TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

8:40 a.m.
Thursday,
March 13, 2003

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

PRESENT:

AUDIT COMMITTEE:

Vidal Gonzalez, Chairman
Beth Anderson
Shadrick Bogany (not present)

STAFF:

Edwina Carrington, Executive Director
David Gaines
Delores Groneck
Bill Dally

ON THE RECORD REPORTING
(512) 450-0342
## AGENDA

| ITEM 1: | Presentation, Discussion and Possible Approval of Minutes of Audit Committee Meeting of February 13, 2003 |
| ITEM 2: | Presentation, Discussion and Possible Approval of FY2003 Annual Internal Audit Plan |
| ITEM 3: | Presentation and Discussion of Reports: |
| a) | External Audit - Communication with Audit Committee Letter |
| b) | External Audit - Opinion Audit on FY2002 Basic Financial Statements |
| c) | External Audit - Opinion Audit on FY2002 Revenue Bond Program Financial Statements |
| d) | External Audit - Opinion Audit of FY2002 Computation of Unencumbered Fund Balances |
| e) | External Audit - Report to Management (Management Letter) |
| f) | Internal Audit - Low Income Housing Tax Credit Inspection Fee Balances Due From/Due To Project Owners |
| g) | Status of Internal/External Audits |

**ADJOURN**
CHAIRMAN GONZALEZ: We'll call the Audit Committee meeting to order. We'll start with a roll call. Beth Anderson.

MS. ANDERSON: Here.

CHAIRMAN GONZALEZ: Shad Bogany. He's absent. And Vidal Gonzalez is here. Two present, one absent.

We'll go to Item 1, which is the Discussion and Possible Approval of Minutes of Audit Committee Meeting of February 13.

MS. ANDERSON: I move adoption of the approval of the minutes.

CHAIRMAN GONZALEZ: We have a motion and I second it. All those in favor say aye.

MS. ANDERSON: Aye.

CHAIRMAN GONZALEZ: All opposed? The motion carries. Then we'll go to the David Gaines Show here, the Presentation, Discussion and Possible Approval of Fiscal Year 2003 Annual Internal Audit Plan.

MR. GAINES: Chair, Good morning.

CHAIRMAN GONZALEZ: Good morning.

MR. GAINES: Members of the Committee, Ms. Carrington. The second agenda item is the Discussion and Possible Approval of the Fiscal Year 2003 Annual Internal Audit Plan. You'll find the plan on the back page of the
minutes you just reviewed, kind of hiding there.

The Texas Internal Auditing Act requires that an annual plan be developed based on risk assessment procedures. And the Internal Auditing Division uses nine different risk factors that it applies to each of the auditable units within the department.

And in the past, we've defined these auditable units as the LBB strategies that are measured to determine the department's progress in achieving its goals and objectives. For the current period, we've replaced some of those measures with the divisions responsible for satisfying those measures, such as the Multifamily Finance, Single Family Finance Production, and the Portfolio Management and Compliance Divisions, to align more closely with the recent reorganization.

We've also added significant functions, such as support services, data services, human resources, facilities and support, payroll, disbursements and purchasing, grant accounting, and the cash receiving processes as auditable units to which we apply these risk factors.

And based on the risk assessment that we've done, it's -- and other considerations as well, not exclusively restricted to the risk assessment, we've developed the proposed audit plan you see in front of you.
I'd like to just briefly walk through each of these projects. The first -- before I discuss the document itself, there is one other project that should be included on this plan that's not. And that's the tax credit inspection fee project that we've been working on.

Following what's been presented to you on that project later this morning, I'd like to include that on the plan to formalize the board's approval for that project. Based on results of that review, the tax credit fee review project I just referred to, a request by one of the board members -- based on a request of one of the board members and the inherent risk associated with cash and cash receipts, we've added the reviews of other fees collected by the department, including the Manufactured Housing Division.

And these are the first two reviews listed on your plan. The objectives will be to assist the effectiveness and controls of the fee collection processes to ensure that authorized fees are collected and properly accounted for.

Additionally, although it's not specifically mentioned here in your plan, an objective of this project, and really all of our projects in the foreseeable future will be to be more cognizant of opportunities for process improvements. And by doing so, we'll be able to
contribute to management's efforts, and doing so, the efficiencies associated with reorganization.

It's also important, especially in these times of budget constraints, to be in a continual process improvement mode. And so we're going to be paying more attention in those respects as we -- regardless of all this audit area we're working on.

The next proposed project is review of the department's draw processes. And the objectives of this review will be to determined the draw is properly accounted for, adequate supported, and in compliance with department standards. That would include any applicable federal laws, state laws regarding those draws.

And this project is being proposed because some of the risk factors we use in our risk assessment identified many areas of the department that's -- have been directly affected by the reorganization as high risk. Those are factors such as recent changes in organization, recent changes in management, complexity of systems, changes in the control process.

So there was so much that was ranked as high risk for the board to focus on, we backed out and said, Wait a minute. What are the inherent risks? The risk that something could go wrong, that there was no controls in place.
And of course, I guess the most inherently risky item would be cash out on the table. If there's no controls, it's not going to be used for proper purposes. So we thought what passes -- it does have some controls over it. It's in this Federal Treasury, and the State Treasury. It's in the local accounts.

So the next tier down, if you will, will be the processes getting to those cash balances, manned cash receipts and cash disbursements. Cash receipt projects were the first tier I referred to, and this would be the other side of the coin, cash disbursements.

In this particular project, we will also focus our consideration to those draw processes most affected by the reorganization.

The next project is our contribution to the Peer Review Process coordinated by the state agency's Internal Audit Forum. And that's -- you're aware of the department's internal audit function recently underwent a quality assurance review as required by professional standards and the Texas Internal Auditing Act.

They were required to do that at least once every three years. And we chose to have members of the State Auditor's Internal Audit Forum to conduct this review, with the cost of this is our reciprocation. We have to contribute hours to that function to be made
available to conduct peer reviews of other state agencies' internal audit shops. And so we budgeted time for that this year.

The remainder of the projects being proposed are ongoing activities of the division, including following up on prior audit issues, developing our annual audit plan for fiscal year 2004, preparing our annual audit report, which basically describes the internal audit function's contributions and results for the year, and coordinating and assisting external auditors.

I've also listed as a project my role in a central database steering committee, due to the time involved in providing that assistance. Are there any questions on the annual audit plan?

Okay. There is one point I would like to bring up before you vote on that plan. You might remember last year's plan was amended to include an ongoing project whereby the Internal Auditing Division was going to facilitate a controlled self-assessment project, and controlled self-assessment program.

And this program was to be owned by management, and be a proactive review to ensure processes, systems, and activities are controlled and executed in a manner that supports the business objectives of the department.

The board approved the plan, but requested that
we delay inception of the control and self-assessment project until after the reorganization has been implemented.

I've excluded it for current consideration. I believe management's plate is very full without placing another initiative on their shoulders. I wanted you to be aware of that. And that concludes my proposal for the current year's plan.

MS. ANDERSON: Mr. Chairman, I move approval of the Fiscal 2003 Internal Audit Plan.

CHAIRMAN GONZALEZ: Okay. And I second.

MR. GAINES: And if I may, with the addition of the Tax Credit Inspection Fee Project added there.

MS. ANDERSON: As amended. Yes.

CHAIRMAN GONZALEZ: All those in favor.

(Chorus of ayes.)

CHAIRMAN GONZALEZ: All opposed? The motion carries.

MR. GAINES: The next agenda item is a series of report items. Items 3(a) through 3(e) relate to the results of all the work performed by Deloitte and Touche, the department's external auditors.

George Scott, the managing partner, is here today to present those results.

George?
MR. SCOTT: Thank you, Dave. Good morning, I'm George Scott. I'm a partner with Deloitte and Touche, and I'm responsible for the -- conducting the audit this year. As we're running audit and financial statement presentation, a lot of trees have been killed for the -- all these documents that we'll go over today.

I'd like -- actually, the financial statements -- there's actually three financial statements. There is the Comprehensive Annual Financial Report, which is in a grey cover. A subset of that is the report on the Bond Program -- Revenue Bond Program, which is a separate document. And the third financial document had to do with computation of unencumbered fund balances.

All those are subsets of the first one, Comprehensive Annual Financial Report. Our opinion on the Comprehensive Annual Financial Report is on Roman numeral II is that it is a clean opinion. In our opinion financial statements do present their financial position of the agency as of August 31.

Also, as you look in the other two reports, they're also clean opinions. Again, our opinion of the financial statements both for the revenue bond program do present fairly that particular program separately, as well as the unencumbered fund balance information, which is a requirement of your bond indentures. It goes through the
different fund balances within those particular indentures.

An audit conducted under Generally Accepted Audit Standards and Government Auditing Standards, since some of this is -- this is a requirement by the state, that you have an audit done under Government Auditing Standards also -- those standards are a little bit more extensive than Generally Accepted Auditing Standards.

Those standards require that we plan and perform an audit to reasonable assurance that the planning statements are free from material misstatement. In order to do that, we have to attach a variety of records and documents. We interview individuals throughout the organization, the various representations from the organization as to the accessibility of information, and so forth.

And during the course of the audit, there were no restrictions placed on it, access to documents or records, or individuals. We received, really, outstanding cooperation throughout the organization. This was a very difficult year for an audit, because as you will note in the financial statements, the basis for the presentation has changed substantially.

So it's not something you've seen before. And all large governments, like the agency here, have gone
through this. And it has not been an easy process. I --
your -- this organization had done some advance planning,
and was prepared to go through that process.

I will tell you I have many clients that had
not -- did prepare at all. And they were still trying to
get financial statements out from last -- even from last
summer. So it is quite an endeavor to do that.

And as you look to the financial statements,
you will see that there are numerous things that are
not -- have not been there before, such as management's
discussion and analysis. And that is similar to what you
see in the SEC environment, but it's not exactly the same.

And what's more important, it's part of the
basic financial statements, which is something that is not
done by any industry, to put an MD&A management discussion
analysis in their review as one of the primary
information presented to a leader. This is very -- this
is a very significant change.

As well as, if you'll go further back in our
report, you'll see that it's presented, in many cases,
more like a commercial entity, in which for a Government
such as the agency here, that is a dramatic change in how
accounts are classified, how they're presented.

Accruals are different, because you're going to
a full accrual basis. So -- and you looking between fixed
assets and capital assets differently, doing depreciation differently than you would normally do -- typically, what governments typically have done.

The interesting thing here is that you're doing it both ways. If you go through the report, one, the complexities of this report is you're presenting it much like you did before. But also now you've added this -- new layers of information on a different basis. And so it is a very complex presentation.

But you have made it through, and it is -- you know, again, I think it is a compliment to the staff to accomplish that. We did not -- do not prepare the financial statements. That is done internally. And so I wanted to point that out.

We continued to -- we were doing the audit, and continue to remain independent of management and the board. This is a requirement that we disclosed to you as an audit committee, that we do need to continue to meet the independence requirements of the ALCFA as well as the General Accounting Office. And that continues to -- and continues to be the case.

As a part of our report, we issue a letter to you that doesn't even have a title on it. It's just a three-page letter. It's called a SAS 61 letter, which is communication with an Audit Committee, and basically
summarizes what I have just talked about.

We have no material adjustments to the financial statements, which during the course of this conversion, that is not true for most organizations. So again, I think you had financial management that was really on top of this situation.

We had -- also, there were no significant past adjustments. One of the things that we are required to present to an audit committee now is occasionally during the course of the audit we may find adjustments that are not material enough to make -- discuss with management. Management may decide they don't want to make adjustments.

We're required to disclose those significant ones to you, and the reasons -- management's reasons for not booking those. We had none in this -- in the current audit.

Also during the course of the audit we performed procedures around compliance with state and federal law, as well as reviewed internal control environment. We identified no situation that we believe is a material weakness in the internal control environment identifying those compliance exceptions with state law that would need to be required in these reports.

However, we do issue a report to management, which is again, another document, which goes through items
that we believe that the audit committee and the board
should pay attention to, plus we review the prior year's
comments that we had and what the status of those were.

And as you read through those, we identify
that -- we encourage the board to look at their directors'
and officers' insurance which lapsed during the year, and
perhaps work with SORM, who is trying to pull together, I
think, a state program to deal with that.

But with the uniqueness of this organization,
we being in the bond market and so forth, the liability of
the board is heightened because of that. It's not a
typical state agency. And so you may want to look at that
pretty seriously.

The other area is on the regular loans, to
review the loan loss reserve, which the agency has already
done, as you see in the response. As we looked at that,
it had not been reviewed for -- it looked like for several
years.

There was no real documentation on what basis
that loan loss reserve was accumulated. And actually, it
looked too high to us based on what we could see as
historical evidence. And I know they've looked at it, and
I think they're adjusting it on a go forward basis.

As far as some of the prior comments, the --
one of the concerns we had last year was the accounting
for the Texas Housing Trust Fund. And basically, that activity was split between several locations, and so it was hard to figure out, or look at it from one perspective. When you asked the agency to look at that, and they have done that, and basically moved that into the general fund so you can see it in one location.

The Down Payment Assistance Program -- we had a concern last year that the down payments were not being reconciled on a timely basis for supporting documents. So you had a disconnect between what was recorded and what may have actually been received. And that procedure has been put in place. We notice in this year's audit we identified no problems with that this year.

There was also -- last year's situation we were concerned about accounts payable being cut off after 30 days. And obviously there were a lot of liabilities that are not paid within 30 days. So to look at that -- and they've done that, and implemented procedures around that.

And the other area was the integrated financial information. We identified that there were several systems that still didn't speak together. You had the PeopleSoft systems that had not been implemented, and you are in the process of doing several of those now. So again, that seems to be an ongoing -- that obviously is not something that we addressed immediately. So it's an
ongoing issue.

So that concludes our report. Again, I'd like to thank everyone's cooperation from the board down. Again, the course of the audit -- it's not an easy process to go through. And it's really quite painful. And we certainly appreciate everyone's help. If you have any questions I'd be happy to answer them.

CHAIRMAN GONZALEZ: I do have one. How often do you recommend reviewing the loan loss reserve?

MR. SCOTT: I think the loan loss reserve should be reviewed at least every two years.

CHAIRMAN GONZALEZ: Thank you.

MR. SCOTT: Thank you.

MS. ANDERSON: I do have a comment. I want to thank our -- all of our staff, and Deloitte and Touche. I appreciate your teamwork, you know, working together on this audit. And I'm very proud of this agency.

Anytime you have a complex agency like this, you have a set of clinging opinions, you know, and I mean, I just think that's something that we really ought to celebrate in this agency that we have, this evidence that our financial house is in good order.

In reading the letter to management that Deloitte and Touche prepared, I was, frankly, very disturbed to see that we had allowed the D&O insurance to
lapse last year. And maybe I missed something, but I don't remember that decision coming to the board. So, you know, maybe I just missed it in a board meeting.

But I think that the decision to wrap something like that should have come to the board, and I think we were -- you know, I think it was -- the timing was such it was before Ms. Carrington was -- before she accepted our offer that we're so thrilled to have her as our executive director.

But I would ask that staff -- that in the audit committee meeting next month, that we have a proposal from staff to reinstate this D&O insurance. This is not something that I want sitting out, you know, as a pending action item for an extended basis. So I would like to have the commitment that we -- staff's commitment that we have an action -- whatever action we need to take to get it reinstated, that we get that on next month's agenda.

CHAIRMAN GONZALEZ: Okay. David, I'd like to at least have a -- some comments, or have somebody from --

MS. ANDERSON: Mr. Bill Dally.

MR. DALLY: Mr. Chairman, we did not bring that to the board, you're correct. But that decision to let that lapse did not come back to the board. And for that I apologize.

That premium that we had was $125,000. And our
experience had been that we had not had any claims against that. We only had about $100,000 deductible. Things -- and in that environment, we were on our own so far as negotiating.

But what I want to bring to you today is we have actually gotten a proposal through SORM for a very reasonable premium. Our $100,000 deductible -- that premium would be $11,136. And then yes, I would recommend that we -- that would be money well spent to put that policy in place.

So what we'll do is we can circulate this proposal to the board members and stuff, and if you want, make that an action item for next month.

MS. ANDERSON: Well, I mean, I'm not even sure that that has -- an $11,000 expenditure we don't have to approve. But let's just -- you know, we can consult with the rest of the board, if we want. But I think the sentiment, I'm certain, I feel -- certainly.

MR. DALLY: But evidently, we got some -- a lot better negotiating power when the State Office of Risk Management put this out -- this proposal out for us. But we got this -- it's dated March 11. We'll be sure someone got this proposal. But --

MS. CARRINGTON: And what we can do, Bill, is just notify the board next month that the D&O coverage is
CHAIRMAN GONZALEZ: The previous one was with CNA. Is that correct? Or what --

MR. DALLY: Marsh was the broker, but I think it was Fire Union, or some other underwriter.

CHAIRMAN GONZALEZ: Okay. That was 125 --

MR. DALLY: $125,000. About a $100,000 deductible.

MS. ANDERSON: Thank you.

MR. DALLY: Thank you.

MR. GAINES: Thank you, George. The next agenda item, at 3(f), which is behind Tab 6(f), is the Internal Audit Report on the Low Income Housing Tax Credit Inspection Fee Project that we've recently completed.

The first couple of paragraphs are standard language that have been tailored to the project. This was considered an agreed-upon procedures engagement. And this type of engagement provides assurances of something less than an attestation engagement, which provides assurances or provides an opinion regarding the fairness of the data being presented.

And basically, what this means is that we applied procedures that had been agreed upon with management, and our understanding of the board's intentions, solely for the purpose of assisting you with
respect to evaluating the amounts due from tax credit project owners that have resulted from construction inspections conducted on the projects.

And while the standards -- the sufficiency of the procedures applied is formally, if you will, sufficiently the responsibility of the users of the report, meaning management and the board, often -- and I'm on the record, but aside from the standards, I believe the procedures have been applied provide you quality information with respect to evaluating these amounts.

And if you will, I intend to focus our discussion on the executive summary. A subsidiary ledger that identifies payments to the inspectors and reimbursements from the project owners by a specific project at the project level has been prepared and reconciled to the accounting records.

As of September 30, 2002, the net inspection fees due from project owners for the construction inspections conducted prior to September 1 totalled $100,126.

This is the same information that was reported to you for several months now in status meetings. This net balance consists of $203,238 due from project owners, and $103,113 due to project owners, netting to the 100,000.
As of February 20, management has billed an additional $152,402 of the 203,000. Management intends to bill the balance of that as it assesses and is satisfied with the documentation supporting those balances.

Effective September 1, 2000, Financial Services Division assumed responsibility for maintaining the detailed subsidiary records supporting the balances due from the project owners. And based on the work we've performed with the Tax Credit Division and the Financial Services Division, and based on our review of the records and documentation and the processes that they're using, we believe the Financial Services Division has the capacity necessary to fully account for these activities and balances going forward.

And I'll be glad to discuss any of the details that you'd like to get into.

MS. ANDERSON: I have a question, Mr. Gaines. If memory serves, when we met last month, you indicated that there was another -- and I think the number was about 40,000 that was about -- you know, potentially about to be billed.

MR. GAINES: Yes, ma'am.

MS. ANDERSON: Do you remember that conversation? Can you give me a status?

MR. GAINES: And that would -- at this point is
the balance, playing the 203 that we're reporting due
from --

MS. ANDERSON: Right.

MR. GAINES: -- and the amount recently billed
of 152. That remaining balance still is out there that,
as of my last check-in with Financial Service Division,
they're continuing to look at it. They intend to bill it
as they assess the quality of that documentation
supporting that.

We're comfortable in walking away from the
project, because based on our sampling of the detailed
documentation, and fairly good-sized samples, we found the
quality of the data to be there. And of course, Financial
Services Division doesn't want to necessarily rely on our
work. They want to look at it independently before they
bill that.

MS. ANDERSON: I would just ask, and I'm not
from an audit perspective, but from just a fiscal,
financial perspective, that we continue to get some
updates on this. It doesn't have to be in the Audit
Committee. It can be a report to the full board, or
something like that, how we're working down those
remaining balances, both the due-to's and the due-from's,
you know, working that sort of, toward a finalish
resolution.
MR. GAINES: Yes. I think we'll have a periodic briefing on that, and include it on the agenda, and maybe let someone with financial services discuss it.

MS. ANDERSON: Thank you.

MR. GAINES: Okay. The final agenda item is behind Tab 6(g), and this is the Status of Internal/External Audits.

For the internal audits, you'll notice the recent completion of the inspection fee receivable report that we just discussed. The next couple of audits are in the planning stage and relate to the collection of other fees collected by the department that we just approved in the audit plan. We began our planning on those projects anticipating approval.

The last project is a review over the controls over tax credit deliverables. And I've classified this as in the fieldwork reporting phase. This project is a holdover project from last year, and it was delayed due to turnover in staff.

It's since been kicked back up and gone through by the newest member of our staff that I'm so pleased to have with us. And it's sitting on my desk at this point pending my review.

And to the extent I'm satisfied with the report, we -- I just need to finalize it. I do need to
assess if there is any more fieldwork necessary to release that report. I hope to be able to get that off our desk by May -- release that in May.

The next series of audits relate to projects conducted by external auditors. The first one is a quality control review of the internal audit function that was completed last month and presented to you, or was presented to you last month.

The KPMG audit refers to the federal portion of the statewide financial single audit which has been completed. This report was released in February. I didn't actually receive a copy of the report until since we posted the board items, so I wasn't prepared to discuss the results of that report with you today. But we'll do that, and I'll deliver the text of the report to you between now and the next meeting.

The next audit underway -- or the next audit listed by the State Auditor's office is one that is underway. It's a review of the department's Community Services Block Grant Programs, or program, and the Energy Assistance Programs, and the Section-8 Program.

The department is expecting a final draft report on this project just any day now. And we expect that soon. The second State Auditor's Project listed relates to the legislative summary documents. And these
were presented to you at the last board meeting.

Finally listed are the Deloitte and Touche Projects that Mr. Scott just discussed with you. And of course, those are all completed. Any questions relating to the status of audits?

MS. ANDERSON: I have one question. On the Manufactured Housing Fee Project that you're getting ready to undertake, does that sort of fall under our interagency agreement with the Manufactured Housing board and stuff, such that David and the division's time and expenses in that somehow gets charged back over the --

Thank you.

CHAIRMAN GONZALEZ: Did I see a nod over there?

MS. ANDERSON: Penny, the answer -- Bill Dally shook his head yes, Penny.

MR. DALLY: For the record, yes. The -- they -- in our interagency agreement, it covers the -- actually, the governmental and communications area of our agency. It covers our financial area and payroll, and the purchasing, those areas.

It also covers the internal audit, because every group is to have an internal auditor. Every agency is to have an internal auditor. And a lot of the smaller ones are going to contract out with third parties to do it.
In our particular instance, David had always been sort of funded, or his group had been funded out of that group. And so when we did the agreement, there was a portion of it. Yes.

MS. ANDERSON: Okay.

MR. GAINES: And so even last year, some of -- he was -- in other words, it's not on an audit basis. He was charging in part the agreement last year --

MS. ANDERSON: Just part of the regular overhead allocation or something.

MR. GAINES: And so he looked at controls and risks for the above groups, and now he's got one that's cash receipts. Well, it's there and it's here. So he's going to do both groups. So yes, it is covered by that agreement.

I mean, in effect, the Housing Division has been made aware of the project. I have not discussed that with their board, yet, which I will.

CHAIRMAN GONZALEZ: Any other comments? Okay. We will entertain a motion for adjournment.

MS. ANDERSON: I move adjournment.

CHAIRMAN GONZALEZ: Second. All those in favor.

MS. ANDERSON: Aye.

CHAIRMAN GONZALEZ: The motion carries. Thank
you, David.

MS. ANDERSON: Thank you, David.

(Whereupon, at 9:10 a.m., the audit committee meeting was concluded.)
CERTIFICATE

IN RE: Texas Department of Housing and Community Affairs Audit Committee Meeting

LOCATION: Austin, Texas

DATE: March 13, 2003

I do hereby certify that the foregoing pages, numbers 1 through 29, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Penny Bynum before the Texas Department of Housing and Community Affairs.

(Transcriber) (Date)

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