Texas Department of Housing and Community Affairs

Audit Committee

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

Friday, March 24, 2000
8:30 a.m.

COMMITTEE MEMBERS:

C. KENT CONINE, CHAIR
MARSHA L. WILLIAMS
JAMES DAROSS

ALSO PRESENT:

DAISY STINER, EXECUTIVE DIRECTOR
DR. FLORITA BELL GRIFFIN, TDHCA BOARD
DAVID GAINES, DIRECTOR OF INTERNAL AUDIT
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**PUBLIC COMMENT**

**ACTION ITEMS**

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**REPORT ITEMS**

- Discussion of Internal Audit Considerations
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MR. CONINE: It's 8:30 and this is the audit committee for the Texas Department for Housing and Community Affairs on Friday, March 24.

We'll call roll. Kent Conine, chair, is present.

Jim Daross?

MR. DAROSS: Present.

MR. CONINE: Marsha Williams?

MS. WILLIAMS: Here.

MR. CONINE: We've got three. That constitutes a quorum.

Get over to my agenda right quick. Is there any public comment today? We've got -- I've got a couple of witness affirmation forms from both Mike O'Brien and Milo Martinez.

I assume you guys want to talk during the presentation as opposed to now. Is that appropriate?

MR. O'BRIEN: Yes, sir.

MR. CONINE: Okay. Any other public comment?

I told Bill this morning we'll see who the hard core are that show up for a Friday morning audit committee meeting --

MS. WILLIAMS: At 8:30.

MR. CONINE: Hard core, right here.
Okay. We'll close public comments, seeing none other than those that I have in my hand.

Action items, Presentation and discussion and possible approval of minutes from the audit committee meeting of October 8, 1999, under tab 1 of your notebook.

MR. DAROSS: I move the minutes be approved as submitted.

MR. CONINE: Motion to approve the minutes. Is there a second?

MS. WILLIAMS: Since I was absent for part of the meeting, I don't think I should second.

MR. CONINE: I guess I'd better second that. Any other discussion? All those in favor say aye.

(A chorus of ayes.)

MR. CONINE: All opposed? So approved.

Next under report items, Discussion of internal audit considerations, HOME Program, subrecipient monitoring report, Mr. David Gaines. Good morning.

MR. GAINES: Good morning, Chair, members of the committee. My names's David Gaines, director of internal audit, for the record.

I'd like to first just start off by thanking you for taking the time to come in this morning for this audit committee meeting. I think it really demonstrates
your strong commitment for the department's overall control environment and support for the audit function itself.

That's demonstrated by taking the extra time and effort. And we could have -- since we were unable to do this last week, I think this is a strong statement by taking the extra time and effort to do it this week.

If you'll turn to report item A -- that's the internal audit report on the HOME subrecipient monitoring function -- and the objectives of the audit were to assess HOME's subrecipient monitoring activities and tools and whether they're adequate to ensure compliance with federal awards -- excuse me -- to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts and grant agreements, and that performance goals are achieved.

The goals include an assessment of adequacy. A process is used to follow up and dispose of recorded issues and to assess the adequacy of reporting the results of monitoring activities to the proper levels of department management between department programs and to the subrecipients themselves.

The first page behind tab A, in the first paragraph, discusses the department's responsibilities. And basically, the department should have controls in
place to provide reasonable assurance of compliance with federal laws, regulations, and program requirements.

This includes monitoring subrecipients as necessary, to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts and grant agreements and that performance goals are achieved.

If you turn to page 1 of 12, I have an executive summary there which is basically our overall summarized conclusions of our project. And in summary, basically, significant improvements are needed to ensure the effectiveness of the HOME Program, the home monitoring function.

Sufficient resources have not been allocated to ensure that the monitoring function is effective, and monitoring tools do not include the procedures necessary to ensure compliance with relevant laws, regulations, and contract provisions.

Contract performance is not formally evaluated and acted on during the contract period, and the reporting process is not adequate to ensure that monitoring results are complete, accurate, timely, and reported to the individuals or parties that are affected.

Processes for following up on reported deficiencies are not sufficient to ensure appropriate
corrective action is taken in a timely fashion.

Additionally, the HOME standard operating policies and procedures are not detailed enough to ensure the quality of the monitoring function or the related documentation. Operating policy and procedures are lacking altogether for some aspects of the HOME monitoring function.

The balance of the report is really the details supporting that, the conditions we noted, the support for those conclusions, and I hadn't planned on walking through the details of the report. Of course, I'll be glad to if you choose, or I'll be glad to respond to any questions you might have.

MR. CONINE: Okay. I guess I'll open it up now for the committee to -- there's quite a bit of meat in this little report, and I'm sure there's some questions from everybody.

Go ahead, Jim.

MR. DAROSS:

Well, I don't really have any questions so much as comments. I mean, this was one of the most appalling reports I've ever read. Essentially, it sounded like what you're saying is the system is just not working to ensure compliance almost not at all.

I mean, it looked to me like there were
deficiencies you noted in every single aspect of the compliance program in this area.

MR. GAINES: All areas that we considered within the scope of our review, that's correct.

MR. DAROSS: Now, the scope -- the review is concluded October -- or August 24. Is that correct?

MR. GAINES: Yes, sir.

MR. DAROSS: And I understand that the staff has submitted their responses to the report.

What is the next step in the process? Are you going to again review the responses and the corrective actions that have been taken?

MR. GAINES: I've worked with management in acknowledging their responses. Their responses are adequate responses. And so what generally happens going forward is we have a tracking system that tracks prior audit issues, and so we'll follow up on the status of this. We try to do that twice a year, every six months.

And ever issue that's outstanding, management will respond to at that time. For those that we consider especially significant or high risk, we may go in and independently verify at that time. For the most part, that doesn't necessarily happen.

If management says they've implemented it, we acknowledge that on our tracking system, and it's in a
holding pattern until we either go back in and do another
job in that area and then we'll independently follow up,
or in some cases, depending on the significance, that may
be out there indefinitely without independent
verification.

MR. DAROSS: And part of the problem appeared
to me to be a personnel issue, where we had compliance
people who are designated as compliance people performing
significantly other functions than compliance functions.
I mean, is that an FTE problem or is that just a problem
of job descriptions?

MR. GAINES: When you start asking FTE
problems, that's a real difficult question, because you
really have to go in and do a workload analysis. I'm not
necessarily sure -- we're short of FTEs. It may be a
matter of allocated the FTEs to the monitoring function.

MR. DAROSS: Yes. We need to do a lot better
than inspecting 10 percent of the HOME Programs as they go
along. I mean, that -- it's just got to change a lot.

MR. CONINE: Marsha?

MS. WILLIAMS: I think Jim's basically said
how -- kind of what my conclusion -- I'm sorry.
Mr. Daross basically stated what I thought, as
well.

MR. CONINE: Daisy, would you -- I know we've
had a lot of personnel fruit basket turnover in the HOME Program over the last several years, and most of the people probably this is targeted at aren't sitting here listening to us today.

But can you kind of give us your historical perspective and give us a perspective of how much emphasis you personally are going to place in the resolution of some of these recommendations over the next several months?

MS. STINER: Yes, sir. Of course. Just responding to the issue of personnel, one of the things that we have instituted over the last several weeks, as you will note in here, is a job audit of all the positions in the HOME Program.

The HOME Program, as you know, is a program that emphasizes production, so it appears the trends over the years have been to employ staff who have been strong in those areas. At one time, you may recall that the department had problems getting the funds out. So it appears just with what happens in terms of how you respond to whatever a crisis at a particular time, you staff with expertise and experience in those areas.

So we have a lot of people that were dedicated to production. Of course, as you all know in a management function, in addition to production -- which is quite
critical and important and sometimes primary -- not a lot of attention has been paid to the areas that is equally as important and significant for a successful operation of a system.

So what we have done as a first step is to do an evaluation of each position in the HOME Program. One of the outstanding audit issues with HUD itself is that they suggested that we dedicate more FTEs to the HOME Program. That is fine, but all of that has to be weighed with all the needs across the board for the department.

We're hoping after this audit is complete and evaluated, we will be able to either furlough some FTEs or put ourselves in a position where we can make a good justification to the LBB and the GBO, which has a mechanism for increasing -- requesting FTEs. But, of course, you have to have that justified.

One of the reasons that I've been hesitant about moving forward on such a request is that we haven't completed a department-wide audit of FTEs. It's one thing to say we need FTEs in a HOME Program. It's quite another to make a reasoned justification if we haven't completed a department-wide audit.

So I've been working with the director of human resources, along with director of the HOME Program to get that audit completed, first in the HOME Program and a
couple other divisions across the board.

Once we're at a point where we have completed a department-wide audit of job responsibilities and what we're facing with that FTE cap, we would be in a better position to make a waiver if it's warranted.

But for the HOME Program specifically, where we've had most of our problems in terms of monitoring and correcting outstanding audits, we are just about there. I think you're seeing a management report. I do know from talking to the director of the program and the human resource director that the job audit has been complete, in the process of evaluating. We will have some latitude in assigning FTEs to that.

You will also note that a bunch of criticism that I've received over the last several months is that I've kept some FTE positions vacant. That has been deliberate. That has been reasoned. That -- when we find that we may not be able to hire the higher-level management positions that we've been holding vacant, those may need to be dedicated to the program level.

So it's a balancing act. It's a matter of determining, you know, what you have, what those skills levels are. I just want to go on record saying every staff person in the department makes a great contribution, but we have just a little overbalance in some areas.
We are very, very heavy on production. We're very, very heavy on staff who has experience and expertise to make things happen in terms of putting affordable housing on the ground, in terms of delivering community services, in terms of delivering community development products.

What we don't have and haven't paid, I think, the proper focus to is making sure that we have a balanced attention to all functions of a system or of an organization that make it perform well.

Some of those areas, of course, is compliance, making sure that the funds that we receive from the Federal Government are properly applied and that the subrecipients who we depend on to deliver our products also are given the guidance that they need to make sure that they remain in conformance.

So we are -- I would just say my -- Mr. Conine, I think you heard me ask -- you asked me, you know, personally, what I plan to do, and that's what I plan to do. I plan to make sure that we have a balanced approach to getting our services delivered; that is not only from the production side, but that's from conforming with the compliance issues; that's from making sure we do proper evaluations -- we have checks and balances. And I think we are headed in that direction.
It has not been easy to devote, you know, a balanced amount of FTEs and time to this area, but it is very important to me. I think with the addition of a manager in the HOME Program -- pardon me -- a director in the HOME Program and a -- who has come in and, I think, put some mechanism in place for us to get there, we will improve in that area.

I think that's all. I answered both of your questions.

MR. CONINE: Is there a -- in the way of an organizational chart for the department, I'm sure? But is there an organizational chart for the HOME Program Division that you could supply us with so we could take a look at, I guess, more specifically what some of the job titles are and some -- how many regional coordinators we have and -- but try to familiarize at least --

MS. STINER: Oh, sure.

MR. CONINE: -- ourselves with --

MS. STINER: Sure.

MR. CONINE: -- a little more of the thought process of the structure we currently have in place?

MS. STINER: Yes, sir. We'll be happy to provide that to you. And what you'll find is that there's been an overemphasis on -- there has been an emphasis on what functions of a particular division have taken
precedence. And you'll see that we have -- I think it's five or six FTEs that's dedicated to program -- I mean, program -- what we call coordinators.

That's the production side that monitors, you'll find, two positions, along with the supervisor of that. But we'll be happy to provide that to you.

And if you'll recall, when I described the job performance -- I mean, the job audits that we're doing in that area, that was the outcome we expected, to find out where we needed to place more emphasis, whether we needed to shift some of those positions to the monitoring function or whether or not some of the functions of the monitoring portion of HOME need to be incorporated into the broader department, compliance department.

But we will certainly provide you an organizational chart of where we are, which would give you a snapshot, and try to keep you informed of where we are moving to as a result of the audit of those positions.

MR. CONINE: Any other questions from the committee members on the HOME Program subrecipient monitoring?

Do you have any other comments, David, relative to this report?

MR. GAINES: A final comment. I'd like to point out the distribution that is required of us, and the
report's distributed, of course, to the department's
governing board, to the governor's office on budget and
planning, the state auditor's office, and the legislative
budget board.

MR. CONINE: Most of the -- I notice most of
the target dates in here for management's implementation
of the recommendations in this report are in June -- first
part of June, maybe, with some slight variations.

This is almost the first of April, I guess, and
I would suspect that -- if we could get a copy of the
organizational chart fairly quickly and then we'll have
another committee meeting in June just to kind of update
and see where we are relative to this process.

And I don't think we need anything prior to
that time other than the general knowledge and awareness
that we've got a problem here that we need to make sure
gets corrected and do the best we can. And we'll check in
on it in June sometime, if that's all right with the rest
of the committee.

MR. DAROSS: All right.

MR. CONINE: Okay. Moving on to the status of
prior audit issues. David?

MR. GAINES: Yes. That's tab B, and you may
have a board book that says, To be provided. I believe,
Mr. Daross, you found yours. If I may, I'll update
[indiscernible] here.

As the chair mentioned, this is summary of status of prior audit issues. This is a report that's been provided to you previously and will be provided to you going forward on a semiannual basis.

It's been enhanced since the last time it was provided to you to include a history of the changes in status since report date and management's target date for resolving the issues. And so you can see by looking at the summary that it's a high level summary of the individual issues and the status as it's progressing, target dates for completion.

It's also been enhanced to provide detail for any particular issue. And I provided you a couple of examples, being issue reference 87 and 115. So if you look at audit reference 87 on page 4 of 7 of your summary, if there was particular questions about that, we could go to the detailed audit finding and changes in status.

And what that will provide you is the original audit finding and management's responses that was originally included in the report and changes in status since that point in time with any of management's comments relevant to the subject with their planned implementation dates.

My intention was not so much to provide these
on a regular basis. I have no intentions of providing
them at all, unless there's a particular issue you would
like to discuss in detail. And then, of course, we can
discuss those in detail, or if there's particular issues
you just would like the detail on, I can provide that at
any time.

MR. CONINE: Any comments from the committee
members?

I've got one. This is a little bit much to
handle when it gets passed out --

MR. GAINES: When what?

MR. CONINE: When it gets passed out 30 minutes
ago.

MR. GAINES: I do recognize that. This
particular report -- you may recall at the last meeting, I
wasn't able to provide it to you. I've been going through
the enhancements I referred to.

MR. CONINE: Uh-huh.

MR. GAINES: I felt, in fairness to management,
I needed them -- needed to afford them plenty of time to
review the history up to this point, since it's never
really been reported in the past.

In the past, they'd give me status updates that
would go in my file and I was aware of them, but no one
else was. And I felt like, in fairness, I had to
distribute back out to management. That process took much longer than I was anticipating to get their feedback and incorporate it into the report.

Going forward, I can certainly appreciate that comment, though.

MR. CONINE: Well, I would -- in order for us not to try to miss anything or to at least keep track of everything that -- if there's a future date that management's targeting and that date may be three or four months from whenever the last report was and it gets kind of lost in the shuffle and so forth, probably what we ought to do with -- in light of this is to take it home, look at it, study it.

If there's any questions that we as committee members have, we can follow up either independently, or we can follow up in June at our next audit committee meeting, any specific questions we might have.

MR. GAINES: No, I'm glad you brought that up. One of my goals and intentions is for each of the audit committee meetings when this is presented, which is twice a year, is to solicit and, in coordination with the chair and the executive director, identify those two or three significant, old, outstanding issues that don't appear to be resolved or getting resolved, and those will be discussed in detail.
Of course, management will be informed that they probably need to be present to discuss the difficulties they're having in moving forward with those.

MR. CONINE: Are there any of those such issues for this report?

MR. GAINES: Yes, sir. Absolutely. There are. However, this is kind of what I consider the threshold of moving forward. I wanted to lay this out for everyone to be aware of what it is.

MR. CONINE: Okay.

MR. GAINES: I hadn't made any particular plans to discuss particular issues this time around, because I believe the approach to that is we need to look at these changes in status -- not me in the isolation, but as a team --

MR. CONINE: Right.

MR. GAINES: -- and focus. And of course, I can direct you to where I believe the more significant ones are, but I'd like to be in general agreement with that before we go into an audit committee meeting; plan adequately; let management be informed so they can discuss the difficulties they're having.

MR. CONINE: Is there anything that's on this report that needs to be highlighted to us today versus waiting, say, until June at our next meeting when we can
have management and everybody up to full speed that we're going to focus on some of these issues?

MR. GAINES: I do believe there's some old outstanding issues, and you can see that by the numerous status updates.

MR. CONINE: Yes.

MR. GAINES: One in particular, I believe, will be coming to our attention again here soon when the state auditors releases their report on their recent single audit, and that's compliance with all the 133, which is the audits of state and local governments and nonprofit organizations. This issue's been reported several years now.

MR. CONINE: Where are you? Where are you?

MR. GAINES: And, let's see. I'll have to zero in on that real quick here. (Perusing document.)


And you'll see there's just been two status updates. That's a little bit misleading, because you'll notice leading into the summary comment, I indicate that it's a repeat finding. So rather than have two findings saying the same thing --

MR. CONINE: Right.

MR. GAINES: -- it's at least a year older than it appears here. And this is what we've been
discussing today, the department's monitoring responsibilities.

MR. CONINE: Okay.

MR. GAINES: And so I believe that will be coming back up in state auditor's reports soon to be released.

MR. CONINE: Okay. Any other issues on this report that we need to handle today versus, say, in June?

MR. GAINES: I really don't believe we're in a position to handle any today. But --

MR. CONINE: Okay. Any other comments from the committee members?

MS. WILLIAMS: I'm sure -- in a lot of the information that's been provided to me that I received it, but could I get a copy of Circular A-133?

MR. GAINES: Yes, ma'am.

MR. CONINE: Ms. Stiner, any comments from management on this, on the status update?

MS. STINER: No, sir. Not beyond what David has relayed, is that for a Circular A-133 to meet all the general requirements of all federal programs, what we have discussed was building a risk assessment model for all programs across the board that has started with the compliance division, and -- according to information I've got, and it can be replicated across the board for all
programs.

So as we work toward the implementation across the program, all program areas, we can report back to you on how that's going.

But there are some general requirements that are required on the A-133 that -- I'll just stop there. David can tell you what all those are. Those have been communicated to the departments that's -- divisions that's responsible for federal programs, and there is a risk assessment model that IS is working with the compliance department to build for the compliance section.

As I said, that's -- I'm told that we can replicate that across the board. That assignment for ensuring that we have a department-wide focus on it has been given to [indiscernible], a position -- deputy executive director, for a high level of attention to it to make sure that it is implemented.

MR. GAINES: I would like to just point out in working through this and enhancing it to provide better summary information so you can really get a feel for what's transpired, I've worked with Daisy in various versions of this. She's been real supportive.

I think a lot of this is kind of news to Executive themselves as far as being old and outstanding. It's just hard to keep up with when you've got the issue
being repeated next year, and sometimes you lose track of how long it's been around. So I think this will serve us all well.

MR. DAROSS: I'd like a copy of Circular 133-A, also.

MR. GAINES: Yes, sir.

MR. CONINE: Okay. If there are no other comments on the -- on that issue, we'll go to the summary status of internal/external audits.

Mr. Gaines?

MR. GAINES: Behind tab C, just the summary that you get on a recurring basis. A couple of issues I'd like to bring to your consideration is the sunset review; the first draft report's expected this Monday, the 27th.

The next issue I'd like to touch on real quickly is the CMIS issue under internal audit reviews. This was Client Assistance Project that we took on when we recognized -- well, to begin with, HUD has had repeated comments towards us with different errors on the -- on their information system that the HOME Program uses, Cash Management Information System.

HOME staff has been working on this for an extended period of time. When we recognized HUD was expecting the department to convert to a new system June -- excuse me -- July 1 of this year and informed us

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we needed all these errors corrected, Internal Audit
decided we might ought to take a look to see why these
problems continue on.

Based on that review, we did come up with
several recommendations, and those related to establishing
control procedures over the data input to preclude the
recurrence of additional errors into the system,
accumulate and classify the types of errors that are being
identified in their resolution of the problems -- once you
identify them and classify them, you can start determining
the cause and develop policies and procedures to preclude
their recurrence, and then to perform a high-level
reconciliation between the CMIS system and the
department's accounting system to assess if the linkages
between the two systems that are designed to keep the
systems in agreement are, in fact, working as management
believes they are.

There's linkages that should keep the systems
in place. We're suggesting a high-level, bottom-dollar
reconciliation of the two systems to make sure we're
reasonably close, since this has been going on since the
early 90s.

And management's been receptive to those
recommendations. I really don't believe Internal Audit
has the resources to provide additional assistance in this
respect. We have no further plans or procedures in mind, other than ongoing monitoring.

Just for your information, the current status of the system, based on HOME staff, as of February 24, is that 87 percent of the issues have been resolved. That's up from 60 percent in December.

Of the 1400 line items on CMIS that need attention, 95 percent have been identified as clerical-type errors rather than actual errors. And the target date for completion is May 30 of 2000.

MR. CONINE: Okay.

MR. GAINES: Finally, I just would like to highlight note 1, and what I'm doing here is proposing to cancel the planned subrecipient monitoring reviews of the Housing Trust Fund in Section 8.

The internal auditing division believes that the department's programs need to consider and incorporate in their monitoring policies and procedures issues relating to the requirements of OMB-A-133, which is, again, the federal regulations of audits of state and local governments and nonprofits, and the uniform grants management system, which is a publication by the governor's office of budget and planning.

We also believe that the department needs to consider the results of the HOME report we just released,
whether similar circumstances exist in other programs and, if so, implement corrective actions when warranted. And once management is satisfied that they've incorporated these different criterion, at that point we'll reassess those audits in connection with our annual audit plan.

I believe, at this point, we'd have similar reports in many respects, and we're in a state of transition trying to acknowledge some of these previous considerations that Daisy had mentioned regarding the OMB-133.

MR. CONINE: Jim?

MR. DAROSS: Again, just a comment on that. I read that note and what it sounded to me like you were saying is you think there may be as many or even more problems like the ones you found in the HOME Program in other areas of the department, and you just want to wait until we get a department-wide review comparing it to the federal and state guidelines --

MR. GAINES: I believe they may be similar.

MR. DAROSS: -- then go back in.

MR. GAINES: I think maybe the comment, As many or more, might be an overstatement. The Home and Housing -- excuse me -- the Housing Trust Fund in Section 8 are much smaller programs with smaller staffs, so they got bigger challenges just to acknowledge and incorporate
this type information.

   So I feel like everyone's been put on notice
that these are things that we need to deal with as a
department. And I know Executive, in my discussions of
this report with them, have been supportive and, honestly,
I believe, a little bit -- as disturbed about the report
as you all are and maybe not aware of some of the
circumstances that we need to deal with.

   But I believe at this point we're moving
forward on it, and I'd like to afford the opportunity to
those programs.

   MS. STINER: Mr. Chair, may I share with the
committee management's response to that --

   MR. CONINE: Please.

   MS. STINER: -- and our discussions with Mr.
Gaines? I -- the Housing Trust Fund, as you know, is a
state-run program and A-133 is not applicable. But
certainly, the benefits that we have gained from knowing
where the problems are relative to the federal HOME
Program, we can certainly evaluate that against the
Housing Trust Fund, even though that's not a requirement.

   I think the same kind of principles relative to
operations, the same kind of principles relative to
monitoring, are applicable for the Housing Trust Fund
Program.
That, again, may lend itself to a broader oversight from the compliance division rather than trying to staff up the Housing Trust Fund, who, as you know, until recently has only administered about a million dollars.

I'm not trying to take away -- it's not as important to administer that program just as well, but we don't feel that we need to staff up and do the same kind of evaluation in terms of FTEs.

The support that the Housing Trust Fund will need to ensure that it's in compliance is probably going to come from the larger oversight of the compliance division.

So I think what we agreed to with David is rather than going through and doing the same kind of audit with a set of standards that's not applicable to the trust fund, we'll wait until we've completed the review of the HOME Program, which has a higher and stricter standard and make sure that the trust fund complies with those, even though it's not a requirement.

But at this time, I think it would be counterproductive and not a good use of David's limited staff to go through and do that kind of full-blown evaluation.

Relative to Section 8, as you know, that's a
program where we use vouchers and certificates, which is a little different from a direct construction program as a HOME Program. But the same set of thought processes that went into thinking that we'll see what we can get out of HOME and we'll apply it against those two programs, we'll do the same thing for Section 8.

Again, with the staffing level in the Section 8 program, we don't expect -- well, I wouldn't expect -- I don't know what the expectations were before me, but I don't expect that with the limited staff in Section 8 that you'll have experts down there who could take on these particular functions.

That will probably be something that we'll move up and assign to the department-wide compliance function that we have for other programs right now.

But again, we're in the process of this. I want to just tell you, as I've told David and his staff, I think this is a healthy process. I think a lot of time, a lot of attention is paid to production and just getting things out there and on the ground for our beneficiaries to use.

But we're held to a standard where we have to make good use, and we have a fiduciary responsibility to make sure that we're fiscally -- as fiscally sound and as fiscally successful as we are in getting housing on the
So we have began to look at that. We have begun to put in place a mechanism that we think will be responsive to this. And I just wanted to -- I think this is a good juncture to tell you as the committee and the board who David reports to that he's been very essential in helping us to find this. I think, as a department-wide basis, we've had that absent in terms of having that kind of internal control.

So working together with you, this committee, and the board and internal audit, we think we'll get there. We know that we have, with Ms. Cedillo now and working with Ms. Morris in the HOME Program, we know we're there, and we think once that's completed it will be applicable and we can apply it across the board to the Housing Trust Fund and Section 8 program.

So I told David that he'll introduce it and I get to add my two cents' worth, because we had an in-depth discussion about what would be the benefits of doing that. So we're hopeful that you can allow us to do that.

And, of course, he will be reporting back to you about how successful we are, once we have the results of the HOME Program, in applying that across the Housing Trust Fund and the Section 8 program.

We're not asking him to not look at it and step
away from it and not pay attention to it; we're just agreeing with him that it's probably not the most expedient thing to do right now, to do a full-blown audit of those two areas.

MR. DAROSS: I agree that the standard we ought to look at is not just complying with the minimum that's required by the regulations, but going way beyond that.

MR. GAINES: I'd also just like to point out that the state requirements are almost a carbon copy of the Circular A-133 also.

I'd like to reemphasize a comment Daisy said also, and that's this was my proposal to her and to you rather than Daisy's proposal to me, and I think you need to acknowledge that.

MR. CONINE: What was the time frame allocated in this year's plan to do both of these audits for your staff?

MR. GAINES: I believe each one was allocated 400 hours.

MR. CONINE: Give me a -- convert that to me. It's a couple months or --

MR. GAINES: Well, let's see if I can do my arithmetic here.

MR. DAROSS: Ten weeks, two and a half months.

MS. WILLIAMS: That would be ten weeks.
MR. CONINE: Two and a half months?

MR. GAINES: We usually have one --

MR. CONINE: But that's one person.

MR. GAINES: -- person dedicated full time to the project. And so for the most part, you're talking about 80 percent of 160 hours a month.

MR. CONINE: Is there -- aside from the full-blown audit that you had planned in both of these areas, is there a, for lack of a better word, a spot check you can go do, especially related to the Housing Trust Fund, and report back in June maybe with a briefing letter back to the committee or something along those lines as opposed to a full-blown audit?

MR. GAINES: I believe if the management of HOME recognizes this is something we want to do between now and June, you can make a review or an audit as focused as you want to, as -- restrict your scope to the extent you need to to fit your time frame.

And so if we had particular questions, such as "Do the monitoring tools consider the requirements?" you can answer that pretty easy. "Are they being applied properly?" takes a little bit more time, but it's something you could have a real restricted scope on and look at.

MR. CONINE: I mean, I can appreciate the
comments of fixing one will probably fix the other. On
the other hand, I know there's a lot of eyes looking at
the Housing Trust Fund from a statewide perspective, and I
think it's incumbent upon us to make sure we, you know,
run that program -- especially with the growth in it here
recently -- as efficiently as possible.

And instead of saying that we're just going to
put those two audits on hold and talk about them in later
life, maybe it's best just to reevaluate those in June and
to have an update from both of y'all's perspective on
what's happening in those two program areas over the next
couple of months to see if we may want to replan to do
that audit in the fall, let's say, as opposed to the
spring or some other time. Is that reasonable?

MR. GAINES: I'd say that's certainly
reasonable. We prepare our annual audit plan in the
summer, so at that time I would be trying to reassess.
That's a difficult process, because there's so many areas
to consider, and I'm relying on management, oftentimes, to
provide the information I need and, of course, they have
their workloads.

But inherent in that process, I'd be
reconsidering it. But I could go beyond mere
reconsideration and do a little bit more of a developing
and understanding of current processes. And based upon
that understanding, we'd be in a much better position to
assess the need to move forward or not.

MR. CONINE: Okay. Then we'll -- I guess -- I
assume the committee is in agreement. We'll take the
advice of your recommendations and maybe take another look
at it in June to kind of see where we are relative to --

I mean, to me, it's just -- you get the HOME
Program report and it's just all this stuff, and then
we're supposed to look at two others and we decide not to,
because we're going to focus on this other one. I want to
make sure we just don't lose it in the shuffle.

Is that okay with the rest of the committee?

MR. DAROSS: Yes. That's fine.

MS. WILLIAMS: Uh-huh.

MR. CONINE: Okay. Any other issues relative
to internal audits?

MR. GAINES: No, sir.

MR. CONINE: Moving on to the discussion of
external audit reports from the general purpose financial
statements, year ended August 31, 1999, we have Mr.
O'Brien.

MR. O'BRIEN: Good morning. I'm Mike O'Brien
with KPMG here to report on the external audit. Again
this year, the team is comprised of my firm, KPMG, and
Martinez Mendoza by Milo Martinez, who will report
momentarily.

The -- we basically do a joint audit. We both sign the opinions on all of the reports issued. It's basically a 50-50-type joint venture.

The focus of these audits that we're going to discuss this morning is financial statement presentation, basically. We're auditing the financial statements that the department issues which go to the state comptroller's office for inclusion in the statewide financial statements, also the financial statements that the department issues to the bond holders and bond trustees.

So it's really geared toward accounting principles and policies and disclosures in the financial statements.

KPMG focuses on the Revenue Bond Enterprise Fund, which is all of the bond programs. How we allocate the work, Martinez Mendoza primarily handles the rest of the agency, and then we review each other's work in order that we can all sign off on each other's procedures.

One change in the audit focus this year is that we're no longer doing the federal audit, the A-133 audit. The state auditor wanted to do that this year, and they have the authority to do that. So they're doing the federal audit work, so we will not be reporting on that today.
What I'm covering is tab F and G, which is the Revenue Bond Enterprise Fund, and let me just give you a little bit of information. The reason why you have a separate audit report on the Revenue Bond Enterprise Fund is to comply with bond covenants. There's bond covenants that require separate financial reporting on that activity that goes to the bond holders and bond trustees.

Tab F is the report for the audit committee, and this, again, just covers Revenue Bond Enterprise Fund. And I'll just say that the audit was very smooth again this year. We didn't have any audit adjustments. There weren't any disputes or disagreement with management over any accounting or financial reporting matters.

There weren't any significant or unusual transactions that we would need to point out. And that's -- there weren't -- oh, finally, there weren't any material weaknesses in the internal control structure, material weaknesses being items that we consider to be of significance that might cause a material misstatement in the financial statements.

We have issued a management letter, which Milo's going to cover momentarily, which contains comments and suggestions over things we noted during the course of our audit, but they're not material weakness items.
Tab G, I believe, is the actual financial statements. You've seen most of this -- these numbers already, so I'm not going to go through these in detail, just to point out that the first page is the auditor's report. That's what we're responsible for as auditors. It looks rather lengthy, but it is an unqualified opinion, which is what you want to have on the financial statements.

Fiscal year 1999 reports still require the year 2000 disclosure information that the Governmental Accounting Standards Board set forth, so that information is included in here. We don't audit that, because at the time we were doing the audit, that was something that may or may not have happened in the future, you know, and our audits are basically historical.

So that's what that paragraph says, that we didn't audit it at this point. It's pretty much a moot point, anyway.

Does anybody have any questions on any of that? Otherwise, I'm going to turn it over to Milo.

MR. CONINE: Any questions on -- for Mike on reports F and G in our folder?

MR. DAROSS: Not for KPMG. I'm going to address a couple questions to Ms. Stiner later, but they don't really --
MR. CONINE: Okay.

MR. DAROSS: -- need to be in this meeting.

MR. CONINE: Okay.

MR. O'BRIEN: Thank you.

MR. CONINE: Thank you.

MR. MARTINEZ: Good morning, committee members.

Milo Martinez with Martinez Mendoza and Garcia. The items that I'm reporting on are tabs E -- I'm sorry -- E, D, and H, and I'm going to cover D last.

What I'd like to cover first is E, which is your general purpose financial statements, and that's the entity-wide audit, and it's got all of your financials. Mike was focusing in on the Revenue Bond. This includes all funds, which you've got a couple of other proprietary funds that are in there besides the revenue bond fund.

One difference that you have this year that you didn't have in there last year is that the financials for the Texas State Affordable Housing Corporation are no longer included in the reporting entity because of the change in the relationship between the two entities and the boards and all that. So that's a difference from one year to the next.

The opinion on the overall financial statements, or the general purpose for the agency, is an unqualified opinion, so it's a clean opinion. And that is
on pages -- should be pages 1 and 2 of your -- actually, it's page number 1. And it's, again, a joint report, as Mike mentioned earlier.

Also, what we're mentioning in here is that the -- not only was our audit done in accordance with generally accepted auditing standards, we also have to follow government auditing standards for the agency.

And with that, we looked at your internal controls over financial reporting and your compliance with certain laws and regulations. One of the foremost that the state really likes for us to look at is your Public Funds Investment Act.

So we do have a report on pages of this tab on the last two pages, which are 47 and 48. It's also a clean opinion. In our testing, we didn't find anything that you were not materially compliant or that would have an -- a material impact on your financials. And also, in looking at your internal controls, we didn't find any material weaknesses in that area.

So other than that, that pretty much covers the highlights. There is an interrelation [phonetic] to opinion on other information in the report, the different combining information for the individual funds, how those combine in to make up your general purpose financials. And again, that's an interrelation to unqualified opinion.
That covers tab E. If we could go to H, which is the last, should be the last tab -- it's the letter on internal control and accounting procedures, which many of you may hear this referred to as a management letter.

We do have a few comments this year. We're also providing a status on -- for the prior year. On page 2, the first comment deals with internal control over cash receipts. And in our testing of that area, we believe that the controls could be strengthened over the incoming mail and cash receipts that are coming in. So we've suggested a revision of that and a re-look at that. So that's what management has responded that they're going to do to improve controls in that area.

In our test of the Public Funds Investment Act, we did note that the report was lacking maturity dates on each separate investment that's got a maturity date. And so, that, I think, has been implemented already and corrected.

There's a requirement under House Bill 1895 that state agencies or departments perform software license audits. And so again, we're recommending that as many different applications and changes and conversions and upgrades have gone through for Y2K and other things that it would be good to do that, so I think the department's working on that.
There is a significant new accounting pronouncement that's coming out, and it's Government Accounting Standards Board Number 34. It's going to make major changes into how your financial statements are laid out, how the reporting happens, how you account for fixed assets and other things.

And so you've got a few years to get ready, but it's going to make -- it's going to require quite a few resources to get that done. And so we're asking everybody to get started on it. It would be effective for fiscal year beginning September 1, 2001, so -- which would be ending August 31, 2002, is when that would be effective.

On the last page, you'll see the status of the previous year comments and a disposition. We had a comment on allowance for possible loan losses. That appeared to be resolved with the changes that we noted this year. The Y2K issues also appeared to be resolved and taken care of.

On the single audit compliance requirements, we were not able to report on those, because this year we were not in charge of the single audit. And you should be seeing a report coming forth from the state auditor in regard to those things -- I think you've already seen some of the status on some of your subrecipient monitoring.

So anyway, you'll be -- you either have
received other reports or you'll be receiving something from the state.

The last item is tab D, which is another letter on the conduct of audit. The one that Mike covered dealt with the bond fund programs. This one deals with agency-wide. There's not anything in here different than what you saw in Mike's, other than that our scopes were a little bit different because we were following government auditing standards.

But the area that is different that I want to focus on is in the -- on page 3 on significant audit adjustments. We did have two audit adjustments totaling $25 million. And basically, the department goes through a process each time of -- each year of collecting and estimating -- they've got certain actual information, and then the rest is kind of -- is an estimate of what the subrecipients downstream in your CDBG and HOME. Those are the significant ones that come up, and that -- for some reason, they've been an oversight that we caught in the audit.

So anyway, it's totaling that much. Other than that, everything else, again, was fine -- had full cooperation, and the audit went very smoothly.

At this time, if there's any questions, I'll be glad to answer any.
MR. CONINE: Okay. Any questions, committee?

Well, give me the nature, again, a little bit more on those $25 million adjustments, those two adjustments.

MR. MARTINEZ: What it is, is your downstream subrecipients that you pass your money through --

MR. CONINE: Right.

MR. MARTINEZ: -- they have to report in to you to tell you, We incurred expenditures through a certain, to our August 31 date. And sometimes they're slow in getting it in.

They may not get all the invoices to you for four or five months down the road. So every year, you go through a process of you pick up what's actual, what you already know, and then you do some estimating, and some of the estimating hadn't been completely finished.

I think it was just an oversight, but when I got the numbers -- as soon as I got the numbers, I said, These can't be the right numbers. We've got to have some more dollars, just because, historically, I know what your payables and what your receivables -- and basically, the transaction that occurs is that you record a payable to the subrecipient and you record expenditures.

But in the same -- then you go back and you record a receivable from the Feds and recorded revenue.
So you're fund balance doesn't wind up changing, because it's just a -- you record -- you recognize revenue when you recognize expenditures.

But anyway, the receivables and payables needed to be adjusted and revenue expenditures needed to be adjusted. And it was because that final adjustment had not -- and part of it, I think, was also the state comptroller wanted you to report some things differently to them and there was a different approach, and I think that's what caused some of the difficulties there. But again, they quickly acknowledged, Yes, we -- it was just an oversight.

MR. CONINE: Ms. Stiner, any comments relative to the management letter?

MS. STINER: No, sir, Mr. Conine. None.

MR. CONINE: We don't take in a whole lot of cash, I presume, on a daily basis?

MS. STINER: Oh, CFO said that it's all relative. We take in --

MR. DAROSS: Cash cash?

MS. STINER: -- cash for like --

MR. CONINE: But not cash cash.

MS. STINER: -- not in the area that he's talking about, the cash receipts.

Do you want to explain the cash receipts?
MR. MARTINEZ: I mean, there's -- we dealt with the checks. And I called it -- that may have been a little bit of a misnomer that cash -- that it's cash.

MR. DAROSS: Yes.

MR. MARTINEZ: But you do have certain days where you have a lot of activity on loans and things like that.

MS. STINER: Quite a bit.

MR. DALLY: Good morning --

MR. CONINE: Good morning, Bill.

MR. DALLY: -- Chair, Daisy and committee members. My name is Bill Dally, chief financial officer.

The cash receipts that come into the department are our home improvement and down payment assistant loan programs and some of our CDBG revolving loan fund programs. Those will come in from cities and from borrowers.

They will typically come in as either checks or money orders. My department -- they first come into the mail room. Those are opened up. The proper segregation of duties and controls means that two people work together on opening up that mail and recording those checks. In order to get some of the mail expedited, there have been instances where we didn't have -- or the checks are later logged in.
There are two people actually opening up and actually endorse, you know, for deposit only to the department's till. And then they're bundled together and then someone else in the mail group was recording those in a control log, and then those are brought up to us twice daily in accounting for deposit at the comptroller's.

We're working, and we made in our response that we're going to adjust those controls and report to you in April to the improvements. I think that is a short-term solution.

We're also looking longer term at seeing if we can't use a cash receipts lock box with Safekeeping Trust Company and see if that won't be -- because it will save us some FTEs and some time spent with cash receipts when really what -- the cash would -- they would collect it and give us the receipts so that we could make deposits and stuff. The cash would be even deposited more immediately.

So I think that's a long-term solution, but we'll -- short term, we'll address strengthening our controls in the mail room.

MR. CONINE: Okay. Any other comments from the committee members?

All right. We want to thank our external auditors for once again doing another great job.

Appreciate your help and support and analysis of how we do
business here at the department. Appreciate your hard
work and efforts.

Mr. Daross, I think -- did you say you had a
comment?

MR. DAROSS: I'm -- just -- I'll address them
to Daisy later.

MR. CONINE: Okay. Any other issues on the
external audit reports to come before the committee?

Just so I -- in my board packet last week,
there was the OIG's auditor report on the HOME Program.

Are we going to deal with that a little later?

MS. STINER: Yes, sir. It's -- we're in the --
we have responded to HUD. We've sent them an
implementation schedule. They've accepted it. What we've
done this morning is handed to you the most recent
correspondence on that and our time table.

I think I sent you a time table. But what you
have now in the packet that I've given the audit
committee, which will get mailed out to the full board, is
the response from HUD accepting that -- unless you want to
talk about some of the detailed findings and the time

Once we have a completed audit, it's -- we have
an opportunity to work with HUD on those outstanding

issues. The deadline for completing it is the next two
months. Without me looking at this --

MR. CONINE: Three months -- I think it says three in here.

MS. STINER: Three months.

MR. DALLY: Yes. I think about three months.

MS. STINER: So that probably coincides with the June --

MR. CONINE: June meeting?

MS. STINER: -- meeting.

MR. CONINE: Okay. We'll take a look at that then.

As I recall reading the minutes, another issue that was outstanding was the performance evaluation of Mr. Gaines. Have you had a chance to do that in all the hiring and so forth you've been doing lately -- or reviewing?

MS. STINER: I've done your job performance -- yes.

MR. CONINE: Okay.

MS. STINER: I've done so many of them. Yes. Yes. I got David. We'll share his with this audit committee. We'll mail you that when we mail the other packet of information.

MR. CONINE: Okay. That will be outstanding.

I know in my discussions with David, he was anxious to get
that done last time.

MS. STINER: We got it done.

MR. CONINE: I'm glad to hear that's done.

I'd also be remiss if I didn't congratulate the staff in the audience, some of who have recently received promotions or increases in job responsibility, and we're thankful that you've accepted those and look forward to working with everyone related to that.

Any comments along those lines, Daisy?

MS. STINER: Nothing, Mr. Conine. We, too, are just grateful that we've had several staff members who've taken on additional roles and responsibilities, and we're very fortunate to have the level of expertise we have in-house.

And we will expand it and adjust it until we get the right mix of people with various expertise in other areas. We think we have it here. We just have to do some reassigning and -- of responsibilities.

As I said, you may have heard me allude to it, to our smaller programs -- we certainly don't think we need to staff up FTEs. What I have committed to do and want to do is take advantage of a department-wide approach to this rather than, you know, an area approach, a division approach, and a section approach.

We think we can do well if we take advantage of
all of the expertise we have already on board. But it
does take a good amount of evaluation, a good amount of
auditing.

So one of the things I've committed to with the
human resource director, as I alluded to earlier, is a
department-wide audit of jobs just to see where we are,
and then we'll be able to determine if we do need a
different kind of expertise up to even making a request
for waiver of our FTE cap to get people in with different
levels and different kinds of skills.

But by and large, we're doing well. And I just
want to say we appreciate the effort that this audit
committee has shown. This is -- I shared with your
internal audit, it's been a long time since we had the
level of this kind of focus on it and we're happy for that
because we feel that it's very healthy; it's very positive
when we know what those issues are so we can approach them
from a focused standpoint.

So thank you for that and --

MR. CONINE: Okay. And also, I'd like to take
note that from the State Auditor's Office in the audience
is Nicole Marrera, and we're glad to have you here and
look forward to working with you as time goes on.

And also, Dr. Florita Griffin, yet another
board member, came in to the committee meeting. Good to
see you.

And do you have any comments for the committee before we adjourn?

All right. If there are no other committee comments, we stand adjourned. Thank you.

(Whereupon, at 9:35 a.m., the meeting was concluded.)
CERTIFICATE

MEETING OF: TDHCA Audit Committee
LOCATION: Austin, Texas
DATE: March 24, 2000

I do hereby certify that the foregoing pages, numbers 1 through 53, 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.

03/28/2000
(Transcriber) (Date)

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