TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

10:05 a.m.
Tuesday,
August 21, 2001

Room E1.012
Capitol Extension
1400 Congress Avenue
Austin, Texas

COMMITTEE MEMBERS:

C. KENT CONINE, Chair
JAMES DAROSS, Vice Chairman
MARSHA L. WILLIAMS

STAFF PRESENT:

DAISY STINER, Executive Director
THERESA CRUZ
BILL DALLY
DAVID GAINES
SID STRUSS
DELORES GRONECK
AGENDA

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MR. CONINE: Okay. We'll call the Audit Committee meeting of the Texas Department of Housing and Community Affairs, on August 21, 2001, at 10:05 a.m. First off, I think we'll call the roll right quick.

Mr. Conine is here as Chair.

MR. DAROSS: Here.

MR. CONINE: Ms. Williams?

MS. WILLIAMS: Here.

MR. CONINE: We've completed a quorum; all three of us are here.

Is there any public comment that we know of, public comment to the Audit Committee today?

(Pause.)

MR. CONINE: All right. Seeing none, I'll call for the close of public comment.

Action items: Tab Number 1, Presentation, discussion and possible approval of the minutes of the Audit Committee meeting on April 26, 2001.

MR. DAROSS: I move they be approved.

MR. CONINE: Is -- there's a motion on the floor. Is there a second?

MS. WILLIAMS: Well, I'll second, but I need to
abstain from the vote on that.

    MR. CONINE: You'll second but are going to
abstain? Okay. Thank you, Ms. Williams.

    All those in favor of the -- any other
discussion?

    (Pause.)

    MR. CONINE: All those in favor of the motion
signify by saying aye.

    (A chorus of ayes.)

    MR. CONINE: Aye.

    And opposed?

    (Pause.)

    MR. CONINE: None.

    And one abstention?

    MS. WILLIAMS: Uh-huh.

    MR. CONINE: The minutes are approved.

    Our report items, Mr. Gaines?

    MR. GAINES: Good morning, Chair --

    MR. CONINE: Good morning.

    MR. GAINES: -- members of the Committee and
Ms. Stiner.

    MS. STINER: Good morning.

    MR. GAINES: The first item on the agenda is
the recently released internal audit report on the
Community Services monitoring function. I'm going to turn
MR. CONINE:  Good morning.

MS. CRUZ:  Good morning, Committee members and Ms. Stiner.

MS. STINER:  Good morning.

MS. CRUZ:  My name is Theresa Cruz, and I am an internal audit manager in the Internal Audit division. I was the lead auditor on this project for reviewing the Community Services programs subrecipient monitoring function, and the resulting report is in front of you. I'm going to go over that report with you now.

The front page is just a transmittal letter, and it gives you a brief description of what the project was. It was on the Community Services programs, which are poverty-related programs, and gives you just a real brief rundown on what we found.

And the next page, which is the table of contents, gives you a more detailed view of what's in this report, covering the program overview, the executive summary, which goes into a little bit more detail of what our findings were, and then the specific findings and recommendations.

The next page is the program overview. The objectives of the audit were to assess whether the Community Services programs monitoring, reporting and
follow-up processes are adequate to ensure that the department awards are used for authorized purposes in compliance with laws, regulations and provisions of contract or grant agreements, and that performance goals are achieved.

The program overview gives you some more detailed information about the programs that we covered in our review; as I said, they're poverty-related programs: Community Services block grant, which includes a discretionary fund; the emergency services grant program and the emergency nutrition/temporary emergency relief program, which is a state program. The chart included on that page gives you the most two current years of funding for each of those grants.

The next page includes the executive summary, which gives you a little bit more detail about what we found in our review, and that's followed by the findings and recommendations in detail, which I'll go over with you right now.

As a result of the audit, we found that the Community Services program monitors are performing the monitoring function fairly well; they have a good rapport with their subrecipients, which include several community action agencies for Community Services block grant. And it covers cities and counties and, also, community action
agencies for the emergency shelter grant and mostly
counties, but, also, some community action agencies for
the entire program.

We did have some recommendations with regard to
monitoring of these programs. The first one was to
incorporate some existing in-house monitoring procedures.
There are in-house procedures performed on an ongoing
basis that Community Services management has not
recognized as part of the monitoring function in order to
determine what procedures should be applied to a
subrecipient on site.

For instance, there are monthly reports that
are reviewed every month that come in. There are
compliance audits going on with single audits in the
compliance division. There are just some general other
things that go on that Community Services doesn't
recognize as part of their monitoring function.

The next is applying monitoring procedures
based on assessed risks. The use of the monitoring tools
has not been risk-based, that is: Community Services does
not consider risk factors when determining the nature and
extent of monitoring procedures to be applied during on-
site visits.

Most of this would have to do with prior
compliance issues -- let's see what else -- and the
complexity of the program requirements for each
subrecipient to decide how they're going to apply
procedures when they go on site.

The next recommendation we had was to improve
their monitoring tools. At -- the monitors use
checklists, and they have -- they review Board minutes and
several other items when they go on site, and they do a
fairly thorough job that we could tell.

However, there's no documentation in the
monitoring files to support some of the responses on the
checklists used. On some of the answers, it's okay if you
say, Yes, No, or, N/A, but some of the questions, we felt,
required more explanation, and we didn't always find the
documentation in the files for that.

There's also no evidence in the monitoring
files that a supervisory review has been performed to
ensure findings are adequate and appropriately reported.
And the -- we feel that the monitoring checklist should be
expanded to include steps to ensure activities performed
by a subrecipient are eligible under program rules and
that performance goals are met.

The checklists include references to several
OMB circulars and regulations, and they cover most of the
general requirements, but we felt that they needed to
cover more specific requirements to the program.
We felt that they should improve their reporting procedures. Report distribution should be improved to include other areas in the department that contract with the same subrecipient more for compliance reasons. If one area's having a problem with a subrecipient, they probably should let other department programs know about that so that they won't contract with the same subrecipients or take steps necessary.

And then, finally, we feel that they should establish a tracking system to follow up on reported deficiencies. Formal procedures should be developed to follow up -- to track and follow up on deficiencies, and we didn't find evidence of that.

We have discussed these issues with the Community Services management, and their responses to our concerns are acceptable at this time. So if you have any questions for me, I'd be happy to answer them.

MR. DAROSS: Yes, I have a question --

MS. CRUZ: Yes, sir.

MR. DAROSS: -- on management's response to the improved reporting procedures and risk assessment, also. The response was that they would post the results of their reviews on the T drive --

MS. CRUZ: Yes, sir.

MR. DAROSS: -- which, as I understand it, is
an agencywide --

        MS. CRUZ: A shared drive.

        MR. DAROSS: -- shared drive that anybody can
access. Does everyone else in the agency know that you
look at the T drive in order to find out whether other
divisions are having problems with the same person you're
dealing with?

        MR. GAINES: I believe each of the program
areas has similar considerations, and there's not a
department standard whereby people would know where to
look. Posting the results of monitoring review, being the
monitoring report, would be a piece of that.

        You also have follow-up activities, the status
of prior audit issues and the resolution of those issues.

        There ought to be mechanisms in place to communicate that
throughout the department to those that need that
information to perform their job duties.

        MR. DAROSS: As I understand the way the T
drive works -- and I may -- I mean it's a very cursory
understanding, but, as I understand it, to look at results
of one of these surveys, you have to go into the Community
Services division's section on the T drive and then go
down to the different programs that you're looking at
before you can find information about a given
subrecipient.
Is there a way that somebody else in another division can just type in "XYZ Corporation" and get that information without having to go through the different layers of files or folders that you have to go through on the T drive?

MR. GAINES: Not at this point in time. I believe there are plans in connection with the database that's being built that presumably are going to accommodate that sort of request.

MR. DAROSS: Well, I would hope so, because you've got to make it easy for somebody to find that information --

MR. GAINES: And I'd say --

MR. DAROSS: -- without going through so much --

MR. GAINES: -- with or without the departmentwide database, that's necessary. And we need procedures in place for people to be able to do that.

MR. CONINE: Ms. Stiner, any additional comments related to the review other than what we've heard or has been written here?

MS. STINER: No, sir. The -- I understand from meeting with Mr. Gaines that management's responses are acceptable. With the additional comment that Mr. Daross made this morning, we'll ensure that -- I don't know what
the interim step would be other than our T drive right now. We just don't have the infrastructure to do it, but that's --

    MR. DAROSS: Right.
    MS. STINER: That's an observation that we'll keep in mind: Perhaps doing an agencywide announcement that in order to look at the history of compliance for the Community Services division, you'll need to go into T drive. But short of having the infrastructure, with Central Database, we'll have to go through those extraordinary steps other than what we were doing before, sending out e-mails and --

    MR. GAINES: I was going to say there are other procedures --
    MS. STINER: -- those in place already.
    MR. GAINES: -- that management tries to work with considering their system limitations, including, We're fixing to go out for an award with this subrecipient; is anyone aware of any monitoring problems relating to that, just going over the e-mail system. And that may work in instances, and it may not work, simply because e-mails are not always acknowledged in a timely fashion.

    MR. CONINE: It looks like we have target dates of either September or January for each one of your
recommendations. Is --

MS. CRUZ: That's correct.

MR. CONINE: -- that right?

MS. CRUZ: Yes, sir.

MR. CONINE: Just --

MS. CRUZ: Some have --

MR. CONINE: -- relatively --

MS. CRUZ: -- already have been partially implemented.

MR. CONINE: Relatively soon then?

MS. CRUZ: Yes, sir.

MR. CONINE: Any other comments, Committee members?

(Pause.)

MR. CONINE: Okay. Proceed on.

MR. GAINES: Thank you, Theresa.

MS. CRUZ: Okay.

MR. GAINES: The next item on your agenda relates to three recently released review reports for audits that have been released since the last Audit Committee meeting. I'll provide brief overviews of the results of these projects.

The first review I want to discuss is the HUD cooperative monitoring assessment audit of the manufactured housing division. The purpose of the review
was to review the administration of manufactured housing division's duties as the state administrative agency pursuant to federal manufactured home procedural and enforcement regulations. These are basically the HUD regs on manufactured housing.

The report concluded that the department, as the SSA, or State Administrative Agency, was adequate and substantially effective in administering the federal manufactured housing program. Adequate -- they basically have three ratings, and "adequate" is the highest rating --

(Laughter.)

MR. GAINES: -- per the audit language.

MR. CONINE: Way to go, HUD.

MR. GAINES: The lower categories would be "needs improvement" and "not adequate." The report concluded that the records are complete and well organized, that consumer cases are addressed in a timely fashion, that the visit they made -- to the dealer and manufacturer that the reviewers made appeared to be adequately monitored.

The report did offer six recommendations; since that time, one of the recommendations has been dropped by HUD. And management has indicated that each of those recommendations has been implemented.
The second review is the annual review of the FDIC Affordable Housing Disposition program, which is administered by the department's compliance division. The review was performed by the monitoring and compliance unit of the FDIC.

The report concludes that TDHCA continues to produce an exceptional work product. The report states that the department carries out its obligations of ensuring that the owners of Affordable Housing Disposition properties are complying with their land use restriction agreements and that the director of the compliance division and their staff continue to be the benchmark that FDIC uses to compare all other monitoring activities of the FDIC affordable housing program. There were no findings or recommendations noted for improvement.

The third report relates to an audit conducted by the State Comptroller of Public Accounts. The review is primarily of the accounting department's procedures relating to purchases and, to a lesser extent, the human resource division's procedures as they relate to payroll.

The report noted that the most recent audit conducted by the comptroller's office was in April of 1997 and that all issues identified by that audit have been resolved. While the audit included a limited review of grant and refund transactions, the audit did not
investigate the department's procedures used in awarding
the grants or in monitoring payments or the procedures we
use to monitor payments made to grantees.

Accordingly, no opinion was offered on those
procedures; however, nothing came to their attention to
cause them to have concerns in that area.

The primary purpose of the audit was to
determine whether certain purchases, travel, grant, refund
and payroll transactions of the department complied with
certain laws and regulations concerning expenditures and
with the processing requirements of the uniform statewide
accounting and payroll systems.

The department was commended on satisfactorily
resolving all monetary issues identified during fieldwork.
And this resulted in a zero error rate for this group of
transactions.

The audit did note several minor issues
relating to prompt payment, missing documentation and
incorrect payment amounts, and there were several
conditions that need to be followed up on by the
department.

These conditions included: Missing job titles
in headquarters on travel vouchers; incomplete designation
letters, which is also another travel voucher
consideration; incorrect comptroller object codes,
document types and the use of interagency transaction vouchers; incomplete payroll security and incomplete W-4 forms, and; noncompliance with internal policies and procedures. Management has responded that they've addressed each of these issues.

MR. CONINE: Okay. Any questions on any of the three -- I guess it was three -- external audits?

MR. DAROSS: No.

MR. CONINE: Move on.

MR. GAINES: Okay. The next agenda item is the summary status of prior audit issues. First, based on recent discussions with management, I'd like to make several updates or corrections to the summary report.

Issue Reference 34 on page 1 of your report should be classified as Implemented. Therefore you need to change the "DX" to an "IX" for Issue 34.

MR. CONINE: Okay.

MR. GAINES: The second issue is Issue Reference 136 on page 2. This should be classified as In process of implementation or "PX" rather than the "TX" that's indicated.

And the third issue is to Reference 64, or is Reference 64 on page 4 of your summary. And this should be classified as In process of implementation or "PX" rather than the "TX" indicated there.
MR. CONINE: Which one was that, David? I'm sorry.

MR. GAINES: Issue 164 of page 4 of your summary.

MR. CONINE: 164? Okay. All right.

MR. GAINES: With these updates, management has reported that they've implemented 13 recommendations, are in the process of implementing 14 recommendations and action has been delayed on one of the recommendations. I've specifically identified several issues to discuss with you; however, of course, we'll be glad to discuss any issue that you would like to.

Those I've identified for specific discussion relate to the prior material weakness finding on the HOME monitoring function --

MR. CONINE: What number, again?

MR. GAINES: If it's all right, I'll get to that in --

MR. CONINE: Oh, okay.

MR. GAINES: I don't have that right in front of me but --

MR. CONINE: All right.

MR. GAINES: -- that is Issue 217.

MR. CONINE: All right.

MR. GAINES: But I'm just going to categorize
what I'm going to plan on discussing, if that's all right:
The material weakness finding on the HOME monitoring
function, and three prior audit issues for which the
target dates -- the most recent target dates have expired
or the target date is not indicated, and one audit issue
for which the action has been delayed.

Of those categories, the first issue, being the
material weakness finding, is Issue 217 on Page 7 of 9.
This issue is actually at this point reported by
management as implemented; it relates to a material
weakness finding of the HOME monitoring function issued by
the state auditor's office in connection with their last-
year federal single audit -- Fiscal Year 2000.

The issue was a repeat comment from the prior
year, 1999; however, since the results of that audit were
not released until a significant portion of the following
year had expired by the time management started taking
corrective action, it was necessary for the SAO to repeat
that comment for the second, subsequent year.

According to management, the report was
substantially implemented by the end of Fiscal Year 2000
and fully implemented as of January of 2001. And I just
wanted to bring this issue to your attention because it is
a significant issue, and the state auditor's office has
the responsibility to follow up on the status of that
issue during the current year audit, for which they're in
the planning process right now.

And so as a result of that audit, we'll have a
current, independent assessment of the status of that
issue. That will probably be sometime in late fall or
early next year.

MR. CONINE: But as far as we're concerned,
it's implemented and --

MR. GAINES: Yes, sir.

MR. CONINE: -- we're right on course? Okay.

Good.

MR. GAINES: Okay. The next category relates
to target dates that have expired or are not indicated,
and there are three issues reported in this category.

The first issue is Reference 136 on page 2.

This issue relates to the recommendation to formalize
processes to identify and capture monitoring-related
information that should be used to monitor and evaluate
the performance of subrecipients, to plan and track the
results of monitoring reviews and to share between
departments programs. So it's real similar to what we had
discussed on the compliance monitoring function -- excuse
me -- on the Community Services.

You'll note in the internal audit comments
section there on your summary report that the HOME and
Housing Trust Fund are tracking necessary monitoring information and that energy assistance and Community Services have been working with the information services division to incorporate electronic processes to gather this information and that Section 8 needs to incorporate formal monitoring processes as a first step in being able to accommodate this recommendation.

And the Internal Audit division just reiterates the needs to formalize these processes and to make the information available, the same issue we were just discussing in the prior report.

MR. CONINE: Is this kind of a case of the chicken and the egg? Can you formalize the process -- and I would presume that would mean some sort of written process -- without having the final software system or the T drive, or whatever, in place and operational? Can you do that?

MR. GAINES: I may have an oversimplified view of the obstacles management faces -- I haven't sat in their seats. But it seems to me that much of this information can be captured on Excel spreadsheets -- We got these outstanding monitoring issues, and we followed up on them. As of this date, the status of these issues -- similar to my prior audit issue report, and that be made available on a regular basis to others in the
I believe one of the biggest obstacles in moving this forward is that -- each division -- each program is trying to assess for themselves how to implement this, rather than take a departmentwide approach to dealing with it. And a system is exactly that. And a five-column pad is a system, and this kind of information can be accumulated on that. Of course, it's preferable to have a nice, automated system to provide this information.

MR. CONINE: Ms. Stiner has been floating around for 18 months or so.

Do you care to comment on his comment?

MS. STINER: I wouldn't care to comment on his comment. I hope we don't go to using columns -- the pad to keep up with the information.

MR. GAINES: That's right.

MS. STINER: But what each division has done is created a system within the division. Now, while that's not preferable to having it department wide, Mr. Gaines and I have talked about this on several occasions, and what he has proposed as an interim step is someone in charge of it on a departmentwide basis.

As soon as I can figure out how to come up with the resources to do that, I will. But in the interim, we are working toward a centralized database, which is a
system that would get us what we need.

But in the meantime -- he is correct; the
department -- the programs are doing it at the department
level -- we'll just have to figure out how to get a
departmentwide SOP, so that everyone will know where to go
to get that information, as an interim step.

So that's what I have to add. It's a real
difficult position to be in; as Mr. Daross has pointed
out, it would take some diligence on the part of every
other division to make sure that they know where to go to
get that information, but I think that's manageable.

And it's something that we certainly will work
toward in terms of implementation, but in the interim,
each of the divisions, in my opinion, have done it; what I
have learned is that not everybody has reduced it to an
internal SOP within each division, which should be done,
and then that can be shared across the department.

MR. GAINES: And I'd encourage the
departmentwide SOP. I believe that needs to include what
types of information to be captured. That's being decided
by the individual programs.

Some -- maybe some programs see value in
reflecting the current status of a recommendation on a
summary sheet, where you can see the status of all issues,
while others are actually maintaining that information in
a manila folder in a file cabinet. So it's real inaccessible.

MR. CONINE: Yes.

MR. GAINES: You know, on what types of information should be accumulated, identify the appropriate information. And each program basically has this monitoring responsibility, and you'd have similar information needs, which would be receptive to a departmentwide policy on, What should we be capturing, and what should we be tracking?

MR. DAROSS: We should not ever be in the position where the left hand doesn't know what the right hand's doing within the department.

MR. GAINES: And that sums it up real well.

MR. CONINE: Okay. Can we -- these are the three -- you're going over three things without target dates on them. Is --

MR. GAINES: With either the most recent target expired or it's not indicated.

MR. CONINE: Well -- and it's not finished, obviously, based on -- if it was finished and it was expired, we wouldn't have a problem. But the task isn't finished.

MR. GAINES: No, sir.

MR. CONINE: And we need, I guess, to come up
with a target date that we can -- because this has been there since the first part of 2000 -- and see if we can come up with an SOP that would get this all across to the department, as opposed to each independent division. Do you --

MS. STINER: Yes, sir.

MR. CONINE: -- have anything to add to that?

MS. STINER: I think that's -- yes, sir, what's what I -- well, that's what I shared with Mr. Gaines when we had an opportunity to look at this. In the departments' or divisions' representations and reports, they are reporting it as implemented. Because it needs to be looked at from a departmentwide standpoint, I asked them to change the status back to in progress so that we could develop a departmentwide SOP.

Other than me coming up with a date right here, I'll visit with him to see, you know, what date, you know, we can get --

MR. CONINE: Okay.

MS. STINER: -- unless you all want to assign a date now.

MR. CONINE: No. That's fine.

MS. STINER: It's something that we can get to in a short period of time.

MR. GAINES: And I'd just encourage that
discussions with management would be -- they'd be able to, you know, share a reasonable target date with us.

MR. CONINE: Okay. Next?

MR. GAINES: Okay. The second issues relates to Issue Reference 119 on Page 3 of 9. And this relates to the need of the department to establish joint monitoring or -- excuse me -- the staff's procedures to conduct joint monitoring visits of subrecipients that administer multiple programs of the department, conduct those visits simultaneously rather than monitoring each program separately or individually.

In a similar sense, the SAO, state auditor's office, reported in one of their reports that the department could improve its oversight responsibilities and monitoring-related costs by doing this, monitoring multiple programs simultaneously.

MS. STINER: Excuse me, David. What number is that?

MR. CONINE: 119.

MR. GAINES: This is Issue Reference 119 on Page 3 of 9.

[indiscernible] reports that a standard operating procedure relating to monitoring has been developed. This SOP includes a consideration of the joint monitoring visits.
The most recent status update that I have received indicates that it's being field tested. Since that update, in discussions with management, I understand that we're backtracking and going back to the drawing board because of changes in the organization relating to CDBG being pulled from the department.

And so we've kind of taken a couple of steps back, and there's different portions of the SOP that need to be thought out in that respect. And management is -- I guess that's in their in box, also, in dealing with that.

The third issue is Reference 164 on page 4 of your summary. This issue relates to the Housing Trust Fund improving its financial management reporting systems for financial monitoring purposes. You'll note that management has reported that it's tracking de-obligated funds, funds at risk of lapsing, construction amounts versus level of completion.

In previous status updates, management has reported that they've updated their database to track contract expenditures on an ongoing basis and their intent to reconcile the general revenues and local fund expenditures to fund balances. These were all portions of the recommendation.

Management has also recently reported that they've -- which is the cause of your reclassification
there: They have established formal procedures for conducting the financial analyses and reviews of funds available for awards, funds at risk of lapsing, expenditure rates, and trends at the program and project levels.

So they've established the procedures to do so in that respect. So they have the financial information, and they have the procedures. The remaining portion of this finding as to why it continues to be classified as in process at this point relates to establishing formal procedures for alerting management when corrective action is needed and establishing procedures for reporting unfavorable conditions to executive management.

MR. CONINE: So the last portion of your comment there that the finding will be dropped from future prior audit issue reports, is not --

MR. GAINES: That was prior to the reclassification --

MR. CONINE: Right.

MR. GAINES: -- process. And --

MR. CONINE: They'll stay on there?

MR. GAINES: -- those comments are at this point being superseded by my testimony today.

MR. CONINE: Any questions, Committee members?

(Pause.)
MR. GAINES: The next category of issues that I believe we need to discuss are those classified as "Action delayed." And this classification implies that management agrees with the recommendation but has delayed implementation for certain reasons. And there's one issue in this category. This is Issue Reference 187 on Page 5 of 9.

This issue relates to the need of the Section 8 program to establish a family self-sufficiency program or for the need to request an exception from doing so. Our management has reported they have requested that exception from HUD, and we're pending -- the action has been delayed, pending no [sic] response from HUD.

MR. CONINE: We've gotten a letter from HUD -- it looks like on July 10 -- stating that they're taking their time analyzing whether or not we'll get the exception.

MR. GAINES: The way I understand it at this point is that they haven't made that decision. So that would be --

MR. CONINE: Have you had some --

MR. GAINES: -- a good inference.

MR. CONINE: -- communication -- verbal communication with HUD?

MS. STINER: Yes, sir. The staff of Section 8
has been working closely with HUD. In fact, a proposal
that we had sent to HUD to use for the self-sufficiency
plan was not approved because the organization we wished
to enter into agreement with decided to create their own
housing authority.

So HUD has worked very closely with the staff,
and suggested that perhaps the route we needed to take was
to request a waiver. And so we have been working with
them. I'm expecting that they'll give us an answer
shortly.

I just want to add to this. It's complicated
by the fact that the department operates a very small PHA
and we've been classified as a PHA relative to other PHAs
across the states.

So I think that's why HUD is considering to
give us a waiver of that, because we don't do case
management that's similar to other agencies', although we
do have local operators out there, but -- because we're
not able to designate, you know, a staff or local operator
to do it for the entire state.

And, plus, our certificates and contracts
are -- we have one with Dallas, we have one with Houston,
and we have one with San Antonio. So it's a little
difficult to get a plan that would work for all of them.
We had anticipated that we could enter into an agreement
with the Austin Housing Authority to do that on behalf of that, but that didn't work out, either; they proposed a fee which we aren't able to pay.

So we've kept HUD informed of this as we've gone along. They've been very helpful, and they've been here on a couple of occasions to offer technical assistance. So we are in step with HUD on this, and we expect back from them very shortly on that.

MR. CONINE: Any other questions relating to prior audit issues?

(Pause.)

MR. CONINE: Okay.

MR. GAINES: If you will, turn to the next agenda -- on the next agenda item. It's the summary status of internal/external audits.

MR. CONINE: Is that pass-out not in here?

MR. GAINES: Yes, sir, that's correct. It updates the version you have in there to reflect a program-specific audit of the Section 8 program that, for some reason, I did not get on the original summary. And that's the first audit listed there.

You'll -- it is the Section 8 Program program-specific audit that was required of the department pursuant to HUD's monitoring letter last year. And the department expects that to be completed sometime this
month.

MR. DAROSS: I believe it was last month or maybe the month before when you reported that you were recommending that the internal audit -- Section 8 audit be deleted for lack of resources. Is this external audit a substitute for that? Can it be viewed as something that gives us enough information that we know what's going on with Section 8?

MR. GAINES: Yes. And that was a big consideration in me identifying that audit as one to -- that would be reasonable to drop, recognizing that this program-specific audit was in process and going on. And I'm surprised I didn't actually refer to it; I was looking for good reasons to drop that.

MR. DAROSS: Okay.

MR. GAINES: The next several reports -- the state auditor's office and Deloitte and Touche and their subcontractor, Garza, Gonzales and Associates, are in the process of planning their annual audits of the department.

The next audit listed is the Health and Human Services of the Community Services block grant program. This review has been tracked since last summer.

I believe their original planned report release date was June of 2000. Based on discussions with management, at this point, they do not believe there's
ever going to be a report released on that project, for
whatever reason. And accordingly, I'm dropping it from
the status report unless further information comes to
light that would cause us to believe otherwise.

The following three reports listed are the
reports I've previously discussed, by the comptroller's
office, the FDIC and the HUD report of the manufactured
housing division.

For the internal audits that are listed,
Theresa Cruz just presented the results of the
subrecipient monitoring of Community Services programs.
And the final project there, which is also the final
project on our amended audit plan, is the single-family
lien procedures. And we're expecting completion of that
project by late September.

Any questions?

(Pause.)

MR. GAINES: Okay. The next few agenda items
just relate to information requests that have previously
been made by the Audit Committee. The first issue is the
loan status report on down-payment assistance funds. In
discussions with management -- I'd like to pull this out
of the agenda. Management would like additional time to
assess the information and provide the summary at the next
meeting.
This came about by a request from you, Mr. Conine, in regard to an adjustment made to the allowance account by the external auditors during last year's audit.

In connection with a recommendation also made by the department's external auditors for Fiscal Year 2000, last year, the department should begin planning and be prepared for full implementation of GASB 34, which is the new reporting standard for governmental organizations.

This standard applies to financial reporting on the financial statements, and it will be effective for the department's financial statements ending August of 2002, which will be released in the fall of 2002. And I was going to turn this issue over to the department's chief financial officer, Bill Dally, to provide an update requested by Mr. Conine by the end of the year.

MR. DALLY: Good morning, Mr. Chairman --

MR. CONINE: Good morning.

MR. DALLY: -- members and Ms. Stiner.

MS. STINER: Good morning.

MR. DALLY: To bring you up to date on the -- oh. I'm Bill Dally, chief financial officer.

To bring you up to date on GASB 34, that will be -- we will issue a financial report in December, which will be for our ending this August, that will not be GASB 34. So in about 15 or 16 months, we will issue the new
report under the new model.

We are working with -- this is going to be a statewide project. The comptroller's working to get the whole plan -- they want to have an unqualified opinion on the state as a whole. So we will be working in tandem and in connection with them.

We'll also be working with our new external auditors, Deloitte and Touche; as we go through the audit of this year, we'll be discussing items that need adjustment and change for the new reporting model.

I do want to tell you: I wish that was all. If we were going to stay the same entity that we are ending this year going into the next year, it would be a little bit simpler. But that's not the way it's going to be.

We're going to -- through the period of this next fiscal year, we will be breaking off and having the CDBG funds and some of that leaving, but there will be a portion of the year where it will still be part of us. We will also be sort of a bit of a subdivision within ourselves just for the manufactured housing division.

So all of those things are even more immediate because there will actually be a transfer of assets and resources as far as CDBG and local government services going to the new agency. At the same time, we'll still
need to administratively support them.

So those are a little bit more on the front burner for me because that's coming even before we report. But we'll be factoring all that in as we prepare.

MR. CONINE: I guess my --

MR. DALLY: Any questions?

MR. CONINE: Yes. What my specific question related more to is, Is the implementation of GASB 34 going to require any procedural changes on the department's part, or is it just going to require the financial statements to be reporting the existing procedural documents in a different manner?

MR. DALLY: For the most part, it's going to be showing it in a different manner. There will be governmental -- government is going to be moving towards full accrual.

And a lot of the accounts and some of the things that we've had over in the fixed asset account group and general long-term debt are going to go away. There are going to be liabilities and assets that are going to come onto the books of the governmental funds.

MR. CONINE: Sure.

MR. DALLY: Now, our particular department has both the proprietary funds, which have always been full accrual -- those bond funds and the tax credits and all
those things have been full accrual -- and the assets have been depreciated. But any of the funds that -- previously that were paid for out of general revenue or federal funds have not been. So those things are going to be coming onto the books, but it will give it a different look. As far as --

MR. CONINE: The --

MR. DALLY: Does that answer your question?

MR. CONINE: Yes, I think. I -- again, where I'm heading is that I wanted this discussion to take place prior to September 1 because, if there were any procedural differences that would help you meet the requirements of GASB 34 that the rest of the department can do, either in the cash management or the -- you know, whatever it happened to be -- because I hadn't read it yet but I knew you had -- then I'd want to implement those procedural differences now, rather than waiting until December or January and waking up and saying, Oh, my gosh, we need to change this; we've been doing it wrong for three or four months.

And that's what I was primarily driving at with the request for you to report back here.

MR. DALLY: I think we're in good shape as far as that's concerned.

MR. CONINE: So I can take your word for it?
MR. DALLY: Yes.

(Laughter.)

MR. CONINE: Good.

MR. GAINES: Would you agree, Bill, that this is primarily an -- accounting and reporting changes, as opposed to operating procedures?

MR. DALLY: Yes. Well, what's going to happen is -- just to be real brief, with GASB 34, you're going to see major funds and major activities and, particularly, things -- government does some things, and we collect fees. And this agency does that, but that doesn't defray all the cost.

But you are going to see the activities and some of those fees, and you'll see what part of the cost is defrayed by those fees and then what's remaining and paid for by general revenue funds or transfers, per se. But it's to give it a new look, you know. And like I say, government's going to be on full accrual. We're going to put the assets and have depreciation and those kinds of things.

MR. CONINE: State government is?

MR. DALLY: Uh-huh.

MR. CONINE: What about local government?

MR. DALLY: Everybody.

MR. CONINE: Everybody?
MR. DALLY: Everybody's moving to --

MR. CONINE: Everybody?

MR. DALLY: Well, the Feds? I don't know.

MR. CONINE: All right.

Any other questions?

MR. DALLY: I don't think anybody has audited or issued opinions on their books.

MR. CONINE: Any other questions of Mr. Dally on this issue?

(Pause.)

MR. CONINE: Thank you, sir.

MR. DALLY: Okay.

MR. GAINES: Thank you, Bill.

The final Audit Committee request, also from Mr. Conine, relates to the results of the security audit referred to by Mr. Struss, during the last Audit Committee meeting, our director of information systems.

(Pause.)

MR. GAINES: And I'd like to turn that over to Mr. Struss -- oh.

Okay. I thought you had left on me.

MR. STRUSS: No. I'm still here.

Good morning, everyone.

MR. CONINE: Good morning.

MS. STINER: Good morning.
MR. STRUSS: My name is Sid Struss; I'm the Director of Information Systems. And, I believe, on my last report, I indicated some of the security implementation procedures that we -- had taken place in information systems.

And, Mr. Conine, you had asked that we give a little bit more of a detailed report when we came back as far as some of the preliminary work that we did and then where we are right now. And I believe this document made it to one of the books here or --

MR. CONINE: We're getting it now.

MR. STRUSS: And, basically, in September is when I came on board. I did my own independent security audit and found what I thought were some very serious concerns with the security.

At that point, in October, we brought on an outside consultant to do a security audit and take his findings and match them up with mine before we made any strategic plan as far as what we wanted to implement. And the outside security audit found most of the same things that I found, but they also found a few more things that we needed to accommodate.

Then, in November, what we did was -- the entire agency -- not to get technical, but the entire agency was on their own address for the internet. That
meant everybody had their own address on the computer.
This was easy for any hacker out there to actually get
into our system.

So to protect that, we started giving out
different addresses from the computer to everyone when you
signed on in the morning. So your address was never the
same, never a fixed address. So by doing that, we closed
one of the security loops.

In our infrastructure upgrade of which the
agency was -- worked very, very closely with information
systems, because we needed to do some infrastructure
upgrades that require certain capital expenditures. And a
lot of folks forgo the purchase of PCs and so forth to
say, We've really got to do something about the
infrastructure.

And what we did -- we went out and -- one of
the pieces of equipment was being used as a security
firewall. And I'm sure you've heard that term used
before, but it was really a work-around for security. So
we bought the necessary equipment and actually put the
necessary equipment in there to block certain people
trying to get in to damage the agency.

Then, in April, what we did -- what we
performed was on our e-mail server. And one of that was
that -- and many state agencies recently got hit by
this -- was that we blocked certain extensions on files. EXE is an extension on files, just as an executable file.

By taking this approach in April and May -- most recently, you've probably read in the newspaper of the Code Red virus, and you've read of the Sircam [phonetic] virus. Our agency was hit, I mean, substantially by these two viruses.

Many state agencies lost a substantial amount of data, which they had to restore from archives. Our agency was able to actually -- because of all of these measures that we made, we were actually able to stop both the Sircam virus and the Code Red.

The -- what we have noticed over the course of the last year is that these viruses and these hackers have become smarter and smarter. We've been studying. A lot of this is coming out of China. This is where the Code Red virus is coming out of, and it will continue -- it continues to get smarter.

On the Code Red virus, what we did was -- we actually in our infrastructure upgrade put certain monitoring programs in effect that makes our pagers in our information systems division go off. We actually go look at the box, and we see the attack taking place.

The first time the Code Red virus hit us -- which was a total different virus -- the pager went off,
and we were able because of the monitoring that we had set up in our strategic plan -- was able to actually get in there. We shut the web server down that we had for the agency for an hour, got ahold of the necessary vendors, got the patches, applied those patches and then brought the server back up.

So as far as the impact on the agency, we were down for approximately an hour. Other agencies were down three days or five days. It was a tremendous hit by the virus.

One of the things that we want to do is -- we expect these attacks to get even more numerous and get smarter because what they try to do -- they -- when we apply these patches, they learn these patches and then they work around these patches.

One of the final things: We probably have -- in an overall DIR-performed security survey, you might say, we ranked at the very highest that was recently done. As far as agency-secured -- as far as the agency's knowledge of security, not just information systems, we went to various managers within the program areas.

We selected them, and they responded to this survey. And when the survey was all put together, our knowledge and concern about security was one of the highest of all state agencies.
One of our final plans to do is that -- we've been working with the state auditor's office. DIR actually has a -- what they call a security audit. Now, we think we have everything in place, but there may be things that we have missed. And DIR actually charges a rate -- they send a contractor, Sprint, out and charge a rate of $7,000.

The state auditor's office will do the -- perform the same security audit at no charge to us. And we've been working with the state auditor's to consider having them run a final security audit of our overall system to make sure whatever we need to do to give that final, little -- I guess we're looking for perfection here. We want to make sure it's completely secure.

This is a very -- security in an agency is an un-visible thing to executive management, to middle management, and to whatever. People don't see what actually has to go in and take place. And because of that, we put so much effort into it -- and it's not visible -- as an example is the central database; it's very visible -- we want to show results.

We want to show where we're going. People ask questions like, How are you doing on that project? But we don't want to lose the sight that security is an unrewarding task but a very important task.
And the state auditor's -- the reason we want to get with the state auditor's is we want to have that last -- not so much from an audit standpoint to let your -- that you need to meet certain issues, but more from the standpoint to make sure that we have not left anything uncovered to get ready for the next fiscal year to protect all the State's assets at TDHCA.

MR. CONINE: That sounds wonderful. I'm pleased to hear those reports. And good job over the last 12 months. It sounds like we're getting there.

Any questions from anybody?

(Pause.)

MR. CONINE: Ms. Stiner, would you like to comment on anything?

MS. STINER: No, sir.

MR. CONINE: Thank you, sir. We appreciate that.

MR. STRUSS: Okay. Thank you.

MR. GAINES: That concludes the agenda items.

Any further discussion?

MR. DAROSS: This is just kind of a general question. I know there was several changes that you made or had us write in on the report items on prior audit issues.

MR. GAINES: Yes, sir.
MR. DAROSS: Generally speaking, how timely is the response that you're getting from the various management entities to your requests for information so that you can put them into reports for us?

MR. GAINES: Basically, on this -- I'll just use this time around as an example. I believe the date of that report you have in front of you is approximately a week ago. The date I actually printed it out and delivered it to Delores for inclusion in the Board books was a week ago.

And I had, oh, given management notice that this is what I was reporting to the Audit Committee several days prior to that point in time, and I'm guessing -- estimating it was a week at that time. So I believe it was two weeks ago that I notified management of the changes or the -- what I -- my planned presentation was.

And since the information was distributed to you in the Board book, any changes that have occurred have been due to input since that point in time from management. And so I guess the short and long of it is that I, in this case for the most part, got responses from management and incorporated that in the printout you see in front of you, and since that point in time, the classifications have changed to how I've updated them.
So yes, I got the input, but yes, it's also changes.

MR. DAROSS: Now -- and this ties in with a lot of other things that we've talked about in terms of timing of -- for instance, we've talked about this a lot on the tax credit information to the Board.

Given the fact that you -- you know, we have to be sent the information at least a week ahead of time for public notice purposes, and given the fact that you need to give management enough advance time that they can get comments back to you before they can be put into the Board books, is there any way to establish like an absolute deadline schedule by which, number one, you have to get your proposed report done and to management and then an absolute deadline by which they have to give you responses so that we can get the most current information in our Board books?

MR. GAINES: I think there's generally always a way. And I guess what I'd like to see in this respect is, in instances where there are last-minute updates or changes, that I, rather than go through the cumbersome process I did of manually changing them, inform management that they can respond with the input they're providing me to the Audit Committee, and we'll work off the information that I had originally presented to Delores.
And, you know, when I do present that to Delores, as I had previously said, I try to give management a heads-up generally -- and, I believe, in this case, at least a week -- to let them know, Here's where I'm at, and this is where I'm going.

MR. DAROSS: Is it possible to get that heads-up kind of notice sent earlier, or is that -- is your notice dependent on getting information from management so that you can give them a heads up? In other words, is this a circular kind of thing?

MR. GAINES: It's a little circular. When I request input from management, generally it's always a week. Sometimes, if I have the time, it's two weeks. And I guess I have the time; I just need to send out my requests earlier. So the status would be a little bit more outdated, but I'll allow management a week to respond by my due date, at least, and sometimes two. And so I can just continue to push that back up.

So if we're having an October meeting, I could request status updates wherever that falls, in mid-September or earlier, and that would maybe preclude some of that.

I think -- I'm not sure to what extent -- when management gets my heads-up memo, This is the way I understand things, and this is how I'm going forward with
the Audit Committee, presumably that's looked at and
management is -- becomes satisfied with it. But at least
this time around, there was last-minute changes going on.

MR. CONINE: Ms. Stiner?

MS. STINER: I think I'd like to comment on
that. What that process needs to include, as well, is a
more formalized process where, even when management
reports back -- because I think David and I -- when we had
an opportunity after my being away for a week, we finally
got together. And executive was given an opportunity to
review management's responses, but there were some that we
didn't concur with.

So we need to build into that process an
opportunity not only for management to respond to Mr.
Gaines' internal audit but for -- also, for executive to
work with management to change any responses that we don't
concur with, because there were some in there that I think
were just simply a matter of formally implementing some
procedures that management said they had in place and that
we were going to close on a report, but that status could
have been improved, in my opinion, by just formalizing and
reducing those procedures to writing.

So we will work with the internal auditor to
build into that time frame a review process whereas
management and the executive office can also visit on
those statuses.

MR. GAINES: Yes, Ms. Stiner. And I agree with you and all that you've said. One thing that hasn't been happening very well that needs to happen is -- included in my request of management to respond, I have a direction that their responses are really responses on your behalf and that they should obtain concurrence and allow the Deputy ED the three-day turnaround time to review that before the system's updated.

So that hasn't really been happening too well. Some divisions manage to make that happen while others don't.

MS. STINER: Well, we're going to make sure that it happens real well.

MR. GAINES: Right. And, again, that's more at the, I guess, manager and director's level, where I try to allow some interface time with executive that -- I guess people get in bottlenecks and bypass that particular aspect of it.

MR. CONINE: Okay. Any other questions of Mr. Gaines?

(Pause.)

MR. CONINE: We appreciate your report. And -- do you have one more item? Okay.

MR. GAINES: This isn't so much an item. I'd
just like to suggest -- we have an annual report that's
due out of our office November 1 of each year. And this
being August, I'd like to just suggest our next meeting be
in October if we can put it off to that length. Our next
audit to be released is probably going to be late
September, so I don't see that we're going to be able to
get that released prior to the September meeting. And
so --

MR. CONINE: All right.

MR. GAINES: -- if that will accommodate, then
we'll --

MR. CONINE: We'll probably concur with that.

And --

MR. GAINES: Okay.

MR. CONINE: You know, I, from -- I guess,
speaking for the rest of the Committee members, since none
of us knows whether we're going to be here at that time,
we appreciate all your efforts and work, along with the
staff's and the department's in general, in trying to
update the Audit Committee on its -- to its best and,
hopefully, improve the procedures that we've put in place
over the last couple of years.

MR. GAINES: I appreciate you all's input and
support.

MR. CONINE: The Audit Committee stands
adjourned.

(Whereupon, at 11:05 a.m., this Committee meeting was adjourned.)
CERTIFICATE

MEETING OF: TDHCA Audit Committee
LOCATION: Austin, Texas
DATE: August 21, 2001

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.

08/29/01
(Transcriber) (Date)

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