

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
An Internal Audit of the Physical Inspections Section of TDHCA Compliance Division
Audit Report # 20-005

Executive Summary

The Office of Internal Audit (OIA) reviewed the Physical Inspections Section of the Compliance Division, including its internal controls, and the policies and procedures that are currently in place. The OIA identified areas of improvement to strengthen data access controls and technology change-management functions.

Finding and Recommendation

- OIA recommends that the Physical Inspections Section establish updated, signed and dated SOPs for key processes to create consistency and efficiency for all parties involved in the program.

Observations and Suggestions

OIA also made observations and suggestions related to efficiency of the Physical Inspection Sections' information technology processes. Internal audit suggests an evaluation of the current Genesis software for travel expense reporting and payment for potential replacement; and development of a business case for presentation to the IS Steering Committee related to certain aspects of the program such as Inspection Site Selection. Additionally, Internal Audit suggests periodic review of access report for critical systems; as well as development of management level review for critical systems program changes and data updates.

Management Action Plan

Prior to our audit, management of the Physical Inspection Sections had self-identified areas for improvement. These included an audit of CMTS data to ensure data integrity and reorganization of supporting files. The improvements included putting detailed inspection reports and photos into an easily accessible location available to all relevant personnel, and creating a monitoring process to ensure consistency and efficiency in staff assignments. Management is also planning to rebuild site selection and travel scheduling spreadsheets to ensure accuracy and integrity of information.

Management Response:

Management agreed and detailed responses to our recommendations are included in the body of the report.

Objective, Scope and Methodology

Our scope included a review of the Texas Administrative Code (TAC) applicable to the Physical Inspection section, HUD's standards, as well as the division's Standard Operating Procedures. Based upon our preliminary understanding of the Physical Inspections Section, we identified critical points and risks, and developed our audit objectives accordingly.

Mark Scott

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Director, OIA

8 / 14 / 2020
Date Signed



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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August 14, 2020

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Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: Internal Audit of the Physical Inspections Section of the Compliance Monitoring Division at TDHCA

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "*Review of the Physical Inspections Section of the TDHCA Compliance Division.*" This audit was conducted in accordance with applicable audit standards. It included the objectives to evaluate and explain the Physical Inspections Section of the Compliance division, and to review the administrative and internal control procedures related to the operation of the division.

Physical Inspections rated high on the annual risk assessment and was included in the approved Fiscal Year 2020 audit work plan because the Physical Inspection section had not been selected for audit previously at TDHCA; a similar function at the Manufactured Housing Division recently underwent an extensive review by the State Auditor's Office.

This report is divided into the following sections:

- A. Background
- B. Scope and methodology
- C. Roles and responsibilities of each party in the Physical Inspections Section
- D. Processes and procedures
- E. Audit Testing
- F. Other audit work
- G. Future follow up

A) Background

The Physical Inspection section performs and administers inspections for developments monitored by the Department throughout the affordability period¹. The minimum affordability period for Tax Credit developments is 30 years, during which the property is subject to routine Compliance monitoring reviews. The federal compliance period is the first 15 years of the affordability period, during which the tax credits that have been given to the developers can be taken away or recaptured by the Internal Revenue Service if the property fails to comply with applicable rules and regulation. Once the federal compliance period ends, the Department relies on State enforcement mechanisms to ensure compliance through the end of the affordability period.

The Physical Inspection section ensures that developments are habitable, well maintained, are ready for occupancy, follow appropriate accessibility standards, and comply with applicable program rules and regulations. Developments funded through the Department's Multifamily Direct Loan Programs are subject to a mid-construction inspection to track construction progress. . All multifamily developments must undergo a final construction inspection to ensure compliance with applicable accessibility standards. These inspections are required prior to the issuance of funding or critical documents, depending on the program. At least every three years thereafter a Uniform Physical Condition Standards (UPCS) inspection is also performed. Some UPCS inspections are conducted by Department staff, while others are outsourced. The Physical Inspection section oversees the contract with the UPCS vendor and ensures that owners correct all identified deficiencies.

Additionally, the section inspects single family homes rebuilt, rehabilitated, and receiving down payment assistance or HOME funded rental assistance; homes and apartments receiving weatherization funds; structures funded under the Amy Young Barrier Removal Program; conducts Housing Quality Standards evaluations; and reviews Emergency Shelters. Inspectors may conduct site inspections, construction inspections, and Uniform Physical Condition Standards inspections on new construction and acquisition and/or rehabilitation multifamily developments and for rebuilt or rehabilitated single family homes.

The Physical Inspection (PI) section also conducts physical inspections for the Housing Tax Credit Program (HTC), the Multifamily Tax-Exempt Bond Program (Bond), HOME Investment Partnerships Program (HOME), Housing Trust Fund (HTF), Tax Credit Assistance Program (TCAP), Tax Credit Exchange Program (Exchange) and the Neighborhood Stabilization Program (NSP) and Single Family housing programs at the participating properties based on the frequency stipulated under each program rules.

The PI section currently monitors about 2400 active properties, with an approximately 800 inspections per year to meet the requirements of TDHCA Programs. The PI section has also recently taken over the administrative duties of the Department's Migrant Farmworker Housing initiative; however, these inspections will continue to be completed by the Manufactured Housing division through a MOU with TDHCA.

B) Scope and Methodology

The Texas Internal Auditing Act, Tex. Gov't Code §2102.005 requires auditing of a state agency's major programs and systems. Our scope included a review of applicable portions of the Texas Administrative Code (TAC), HUD's standards, and TDHCA Board resolutions, as well as the program's Standard Operating Procedures (SOPs). Based upon our preliminary understanding of the Physical Inspections Section we identified critical points and risk, to

¹ The minimum affordability period for a Tax Credit development is 30 years, and refers to the minimum time period that the property will remain under established rent limit.

develop our audit objectives and an audit program including methodology. Utilizing the International Standards for the Professional Practice of Internal Auditing, OIA determined the scope of this audit in light of the recent COVID-19 Pandemic under Standard 2220² and 2220.A1³.

Due to the impact of COVID-19, the physical inspections of properties under TDHCA purview have been limited to mid construction and final construction inspections for new construction of multifamily properties with Direct Loan financing. Per HUD guidelines, these inspection are required to be completed, and since the properties are vacant the inspectors are not in close contact with others during their inspection visit.

In addition, planned changes to key processes by management and major regulatory updates expected in early 2021 limited the scope of this review. Management change within the PI section took place in February 2020, and the new Physical Inspection management has embarked upon several initiatives to improve the effectiveness and efficiency of operations. The current areas of focus by management are listed in the body of this report for future OIA follow up. Beyond these management assertions, OIA adapted its scope to focus primarily on understanding both current and future operational processes and detailed review of technology related controls. Our understanding of the primary processes and procedures is reflected in the Processes and Procedures section below.

Standard Policies and Procedures (SOP)

An SOP is a procedure specific to the operation of a division that describes the activities necessary to complete tasks in accordance with applicable rules and regulation. It defines expected practices in a process where quality standards exist. SOPs play an important role in any organization and division as policies, procedures and standards needed to operate in a successful way. They can create efficiencies, consistency and reliability, fewer errors, and value added to the division.

As the section adjusts with management changes and during the halt on inspections in the current COVID-19 environment, the Physical Inspection Section management has been working on standardizing processes and documenting them into SOPs. All key processes reviewed had SOPs in progress, completion of which will be verified at a later follow up date.

Finding Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-005.01	The Physical Inspections Section will establish updated, signed and dated SOPs for key processes to create consistency and efficiency for all parties involved in the program.	October 31, 2020	Manager of Physical Inspections

Management Response

The Physical Inspection section is working diligently to revise existing SOPs as well as identify new SOPs which need to be written. This is an ongoing process that is anticipated to be completed by October 31, 2020.

² Standard 2220; *The established scope must be sufficient to achieve the objectives of the engagement.*

³ Standard 2220.A1; *The scope of the engagement must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.*

C) Roles and Responsibilities of each party in the Physical Inspections Section

- **TDHCA Staff**

The Physical Inspections Section consists of 16 staff that operate under the Director of Compliance. The team consists of the Manager of Physical Inspection, a program specialist, a construction specialist, three senior physical inspectors, and ten inspectors. This team completes all the physical inspections of multifamily properties operating under one or more of the many TDHCA managed Programs (The complete list of TDHCA managed programs is provided under Processes and Procedures section of this report). In addition, the inspectors responsible for mid and final multifamily property construction inspections as well as various single-family Program inspections. Some inspectors are also responsible for reviewing construction plans based on Program requirements.

The PI section receives administrative assistance from the Financial Administration division for vendor selection requirements and payment of invoices by contracted inspectors and by Information Systems (IS), primarily due to the use of the Contract Monitoring and Tracking System (CMTS) which assists in the tracking of physical inspection requirements and scheduling.

- **Property Owners / Managers**

Property Owners are organizations that create and manage affordable housing via various federally funded Programs. Physical Inspection staff coordinate with Property Managers to schedule, complete and communicate results of physical inspections. Property Owners, via their Property Managers, are responsible for complying with scheduled inspections and closing out any deficiencies found during the inspection process within a specified time period.

- **Internal Revenue Service / Department of Housing and Urban Development**

The IRS and HUD are federal agencies that require both TDHCA and Property Owner's compliance with established rules and regulations related to state and federally funded housing programs. TDHCA ensures compliance with the applicable rules and regulation through the Physical Inspections process.

- **Onsite Inspectors (Contractor)**

TDHCA assigns multifamily development physical inspections to its contractor, On-Site Insight, to reach areas that may not be easily accessible for TDHCA staff or to conduct excess inspections once the staff has reached capacity. The PI team works with the contractors to ensure accurate and complete reporting on all inspections.

D) Processes and Procedures

Each year TDHCA is allocated funds under various federal programs for the purpose of incentivizing private organizations to create additional affordable housing inventory. For the purpose of maintaining compliance with each Program's rules and federal requirements, the Physical Inspections Section completes inspections for the following programs:

- IRS Low Income Housing Tax Credit (LIHTC) – LIHTC program allocates a certain amount of housing federal tax credits annually for financing development of affordable multifamily housing. The allocations are awarded to private developers through an annual competitive bidding process.
- Multifamily Tax-Exempt Bond – This program provides for an annual amount of Private Activity Bonds that may be issued for the purpose of financing development of affordable multifamily housing.
- HOME Investment Partnerships Program (HOME) - The HOME Investment Partnership Program is funded by HUD with the purpose of expanding the supply of decent, safe, affordable housing and strengthening public-private housing partnership. TDHCA administers the HOME Program on behalf of state of Texas primarily in rural parts of the state.
- Section 811 Project Rental Assistance (PRA) program– The Section 811 PRA program is a federally funded program with the purpose of providing project-based rental assistance for extremely low-income persons with disabilities linked with long term services.
- Housing Trust Fund (HTF) – The State Housing Trust Fund provides loans and grants to finance, acquire, rehabilitate, and develop decent and safe affordable housing. The State HTF currently administers the following single family programs; Texas Bootstrap Program and Amy Young Barrier Removal Program.
- Tax Credit Assistance Program (TCAP) – Multifamily direct loans
- Tax Credit Exchange Program (Exchange) - Program administered by TDHCA allows for the limited exchange of HTC credits for cash grants, appears to be phased out at this time
- Neighborhood Stabilization Program (NSP) - The NSP is a HUD funded program authorized by the Housing and Economic Recovery Act of 2008, as a supplemental allocation to the Community Development Block Grant (CDBG) Program.
- Single Family housing programs – This program includes various programs related to single family home development for low income individuals in Texas

Each of these programs has its own individual requirement for the timing and frequency of physical inspections, but the most common interval is every three years. However, each development may be subject to the requirements of multiple programs. Therefore, the development will be subject to the most restrictive requirement. These physical inspections are part of the program requirements under which the property was constructed and will be funded. The developers are required to submit an inspection report that shows compliance with all the program’s applicable rules and regulations during the Construction Cost Certification process. An outstanding deficiency on the physical inspection report can delay this process and prevent the developer from completing the funding process. Inspections can be made at mid and final phases of the construction, as well as on a periodic basis during the affordability period, which is defined by the Programs under which it was constructed.

As part of this audit, we reviewed the processes and procedures involved in the inspections of new constructions, and tested a sample of properties for accuracy, completeness, and timeliness. We found that the process starts with the property managers/owners submitting a Request for Inspection, either through CMTS or FTP server. CMTS has the capability of generating an e-mail notice to the Department staff member to whom the

documentation is uploaded. , In addition, the Construction Specialist performs regular reviews of both systems to ensure timely processing of any requests for inspection. Property managers are generally proactive in notifying the staff directly and letting them know once they've submitted their request for inspection. The PI report is one of the required documents for the Construction Cost Certification package, and therefore no property will be able to complete their certification and funding process without a final and clear inspection report.

Once the inspection request is received and entered into the master spreadsheet on the division's shared drive, a notice will be sent to the property manager notifying them of the date, time, and the name of the inspector that will be conducting the inspection. The inspectors follow an established checklist that is also available on TDHCA website for property owners' reference. The Division is required to issue the inspection report within 45 days of the inspection. If any deficiencies are identified, the property owner is given 90 days to respond to the deficiencies with proof of corrections. Although no follow up visits are made by the inspectors to verify the corrective actions, the property owners are required to submit evidence of actions taken, such pictures and receipts.

E) Audit Testing

We randomly selected eight properties that have been inspected since Sep 2019 (beginning of FY20) through July 2020 for testing, and found that the properties were inspected in timely manner, reports were issued within 45 days of inspection, property owner's response included evidence of corrections for each deficiency, and the final report was issued by the division clearing all deficiencies. We also randomly selected another sample of eight properties that were initially inspected in 2016 as "New constructions". We found that all selected properties had a second inspection conducted within three years with appropriate records for follow up on noted deficiencies.

Annually, on a fiscal year basis, the physical inspection section identifies the properties that are due for physical inspection. The process starts by Physical Inspection management creating an Excel spreadsheet by downloading all active properties from CMTS. Foreclosures and qualified contract sales* properties are removed from the spreadsheet, and low scoring / never inspected properties are identified. Additional manual steps are taken to reconcile the data. The properties are then sorted and grouped by the month inspection is required and the location for assignment.

***Qualified contract sales;** Property owner utilizing Housing Tax Credit can request the Department to find a buyer for their property at the Qualified Contract price within one year of end of Compliance period.

Observation and Recommendation

The process of identifying properties that are due for inspection is highly complex and subject to human error as currently completed and could result in missing inspections within the required timeframe.

Internal Audit recommends the development of a business case for presentation to the IS Steering Committee for certain aspects of the program such as Inspection Site Selection.

Once the list of the properties to be inspected is identified, management determines the property that will be inspected by the outside contractor, On-Site Insight, and those assigned to TDHCA staff. The physical inspections are scheduled through CMTS and completed utilizing UPCS4 (inspection software based on HUD's Uniform Physical Conditions Standards) that tracks detailed findings and generates reports. If the inspection was conducted by On-Site Insight the contractor submits the inspection reports and photos to a specific location on Serv-U (a secure file transfer system utilized by TDHCA to share files with external parties). TDHCA staff reviews

the detailed information from UPCS4 and other documentation, writes up reports and creates appropriate notifications for all parties involved. The notifications are then sent to the property owners/managers. TDHCA staff are responsible for following up on any deficiencies, issuing resolutions, closing out the inspection when possible, and referring properties with outstanding and unresolved deficiencies to the Enforcement Committee as deemed appropriate.

With the management change in February 2020, Physical Inspection management has identified several areas with opportunities for improvement. During the COVID-19 Pandemic, and since physical inspections are currently limited to Multifamily Direct Loan properties, the team is working on these defined projects as noted by management below.

Management Action Plan Based on Prior Management Review

Management Action Plan	Target Completion Date
Management will conduct projects to audit CMTS data to ensure data integrity and reorganize supporting files such as detailed inspection reports and photos into an easily accessible location available to all relevant personnel.	Completed ⁴
Management will rebuild site selection and travel scheduling spreadsheets to ensure accuracy and integrity and will review and revise all output such as form letters and IRS notifications to ensure they are updated.	October 31, 2020
Management will create monitoring processes to ensure staff assignments are processed in a balanced and efficient manner; once new processes are implemented after the COVID-19 Pandemic, management commits to hands-on review, training and continuous improvement of processes.	Ongoing

The OIA will review and evaluate the status of the management assertions and action plans listed above during the follow up audit of the Physical Inspection section in FY2021.

Genesis is a systems application that is used by TDHCA staff for travel expense tracking, reporting and reimbursement. Per discussion with IS management, the version of the application is character-based but fully supported by the vendor based on a software maintenance contract which is renewed annually. Although changing this system would not necessarily create efficiencies for the PI group, it would eliminate an archaic application as well as its support fees from TDHCA’s systems environment and allow for using PeopleSoft’s HR CAPPS Central that is already supported and maintained centrally for several agencies.

CMTS primarily serves as an input and repository of data, with some processing of reports completed in order to create documents required by federal authorities such as the IRS. CMTS is accessible both internally by TDHCA staff, and externally by property owners / managers. The system provides an electronic location for Property Owners / Managers to submit reporting and required documentation, and to receive information from TDHCA.

⁴ The Management Action plan related to CMTS project was not reviewed or tested by the auditor during the course of this audit. OIA will verify management assertions during the follow up audit of the division.

Since CMTS is the primary system utilized by the Program, OIA reviewed multiple layers of user access to CMTS functions within the system and found that access was appropriately granted. OIA did note that a few users have secondary user names due to limitations in the internal security of CMTS. Compensating controls such as Financial Administration approvals limit the exposure from additional access. Management reviewed these items and made updates where possible to further restrict this practice.

In addition to reviewing internal access to CMTS, OIA reviewed the change management process for this critical system. OIA examined multiple program change and data update requests from Track-It (help desk software platform used by IS to track system requests, problem reports, and data updates) and found that management review and approval of changes to the production environment is not consistently applied. When management is not approving consistently, changes can be made without management’s knowledge, communications may not be broad enough, and updates may affect other Divisions’ use of CMTS adversely. In addition, systems work may be requested that is not necessary due to Program procedures in place or staff training issues.

OIA reviewed the data update requests that were being logged and discussed them with IS, noting that in 2020 alone there had been 27 requests during the first 6 months. IS management identified two items that make up 95% of these requests: property units setup changes and deletion and running reports when external or internal parties cannot access them. IS should be removed from the process of updating data directly; to the extent possible, data updates should be in the control of the Program areas.

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
20-005.01	Internal Audit recommends process and systems changes required to reduce dramatically the intervention of IS resources into data updates for CMTS.	Ongoing - Aug. 31, 2023	Director of Information Systems

Management Response

TDHCA Information Systems Division (ISD) has received several help desk requests for modifications and improvements to CMTS. In 2019, TDHCA ISD began an initiative to reduce the number of database update requests requested by program staff. The initiative included several changes to help improve the integrity of the data and eliminate known application issues. Several of these work orders have been implemented, have reduced the number of data update requests ISD received, and has helped to improve the reliability of the CMTS database and application. ISD also has a capital budget project for FY2022-23 that will continue to address issues and improve system functionality and efficiency, including the triggering of the AOCR reports⁵.

TDHCA ISD will continue to work on open work orders to resolve any issues that are brought to our attention. ISD will also begin working on and planning for the implementation of CMTS Upgrade FY2022-23 Capital Budget project. This project will focus on resolving issues and improving automation in the CMTS system.

⁵ Title 10, Rule§10.607 requires that each rental housing development funded by the Department to submit an Annual Owner’s Compliance Report (AOCR), by April 30th of each year. The information in the report reflects the current development data as of December 31st of the previous year.

Observation and Recommendation

- Internal Audit recommends the evaluation of the current Genesis software for travel expense reporting and payment to schedule replacement.
- Internal Audit recommends the periodic review of access reports for critical systems to ensure access is still appropriate as people change positions or functions change. This should be done at least annually if not more often depending on the level of changes within the Division.
- Internal Audit recommends the development of management level review for critical systems program changes and data updates.

F) Other Audit Work

This is the first internal audit of the Physical Inspections Section's processes and controls. TDHCA contracts with the Texas State Auditor's Office ("SAO") to conduct annual financial statement audits of the Agency. The latest audit was issued in December 2019 and stated that the financial statements were presented in accordance with Generally Accepted auditing Principles ("GAAP"). As part of that audit, SAO reviews Information Systems general controls.

G) Future Follow Up

Once the future processes and procedures are established and have been in operation for an appropriate amount of time, OIA will schedule a follow up audit to comprehensively audit the administration of Physical Inspection section.

OIA extends our sincere appreciation to the Directors of Compliance and the Director of Information Systems, the Manager of Physical Inspections and their respective teams for their cooperation and assistance during the course of this review.

Sincerely,

Mark Scott

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Internal Audit Director

MS/SN/NS