audit in the charter; greater emphasis on requiring compliance with the standards and codes of ethics. It requires that we periodically report to the audit committee on staffing levels, includes consideration of the scope of outside audits and how they affect our risk assessment and our audit plan, requires periodic review of the charter and

board resolutions, and requires a confirmation of internal audit's independence.

The changes to the board resolutions authorize the audit committee to pre-approve the annual audit plan and to approve non-audit services or requests for audits or investigations outside the annual audit plan and clarifies that the audit committee can meet as part of the regular board meeting or in a separate audit committee meeting.

Staff is recommending approval of the internal audit charter and the board resolutions which is Resolution Number 09-028. Are there any questions?

MS. RAY: Either of you have any questions?

MR. CARDENAS: No.

MS. RAY: The Chair will entertain a recommendation.

MS. BINGHAM: Madame Chair, I move to approve.

MR. CARDENAS: Second.

MS. RAY: It's been moved and seconded to approve the Internal Audit Division's revised audit charter and board resolutions.

All those in favor, please say aye.

(A chorus of ayes.)

MS. RAY: Those opposed, no.

(No response.)

MS. RAY: The ayes have it and we have approved the revised audit charter and board resolutions.

MS. DONAHO: Thank you. Item 2 is the presentation and discussion of the audit standards, code of ethics, the definition of internal auditing and confirmation of the Internal Audit Division's independence. This is the annual stuff that we talked about that we have to do every year.

The recently revised standards require we have manual discussion about these things, so first the definition of internal audit, and this is a standard definition from the IRS. Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes.

The Internal Audit Division follows the Institute for Internal Auditors standards and the U.S. Government Account Office's auditing standards for every audit that we do. The standards are required by our charter -- the charter that you just approved -- and the

Internal Auditing Act and ensure that the division's work is independent, thorough, accurate, reliable and objective.

The division has adopted and complies with the Institute of Internal Auditors Code of Ethics which is also in your board book. This is also a requirement of our charter. The code requires us to uphold principles of integrity, objectivity, confidentiality and competency, as well as follow rules of conduct related to these principles.

Organizational independence requires independent auditors to report to a level in the Department that allows us to fulfill our responsibilities without interference from management and to be free of operational and management responsibilities that would impair our independence. Our charter ensures our independence by requiring that I report to Ms. Ray, as chair of the audit committee, as well as to the entire board. Individual independence requires my staff and myself to have an impartial, unbiased attitude and to avoid any conflicts of interest.

The Internal Audit Division meets the independence requirements this year.

Any questions on the standards or code of

ethics?

MS. RAY: There are no questions, but the Chair would like to commend the Audit Division's comprehensive information in order to allow us to make decisions on impartiality and lack of stress within the management of the department. And we'd also like to commend you for what you very cohesively went through to resolve issues. Thank you very much.

MS. DONAHO: Thank you.

Item 3 is presentation and discussion of the audit results from Deloitte and Touche, CPAs, for fiscal year ending 8/31/08, and Julia Petty will come up.

MS. RAY: The Chair will recognize Julia Petty at this time.

MS. PETTY: I'm Julia Petty. I'm director of the audit firm of Deloitte and Touche and am here to present the results of our audit for fiscal year ended 8/31/2008. You have a number of documents that were provided to you.

The first document is our required communication to the governing board. We basically outlined that the financial statements are the responsibility of the management of the Department. Our responsibility is to audit those financial statements and

the underlying books and records.

There are three audits that we do on the basic financial statements of the organization as a whole, a subset of that which is the revenue bond program report, and the unencumbered fund balances which is something unique to the Department but required by state law. All three of those reports are unqualified opinions, clean opinions. Management does an outstanding job in putting together information and we'd like to compliment management, from Mr. Gerber all the way down for the help that they give us throughout this audit. They've been very helpful and they know what they're doing.

I did want to also tell you that there are no material weaknesses in the internal controls. We do not do a special audit of internal controls; we do not give an opinion, but we do test internal controls, and from our prior audit, we did not find any material weaknesses or any non-compliance with laws and regulations. Likewise, we did not have any material audit adjustments that were discovered as a result of the audit.

The last item is a report to management on a couple of control deficiencies which are related to the IT area, and primarily relate to documentation about changes made. The Department is making changes and they do appear

to be appropriately made and approved but documentation was lacking and we believe that the Department is already taking steps to remediate those issues that were noted. Deficiencies from prior audits have either been addressed already or are continuing to be worked on by management.

So with that, I'd be happy to answer any questions you may have?

MS. RAY: Are there any questions?

(No response.)

MS. RAY: I want to thank you very much for your audit and the Audit Committee would like to commend the financial department. We thank you very much for your folks working with our auditors and certainly keeping transparent the process. We just love getting unqualified reports. The Chair would like to have recommendation for acceptance of the Department's audit report.

MS. BINGHAM: So moved.

MR. CARDENAS: Second.

MS. RAY: It's been moved and seconded to accept the Department's audit report from Deloitte and Touche.

All those in favor, please say aye.

(A chorus of ayes.)

MS. RAY: Any opposed?

(No response.)

MS. RAY: The ayes have it and we have accepted your report. And we also look forward to addressing with the financial department the recommendations that you've made for improvement in 2009. Thank you so much.

MS. PETTY: Thank you for your time.

MR. GERBER: Madame Chair, if I could just interject. David Cervantes, who is our CFO, and his team do an extraordinary job. I wish more of them were here today, but they do a tremendous job. Curtis Howell is here as well from our IT division and heads that up where much of the heart of work implementing some of these process changes really is going to take place, and we are really blessed to have such talented people in that division, so I just wanted to thank them for their hard work and cooperative work implementing the many recommendations that Julia and her staff have made.

MS. RAY: Thank you so much for your professionalism. We appreciate it.

Item number 4, the Chair recognizes Ms. Donaho.

MS. DONAHO: Item 4 is presentation and discussion of recent external audit reports. I'll move through these quickly, but since all of you have seen them and read them, if you have any questions, just feel free

to stop me and ask.

The first one is HUD's review of the Emergency Shelter Grants Program. HUD's audit scope included recipient management, eligibility/beneficiaries, the overall management system and financial management. They had three financial findings. The Department was unable to reconcile its administrative expenses to its administrative draw requests, and the Department was drawing funds in advance of need. Advances of federal funds are generally limited to actual immediate cash requirements. The Department was in a positive cash position beyond the three-day standard for seven consecutive months. However, both of these issues were identified in the previous audit and were in the process of being addressed at the time of this audit. The Department's new procedures went into effect on September 1 of 2008 and HUD concluded that no further action on these issues was required.

During an on-site review of the recipient program, HUD also noted the processes used by the agency to allocate certain costs should be strengthened to ensure that the costs were allocated fairly across multiple funding sources. They noted the following issues: ineligible depreciation, ineligible mileage and

unsupported time allocation processes. HUD recommended that recipients be required to scan supporting documents and submit them to the Department for review and that \$247.50 in depreciation costs be reimbursed to the Department or offset against other costs. The agency offset this amount in their program year closeout which closed that funding as well.

Are there any questions on this audit?

MS. RAY: No.

MS. DONAHO: The next one is HUD's Disaster Voucher Program Validation Review. HUD conducted a remote validation review of the Department's Disaster Voucher Program -- this is part of Section 8. HUD identified two errors and made two observations. The two errors were utility reimbursements were not calculated correctly for two families; one family was overpaid \$648 and the other underpaid \$1,386. A reimbursement was issued and the overpayment was requested. HUD has closed this issue. Non-homeless families were incorrectly reported in the homeless category in the voucher management system during the last six months of calendar 2007. The information was corrected and HUD closed that issue.

The two observations related to errors in data in the Disaster Information System and the reporting of

expenses on a cash basis rather than an accrual basis in the Voucher Management System. Both of these were also corrected and closed by HUD.

Are there any questions on this audit?

MS. RAY: No questions.

MS. DONAHO: And also the next audit is the Comptroller of Public Accounts Post-Payment Audit, an audit of certain payroll, purchase and travel transactions processed between March 2007 and February 2008. The objective was to determine if the Department's expenditures complied with state laws and rules. The audit found that there was an error in one employee's longevity pay calculation and one payment was not properly scheduled which resulted in a loss of interest to the State Treasury of \$22. The auditors recommended all payments greater than \$5,000 be scheduled at the latest possible distribution date so the state doesn't lose interest money.

No errors were found in their review of benefit replacement pay, duplicate payments, refunds or travel transactions.

Are there any questions on that audit?

MS. RAY: No questions.

MS. DONAHO: And finally, HUD OIG's review of

Supplemental I Disaster Recovery Program Funds. HUD OIG, the Office of Inspector General, reviewed the Round 1 Hurricane Recovery funds to determine whether the Department administered funds in compliance with the *Federal Register* requirements, HUD policies, and the State of Texas' Disaster Recovery Action Plan. They found that the Department administered the funds in compliance with the various requirements, used the funds for eligible applicants and projects, and ensured that the funds were properly accounted for. They did not identify any findings or areas for improvement. So that's good news.

Any questions on this audit?

MS. RAY: No, I don't have any questions, but I would like to commend the Disaster Recovery department staff for their very dynamic role in our business and they come out that clean. Good job. Thank you very much.

MR. GERBER: Thank you, Madame Chair. I would just interject that actually the State Auditor's Office also did an audit on Round I funding and some of the members of their team are here as well and are going to revisit some of those issues as well. We really welcome the process improvements they've already made thanks to the Auditor's Office recommendations a year and a half ago. And we look forward to working with them to maintain

our processes. We look forward to keeping our programs running.

MS. RAY: That's very good, considering the dynamics that I've experienced before. Thank you very much.

Thank you, Sandy. Item 5.

MS. DONAHO: Item 5 is a presentation and discussion of internal audit reports on the Office Colonia Initiatives' Bootstrap and Self-Help Center Programs.

I'll cover the Bootstrap audit first. The objectives were to determine that the program's policies and procedures were adequate to ensure that owner-builder requirements were met, that the program was in compliance with all state and federal laws and the Department's rules, and that the reservation system resulted in an increase in the disbursement of program funds.

The Government Code requires that two-thirds of the funding for this program is spent in counties that are identified as economically distressed and are eligible for funding under the Water Code. They are 41 counties that meet that criteria. In 2008, \$6.5 million was allocated, and at the time of the audit, 61 percent had been committed or spent; 13.2 percent was in eligible counties. The reservation system that we just implemented recently

was set up to track this by county, and I think there was some confusion over the Water Code's interpretation of eligible counties and our reliance on their interpretation so I think that probably has been since resolved.

MR. GERBER: Well, it's stopped. We were relying on a Water Development Board interpretation on what counties were eligible under the Water Code. Their general counsel clarified for us that we were using an incorrect interpretation of the statute, and so we then went back and revisited that based on what their interpretation was and based on our general counsel, so we now have a limited scope of service for those funds. I know there have been some efforts to try to address that issue but we stopped to try to make sure that we are strictly in compliance with the statute, except for those families that are currently in process, we didn't want to do anything to impact the families. So there are no new families coming in that would be in violation of this issue that's been identified by Sandy and her team.

MS. DONAHO: The next issue was that the Government Code limits loans through the Bootstrap Program to \$60,000, \$30,000 from the Department and \$30,000 from another funding source. There's some question about whether forgivable liens count for that \$60,000 or not.

We looked at 426 loans, 201 of them funded between September of '05 and June of '06; 42 percent of those exceeded the \$60,000 limit.

The next issue was that the Government Code requires the Department to establish an owner/builder revolving loan fund where the funds from Bootstrap loans and revolving payments go into that account and are allocated back to the program. There's some question about how those funds were allocated and whether there's an actual account for that money to go into. The repayments at this point were going into the Housing Trust Fund and potentially they could have been de-obligated to another program. In 2006-2007, \$3.2 million was de-obligated from the Bootstrap Program, so it was de-obligated and went back to the Housing Trust Fund.

The Texas Administrative Code requires the Department to have the first lien position if our loan is greater than any other loans. Of the 426 loans that were looked at, in 53 percent of the cases the Department's loan was subordinate to a loan of equal or lesser value; in 19 percent the Department's loan was subordinate to a deferred payment or a forgivable loan which is also not allowed under the Administrative Code rules.

Since September 2007, the reservation system

used for the Bootstrap Loan Program has resulted in a more efficient process for distributing funds to nonprofit owner/builders and housing providers. During the first nine months the reservation system was used 57 percent of the available funds were committed or expended compared to 32 percent in the same length of time under the old application process. So the reservation system that the board approved several months ago appears to be working.

Are there any questions on this audit?

MS. RAY: No questions.

MS. DONAHO: I'd like to say at this point, between this audit and the one I'm going to talk about next, management has agreed to implement the audit recommendations in order to improve compliance with requirements and they've indicated the changes to the program are already underway. I think that they're making a concerted effort to fix some of the issues and to make changes to these programs to become more respondent.

MR. GERBER: I'd notice that with the concurrence of staff, we'd welcome the Audit Committee's direction to the auditor, and I believe we pretty much agree that a re-review of these audits in six months' time and in a year's time to go back and look at those changes being made. These are some of the very few state funds

that have been provided to affordable housing and we want to make sure that we get it right, and we really appreciate Sandy and her team's efforts.

MS. RAY: The Chair, on behalf of the Audit Committee, would also like to alert the State that we take very seriously the professional interaction between the auditing partner and management and the staff. We see the audit process as our attempt for a continuous of improvement in all areas and we insist that staff work appropriately with the auditor in order to ensure continuous process improvement.

Thank you very much, Sandy.

MS. DONAHO: The next audit is an audit of the Office of Colonia Initiatives Self-Help Center Program. Our objectives on this audit were to determine that border field offices ensure that subrecipient requests for reimbursement are adequately supported and comply with laws, regulations and policies, and are properly authorized and approved, that desk reviews result in accurate and clean contract files and that quarterly reports are submitted to ORCA as required.

The Office of Colonia Initiatives, at one point before this audit started, was not requiring counties to submit supporting documentation of expenditures with their

requests for reimbursement for all draw requests. We found at least one issue with each of the twelve draw requests tested that should have prevented reimbursement.

The next issue is that HUD has determined that the Davis-Bacon Act of prevailing wages paid to construction workers applies to the self-help center contracts. I think prior to that point, there was some confusion about whether Davis-Bacon applied to the self-help center contracts or not. Five of the ten contracts we looked at did not contain the required Davis-Bacon language. Of the five that did, there was not documentation to support the prevailing wage in the contract file for review.

Also, the Office of Colonia Initiatives did not retain environmental clearance documentation. At least one contract had environment clearance approved by a non-authorized individual. These clearances must be reviewed prior to release of draws. Counties were reimbursed prior to the completion of environmental clearances and in some cases were reimbursed for homes where a clearance was never completed.

Also, the Department's administrative thresholds set to limit the expenditure of administrative funds proportional to other funds; the Department uses

these thresholds as set by ORCA. What this means is that 90 percent of the administrative funds on these contracts can be extended after the start of only one home. Three of the nine contracts we reviewed exceeded the first and second thresholds, so the construction was not keeping up with the administrative costs being charged to this program.

Are there any questions on this audit?

MS. RAY: Are there any question?

MS. BINGHAM: No, Madame Chair.

MS. RAY: And you did say, Mr. Gerber, that we are going to do a review on these findings?

MR. GERBER: Yes, Madame Chair. Incorporated into the audit findings probably within six months and at a year's point as well, given the scope of changes, we would very much welcome that review. We talked to the division director, Mr. Cabello, about working very closely with the audit team and with executive staff to make sure that we really get it fully within the letter of federal law and statutes and state law and regulations to make sure that we are administering these programs correctly. He's embraced it and we want to be able to report back to you all the progress we're making at the six-month point and at the financial year point as well. There's a lot of

work ahead.

MS. RAY: So you would expect to have an initial report in June, Sandy?

MS. DONAHO: I think we're probably six months from the end of these audits and we'll start our work in May so June or July at the latest. I would like to say that the Audit Division has been involved in some discussions with management, both at the department level and executive management, about these audits and how to implement the recommendations and what the recommendations really mean. So my understanding from that, my feeling from that, is that management is on top of these things and making a concerted effort to address these issues and to implement the recommendations the way these auditors would like to see them implemented.

MS. RAY: Thank you very much.

MR. GERBER: And Madame Chair, I would just interject also that many of these changes will required changes to statute, so being able to test, we'll have to wait till after the legislative session. We're aware of at least a couple of bills that are being introduced where I know that they have been made aware of some of the issues and there's legislative in the Bootstrap Program, particularly from our border members and from others who

work with our partners who know that we've stopped being able to do business as we usually have because of the issues that have been identified.

So we're optimistic that changes will be made.

These are tremendous programs that have built literally hundreds of homes along the U.S.-Mexico border and across Texas, Habitat for Humanity, self-help housing, it's extraordinary to see but we've got to get it right.

MS. RAY: Thank you very much, Mr. Gerber.

MS. DONAHO: Item 6 is the presentation and discussion of the status of prior audit issues, and I've been looking forward to this one for several days now. When I assumed the position of Internal Audit director we had a database that had 457 prior audit issues. The board requested, when I came onboard, that we perform follow-up work to clear all of these audit issues. It's taken us over a year to do this work but I'm happy to report we've completed it and we were able to clear and close all but seven of those audit issues. We're also waiting on some supplemental information on 26 issues, but I feel certain those will be cleared as well.

So I had promised Mr. Cardenas in June that we would have it done by December, we missed that by about two weeks, but we did manage to close all prior audit

issues.

MS. BINGHAM: Wow.

MR. CARDENAS: Very good.

MS. RAY: Very good work, Sandy. You put the fear of God in us. That's extraordinary.

MS. DONAHO: Thank you.

MS. RAY: And I'd like to commend the entire audit division for your professionalism in moving these prior audits forward, clearing them up, along with your total workload, and I recognize loss of staff and the shortages that you've had to deal with in the process.

So very commendable and we thank you very much for that process.

MS. DONAHO: Thank you.

MS. DONAHO: The bad news is that since I came onboard we have acquired or created 74 new since the start of fiscally year 2008, so there's the seven that were carried forward plus 74.

MS. RAY: Beats the heck out of 457, though, doesn't it?

MS. DONAHO: That's true. Most of these -- 69 percent are internal audit issues, so we've been doing some work. We've started a new database, we're going to start prioritizing these issues so that we can clear the

ones that we think are most crucial and riskiest first and then move on to the ones that are less high risk.

MS. RAY: So the bad news is good news also.

MS. DONAHO: The report in your board book contains the 81 total issues. Fifteen of them have been reported as implemented by management, so we'll start closing and clearing those as our time allows. As a reminder, once they're reported by management as implemented, they drop off of your report and then we start to work to clear them.

Nineteen of them are related to the Office of Colonia Initiatives audit reports that I just talked about. Management has reported to us that seventeen of these are in the process of implementation and that two of them have been delayed slightly.

Are there any questions on prior audit issues?

MS. BINGHAM: No.

MR. CARDENAS: No questions.

MS. RAY: No questions. We can move to item 7.

MS. DONAHO: Item 7, this is status of our fiscal year 2009 work plan. We've been short staffed for almost four months now and that's impacted our ability to complete our plan on time. We have a new auditor starting on February 19, so you'll meet her at the next board

meeting. However, we had another resignation so we still have an open position to fill. Auditors are in high demand and those positions are very difficult to fill.

The HOME Program, loan servicing and recycling of program income, we're working on now. It's in the testing phase; we hope to have a report to you in the next month or so on that audit. The Disaster Recovery Phase II testing of setups and draws and Phase III subrecipient monitoring, both of those were carryovers from 2008 because we were waiting for enough files to test.

The timing and procedures of both of these Disaster Recovery audits may change depending on the scope and the timing of three outside audits that are currently underway in that area. Right now we have HUD, HUD OIG and the State Auditor's Office all auditing this program area at the same time, so Internal Audit will have to stand in line for that. I don't want to revise our audit plan until we know what the scope and extent of their testing procedures are, and then we can pick up anything that's not covered.

MS. RAY: I believe I can speak for the Audit Committee that we are satisfied with your 2009 audit blend and we concur with your decision not to adjust it at this time.

MS. DONAHO: Thank you. Are there any questions on the work plan?

MR. CARDENAS: No questions.

MS. DONAHO: Item 8 is the status of external audits. As I just mentioned, we have three groups of auditors looking at Disaster Recovery. The State Auditor's Office, that Mike mentioned earlier, is conducting their follow-up to the fall 2007 audit and they're looking at Round I and Round II funding. HUD just completed field work in Houston on Supplemental Round II funds and HUD OIG is looking at Supplemental II funds as well.

The Workforce Commission is coming to visit us in May to look at access controls that are the unemployment insurance data used by Community Affairs -- that's Section 8. And we anticipate the result of KPMG's work on the energy assistance program and the license program in March. This is part of the statewide annual financial audit for federal funds.

The other audits listed in your board book are completed and I've reported the results to you today.

Any questions on any of these?

MR. CARDENAS: No questions.

MS. BINGHAM: No.

MS. RAY: There are no questions. We thank you very much for your report; you covered a lot of information in a very expeditious manner and we appreciate it.

And we would like to also take this opportunity, Mr. Gerber, to commend the Internal Audit Division and management for working so cooperatively to move us toward continuous process improvement, and we thank you so much for your professionalism and your staff members in all of the departments, and we're very pleased with the work that the Internal Audit Division has accomplished in this one year and we look forward to another successful year during 2009.

MS. DONAHO: Thank you.

MS. RAY: Thank you so much.

This concludes the items under the Internal Audit Division. I have no more documentation for requests for public comment.

Mr. Cardenas, do you have anything else?

MR. CARDENAS: No, thank you.

MS. RAY: Ms. Bingham?

MS. BINGHAM: No, Madame Chair, thank you.

MS. RAY: The Audit Committee meeting is now adjourned.

(Whereupon, at 9:05 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: February 5, 2009

I do hereby certify that the foregoing pages, numbers 1 through 32, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Nancy King before the Texas Department of Housing and Community Affairs.

(Transcriber) 2/09/2009
(Date)

On the Record Reporting
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