

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
AUDIT COMMITTEE
MEETING

Thursday, February 1, 2007
Capitol Extension Auditorium
State Capitol
1100 Congress Avenue
Austin, Texas

COMMITTEE MEMBERS:

SHADRICK BOGANY
GLORIA RAY

STAFF:

MICHAEL GERBER, Executive Director

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P R O C E E D I N G S

MR. BOGANY: We are going to call the roll call of the Audit Committee, February 1, 2007. Ms. Ray?

MS. RAY: Here.

MR. BOGANY: Shad Bogany, here. We have Sonny Flores. We're going to call the Audit Committee. We have a quorum and we are going to call it and get it going, and call it in session. And we are going to start off with a public comment. Any public comment on the Audit Committee?

(No response.)

MR. BOGANY: Sure no public comment? Three minutes.

(No response.)

MR. BOGANY: Okay. We are going to move into our action items, and we are going to have David Gaines come up and discuss and possible approval of the 2007 TDHCA internal audit plan.

MR. GAINES: Good morning, Chairman.

MR. BOGANY: Good morning.

MR. GAINES: Ms. Ray and Mr. Gerber.

MR. BOGANY: David, I have one question for you. Would you want to go ahead and do Item 2, which brings our auditor up?

MR. GAINES: If that is your pleasure. The Audit Plan?

MR. BOGANY: Yes. Let's go ahead and do that first. I would like to bring our financial auditor.

MR. GAINES: The financial auditors? Okay. That would be the first item on the docket?

MR. BOGANY: Right.

MR. GAINES: Okay. I am sorry.

MR. BOGANY: Ms. Ray. We have got Item 1, and we were going to do the internal audit, but we also have Touche and Dodge [phonetic] here with the audit report, and we are going to probably do them first.

MR. GAINES: I am with you now. This is Julia Petty from Deloitte and Touche. She will presenting the results of our annual audit.

MR. BOGANY: All right.

MS. PETTY: Thank you. I am Julia Petty with Deloitte and Touche. I am the Director who is in charge of the audit engagement this year. And I am here to present those results to the Committee and answer any questions that you have. There are a number of reports that you have in front of you. The first one that I want to go through is our required communications with this Committee.

It is a letter dated December 19, to the Audit Committee. And it lays out the responsibilities of the Department and our firm as the external auditors. The Department is responsible for all of the financial statements that you see, making sure that the books and records are in appropriate order, that the financial statements are presented in accordance with Generally Accepted Accounting Principles.

We believe that we got access to all of the books and records that we needed, access to all of the personnel that we needed to make inquiries of, and were able to perform our audit in accordance with generally accepted auditing standards, and government auditing standards, as required. We did not have any significant adjustments throughout the audit.

Our firm did not provide any additional services outside the scope of this particular audit to the organization. And we received outstanding cooperation from the staff.

And I want to give my appreciation. No one likes to go through an audit. It is a difficult process, and it is on top of everyone else's daily duties. And again, we just received great cooperation. There are several opinions that we do provide to the organization.

On the overall financial statements, which is the bound document that you have, we did get a clean opinion on the financial statements of the organization as a whole. We are also engaged to give an opinion on the revenue bond fund specifically. That one also is a clean opinion. Those financial statements present fairly the financial position and results of operation of the revenue bond fund as a standalone.

And then the unencumbered fund balance, which is a legislatively required calculation that nobody else does but this organization. But again, that is in accordance with the statutes. So our opinion does say that. My understanding is that Bill Dally will be walking you through some of the specific financial information, because the financial statements are management's responsibility.

There is one other document that I would like to turn your attention to, and that is the report to management. As part of an audit, we do not do a separate opinion on internal controls in the way that public companies do nowadays. However, we do assess internal controls as part of our audit, to determine whether those things are properly designed and are operating effectively.

We do not find any material weaknesses or reportable conditions in internal control, meaning breakdowns that could affect the organization's ability to prepare appropriate financial statements. We have found no such instances. But we did have a few recommendations. Those are included in the document.

The first one is forward looking about governmental accounting standards that are coming due to be effective in the next year or two. To make sure that the organization is aware of those, and is assessing the impact that those could have on the organization. Some of those do require quite a bit of lead time on management's part, to be able to gather the information, the data that they need to appropriately implement those. And we believe management is focusing on those appropriately.

Controls related to other assets. There was a changeover in systems on one of the receivables, accounting functions in the current year. And as a result of that changeover, there is much focus on the new system going forward, not as much focus on the information that was remaining in the old system. And we have pointed that out to management. They have gone in and addressed those issues and we believe will focus appropriately on that through any system changes on a go-forward basis.

Another item that we noted regarded reference checks. As people are hired into the organization, the policies required that reference checks are prepared and documented in the files. We did find one instance where such documentation was not retained. We believe obviously that that should be retained. And we had discussed that with management who agrees.

Our IT auditors were also part of our audit. They had some assessments as well during their portion of the audit, first of which deals with password parameters.

The system that exists does not have built in password parameters, and we would recommend that password complexity, length of time that one could use the password, those sorts of basic security measures should be upgraded at the organization.

Change management is another area of focus. As new systems come online, there should be policies and procedures in place to make sure that that process is sought out in advance. Certain protocols are followed as systems are tested and put into production, and any changes that are made once in production are appropriately documented and tested.

And while some of those processes were going on, it is not necessarily formerly documented and

followed. And so again, we are recommending that be put into place. And with that, that is the results of our audit, and I would happy to answer any specific questions that you have.

MR. BOGANY: Okay. Ms. Ray?

MS. RAY: I have no questions, but I would like to thank you for the thoroughness of your audit. And it is always music to our ears when we hear of a prudent audit and my congratulations goes to the management --

MR. GAINES: Yes, ma'am.

MR. BOGANY: Ditto, Ms. Ray. And thank you.

MS. PETTY: Very good. I will turn it over to Bill.

MR. BOGANY: Bill.

MR. DALLY: Thanks. We do, if you looked at this book, it's very thick, and there are lots of financials and reports, the first being the basic financial statements. And then there is a revenue bond, and that unencumbered fund balance. If you will, I was trying to think how I can be very succinct and show you what the year's activities were. And I think if you will look behind -- in that basic financial statement, if you will look back behind Tab 2(A)(2). And you turn past the MBNA sections but go on to page 3.

This particular account is the statement of activities, government-wise. And this presents in one place both the governmental fund activities and our proprietary fund activities. Within the governmental fund are appropriated state and federal revenues and all of the activity of the Manufactured Housing Division.

Then that listing where it says, business type activities. That is also referred to as a proprietary fund. That is a reflection of our activity with respect to our single family bonds, our multifamily bonds, our Housing Trust Fund program, and then there are some administrative expenses that are borne by that fund. And then there are administrative expenses borne by the governmental activities.

This basic statement starts out, and it shows the expenses associated with each of the activities; manufactured housing, HOME, energy assistance, community services, Section 8, Housing Trust Fund and then administration/CDBG. And then you drop down to business activities, it is single family bonds, multifamily bonds, Housing Trust Fund administration. So you will see in that first column, all of our list of expenses. We then go over, and under the next two columns, are the program revenues.

In that first column are the charges for services. Those are the fees that we charge in relation to these various programs. As you look up at manufactured housing, they have a whole list of fees; titling fees, and inspection fees that they prepare as part of their program.

And then there are, in that far column, under operating grants and contributions, these are the federal grant monies that have come into the Department related to the Home and Energy Assistance. You then go over to the next column, and it shows our net expenses and revenues. A negative would be that our expenses exceeded our revenues and the positives in that we are just the opposite.

One thing I want to point out to you is, in the business type activities, you will see under the single family bonds, our expenses were \$62.8 million and our chargers for services were 59,8, leaving a difference, meaning expenses greater than our revenues there of \$3 million. That is related to what we call our grant expenses, and those are part of when we do our assisted loans where we add the 5 percent in our bond program, that goes out as a grant expense and it is not set up as a loan, as we would typically do with the rest of the money.

And so there is not an asset necessarily created that will pay out over time. Economically, that works because we have got a higher rate on that.

And so when you do your cash flow, you look out over time, and that difference in points creates a present value that you tap into and use as your grant expense, and because you have positive net assets within your trust indenture, you are able to put that money out now, knowing you will recover that over time with the higher rate on those particular loans. I would also point out in the Housing Trust Fund program, we had a new rider in our legislation where we made a transfer from our governmental funds where the appropriations are over to the proprietary fund.

And as you drop down under that section that says General Revenues, you will see transfers in and out.

And you will see it move 12 million from the governmental fund over to the business type activities. Well, associated with that are the creation of loans.

And up above, on the Housing Trust Fund, where we have the 2.7 million of expenses greater than our revenues there, again, that is related to the grant expense associated with creating those loans. And the revenue is recorded over in the governmental funds, but

then it drops below the line, and comes in as a transfer and so you don't have a matching.

The other significant number, if you look down at that bottom section, there is a net decrease in the fair value of investments of \$33.4 million. That is what is referred to as an unrealized loss. And so they have done -- we are required by GASB 31 to do a market valuation of our mortgage backed securities. Well, those securities, by our very purpose, are below market, and that is the way they are created as investments.

And so when you value those out at a market rate, you are going to have typically in this environment, in this interest rate environment, you are going to have a large fair value reduction. The significance though is, if you continue to hold those, if you don't sell those, and you don't take that loss as a realized loss, you hold those in your portfolio to pay your bonds.

In conclusion, our fiscal health is, we have got sufficient cash flows that are going to cover our long term obligations related to our bonds. And then in the short term, we have got sufficient cash flow to cover our operating budgets. If there are any further questions, I would be happy to take those.

MR. BOGANY: It sounds good.

MR. DALLY: Okay.

MR. BOGANY: Ms. Ray, do you have any questions?

MS. RAY: No.

MR. BOGANY: Okay. Thank you, Mr. Dally.

MR. DALLY: Thank you.

MR. BOGANY: Mr. Gaines? We are going to go back up to Item 1, and have Mr. Gaines come in and do presentation, discussion and possible approval of TDHCA internal audit plan.

MR. HAMBY: Well, actually, if I could jump in here for a second, Mr. Bogany.

MR. BOGANY: Okay.

MR. HAMBY: We have this on the agenda as the Audit Committee accepting the report. So if you could add a motion to accept the report.

MR. BOGANY: Okay. So we just need a motion to accept.

MR. HAMBY: Yes.

MS. RAY: So moved.

MR. BOGANY: Second. All those in favor.

(A chorus of ayes.)

MR. BOGANY: Thank you, Mr. Hamby. Mr. Gaines.

MR. GAINES: Good morning, Chair, once again.

Ms. Ray, Mr. Gerber. Before I get started today, I am really excited to introduce Greg Magness. He is our newest staff member on the internal audit. He has been with us now for 25 minutes.

His first assignment is to show up this morning. We're just real excited to have Greg. He is a certified internal auditor, a certified government auditing professional. Both of these certification are issued through the Institute of Internal Auditors, both respected certifications.

Mr. Magness or Greg, I told him the other day that actually his first assignment was to call me David, instead of Mr. Gaines, so I will do the same. And Greg's professional career has had a steady progression of success. Responsibility as demonstrated by over six years of experience at the Texas Workforce Commission, where he continually, on a regular basis graduated his position title levels of authority and responsibility.

But last year, he has held a senior audit position with the Office of Inspector General at the Texas Health and Human Services Commission. He has much experience in federal funds. He is going to be a great asset to the Department, I know that. And we are just real excited to have him, and we're looking forward to

getting with him after the meeting, and start talking about our future plans.

MR. BOGANY: Welcome aboard. David, would you introduce Lorrie and Colleen?

MR. GAINES: Yes. Colleen, why don't you stand up; you're our newest team member. Besides Greg, Colleen has been with us for just right at a year now. Graduated from UT Arlington in accounting. And she has been great. My biggest challenge is trying to keep up with her. A lot of energy. And just catching on real fast, and I am looking forward to hopefully a long career with Colleen as well.

Lorrie Lopez graduated from UT San Antonio, and has been with us just over three years, two years. It goes fast when you're having a good time. And Lorrie is just great. And I keep encouraging her to just speak up a little bit so that everyone else will recognize that also.

So thank you for suggesting that, Mike. It has been awhile. And I am not sure Ms. Ray has met them at all. But it is -- yes. Okay.

The first agenda item, or actually I guess that would be the second at this point, behind Tab 2(b) is presentation, discussion and possible approval of the

Internal Audit Plan. For the most part, I am going to be speaking right off your Board action request summaries, which is the page immediately following the tab. If you care for me to elaborate, of course, I will be glad to.

But the Texas Internal Audit Act requires that an annual plan be developed and developing this proposed plan reports are being heard from management staff, the executive team, the Department's internal auditors, including KPMG, Deloitte and Touche and the State Auditors Office as well as associating input from the Department's governing board. And while there were significant risks identified during the planning process that are not included in this Audit Plan, the Department does have formal processes in place for management to review, evaluate and mitigate those risks, if appropriate, to an acceptable level.

And what you have in front of you is the plan that was proposed to Executive, to solicit their ideas and input. In addition to the plan you see in front of you, Executive has identified two additional areas of concern that they would like to include in the Plan and we'll discuss those momentarily. The Plan emphasizes the CDBG Hurricane Disaster Recovery Program and a review of the program is planned in three phases.

Phase One is a review of control systems, policy and procedures, to obtain an understanding of the system of the Department's controls in place to manage the significant risk associated with processing payment requests from subrecipients and subrecipient monitoring. And when I speak of the risk associated with subrecipient monitoring, what I am really referring to are the risks relating to and ensuring subrecipients comply with relevant laws, regulations, contract terms and that contract performance statements are achieved.

On the first page of the Audit Plan, there is a series of bullets under Phase One. And those are the risk areas we are currently planning on pursuing. And I kind of emphasized currently, because as you get into an audit and assess your risk, you might say, well, this one is not that significant. Maybe it drops off, and we'll add another one in its place. And so of course, we try to go after the important areas.

Phase Two will include tests of the operating effectiveness of the Department's application of these controls. Phase Two relates to the controls over the draw processing function. The processing of requests for payments from subrecipients. So we will review the controls in Phase One, see if they are adequately

designed.

Phase Two we'll actually test those controls to see that they are operating effectively. Phase Three, the same ideal, except that it will be in the area of subrecipient monitoring. We will review the adequacy of those controls in Phase One and in Phase Three, we will test those controls to see if staff is following the prescribed procedures and if in fact those controls are operating effectively.

Within Phase Three, we will be looking at the field monitoring function, and the desk review function. Desk review is designed to monitor subrecipients' performance and expenditures. Any questions on the CDBG program hurricane relief?

MR. BOGANY: Yes. I have one question. Let's just say the Agency that we are dealing with or distributing funds to is monitoring themselves. Do we monitor them?

MR. GAINES: Well, of course, we expect them to be monitoring themselves, and yes. We have responsibilities as a pass-through Agency.

MR. BOGANY: Even though we are passing it through, and they are going to distribute it themselves, and follow the rules that we are supposedly following,

versus monitoring through us. We still have a responsibility to make sure that they are doing what they are supposed to be doing.

MR. GAINES: Yes, sir. That is correct. In this case, one of our subrecipients actually has two additional subrecipients.

And so as that first tier subrecipient, if you will, they have responsibilities to oversee those lower tier subrecipients. And the requirements on us just domino down the food chain if you will. And so our responsibilities roll to the sub, and then further down to their subs. You are talking really about monitoring the initial tranche of \$74.5 million that we have received.

MR. BOGANY: Yes, sir.

MR. GAINES: On the second tranche of funds, where there is some talk about in Harris County and Houston getting those jurisdictions responsibility for having a direct relationship with HUD. Should HUD agree that they can do their own monitoring and reporting directly to HUD, because both operate sophisticated CDBG programs that our Department would not have responsibilities there.

MR. BOGANY: All right.

MR. GAINES: Is that clear?

MR. GERBER: Depending how that arrangement is worked out with HUD, that yes. And this is the 74 million. Yes, sir.

MR. BOGANY: Okay. So the 74 million, but the new money, it would be up just to Harris County, for example, and Houston to do their own monitoring.

MR. GERBER: Yes, sir. I mean, we would have responsibility for the other 368 million.

MR. BOGANY: Okay.

MR. GAINES: Thank you for that clarification, too. The Plan also includes follow-up projects and stated supra internal audit issues. And to independently verify the corrective action is taken by management in response to finding some recommendations. And follow-up projects will be pursued as issues relating to an audit or reported by management is implemented.

And you will see a series of bullets on Page 2 or 3. There is five audits listed there that need to be followed up on at this point. So we will be allocating time to do that as well.

MR. BOGANY: What do you think the time frame of getting those cleared away? Like some of them are, well, I won't say 18 months old or something.

MR. GAINES: Well, the issues themselves, for

the most part have been reported by management as implemented.

MR. BOGANY: Okay.

MR. GAINES: And it is a matter of following up. Sometimes you want a history of transactions before you even try the follow-up.

MR. BOGANY: Okay.

MR. GAINES: Good morning, Mayor.

MR. BOGANY: Mayor.

MR. GAINES: The plan includes completion of two engagements that were carried over from fiscal year 2006. The two engagements included an audit of the Department's Energy Assistance subrecipient monitoring function and the Manufactured Housing Division's Homeowners Recovery Trust Fund or HRTF as it is commonly referred to.

The Energy Assistance audit, the scope of that audit was limited to the Weatherization Assistance Program subrecipient monitoring function. And that audit has been completed. It was released in December, and we'll be discussing the results of that audit momentarily. And the remaining task on the HRTF audit include review and events subsequent to field work. This project has been delayed somewhat. So we want to look at what has happened since

we did our field work.

Test any subsequent events if we think that is appropriate, and then preparing the report. And during the course of this audit, we identified several significant improvements to the accounting and tracking processes. And in discussion with the Executive Director of the Manufactured Housing Division, he would like -- they have taken corrective actions on those, and at this point, he would like us to go back and revisit those, take a look at those to see if in fact, they were implemented according to -- as intended by management.

And so as we do that, then of course, we will release our report. We are currently planning on that being released in March. The Plan puts three other significant projects relating to the reporting and tracking of prior audit issues versus following up and verifying them which was the other one I mentioned. Developing an annual audit plan for the coming year, and preparing an annual internal auditing report that is required by the Texas Internal Auditing Act. Immediately following the proposed plan, you will see a letter from Executive, Mr. Gerber. Two projects that they brought to my attention and would like to consider to incorporate within the Plan.

One is an audit of the Housing Tax Credit program. And it is anticipated that the significant phases of the 2007 tax application cycle will be reviewed for the purposes of identifying risk associated with the tax credit award process and if the adequate controls have been put in place to address those risks. The project will also consider significant compliance requirements and if the Department complied with those requirements. Compliance requirements being laws, regulations, the Qualified Allocation Plan.

MR. GERBER: And Mr. Gaines, if I could just note, the tax credit program has not been audited in at least the last six years. And given the complexity of the program and the risk attendant with it, that is why I was recommending that to the Board, that it be considered for -- included --

MR. GAINES: Yes. And I am really in agreement that both of these are worthy projects, because of the significant risks to the Department. They are both highly complex programs. A lot of public interest, third-party interests, significant dollars or taxpayer funds at risk. And so we are in agreement with both of these projects.

The second audit is an audit of the HOME program procedures. And with the newly reorganized HOME

program, which the reorganization itself is going to increase the risk, considering again the significance and complexity. New management staff. All of those elements, at least initially will increase the risk of new division like that.

And so again, Executive has requested it, so we review those procedures, assess their adequacy. And included in that request also is that we put on the back burner if you will, incorporate into next year's plan an audit to go in and verify that management has been compliant with these procedures we will be reviewing during this audit. And again, we are in agreement with both of those.

Having said that, I am somewhat concerned about the resources available to do these projects within the current year. I don't have a real good estimate of what those are going to take. So as we get into the projects and review and assess what it is going to take, we will of course, keep you briefed as during regular status reporting that we do to you.

And it is not just a matter of resources from our end. It is also a matter of resources from the Department's end, in that coordinating our information needs with management and staff's workload, sometimes that

in itself is real challenging.

MR. BOGANY: Do you think we can implement this this year?

MR. GAINES: I do need to visit a little bit further with the Executive. I believe -- I need better understanding of what their priorities are, if it be the HOME review or the tax credit cycle. And on both those, I can see doing it in mini reports or mini reviews, if you will.

For example, HOME might have twelve, 14 significant sets of procedures. Maybe we can take one at a time and issue a little one or two-page mini report, addressing just that standard operating procedure. So by doing it like that, we can do several. We can do those considered most important. Those that are most time sensitive.

And then likewise, in the tax application cycle, break that down into the significant phases, the significant milestones. Maybe one is the award process. One is the scoring process. Pre-application, and we can take those individually. So yes, we can certainly make progress on these.

It is a matter of defining your scope. One fellow I worked with, that I highly respect working on the

statewide audit for years, I remember a question directed to him as the state auditor for trying to get down to the lowest number of hours. And we went from 135,000 down to about 80,000 hours.

The Director one day says, Ronnie. What is the lowest we can do. What is the smallest number of hours we can do this audit in? And his response was, I can complete it by this afternoon, if you are willing to accept that level of risk. You know, and I appreciate that.

MS. RAY: Mr. Bogany.

MR. BOGANY: Uh-huh.

MS. RAY: Given that this request was given to Mr. Gaines to add these two very complex items as a part of the Audit Plan for this year, we are here today to accept that Audit Plan for 2007. Would it be appropriate -- I am very new to the process.

So please excuse what might sound like a very infantile question to this particular process, in accepting this as part of the 2007 Audit Plan. How often are we scheduled for the Audit Committee to meet, Mr. Bogany?

MR. BOGANY: We have typically been meeting probably once a quarter. We were doing a monthly deal.

And then we kind of got away from it, because things started getting in place and Mr. Gaines' staff was doing such a great job, we just didn't have anything to talk about.

So now, and I am going to rely a lot on David.

I think from the Board side, we like to probably go back to that monthly deal, just to keep the same momentum going. But it is going to really be up to the Board and this Committee on how often you guys meet.

MS. RAY: And the reason I ask that question, is because this letter written to Mr. Gaines and to this Board was written on the 24th of January. And based on the discussion that I just heard from Mr. Gaines, it is going to take a little time for him to assess what the extent of the audit requirement is going to be, both internal to the Agency and certainly for the internal audit staff, that perhaps before we take an action on this, we might wish to get a report from Mr. Gaines of the scope, before we definitely add to the Plan today.

Because it might be something that looks good, but we might not be able to accomplish in 2007, until we make that assessment. So I would like to recommend or move that we hold this recommendation in abeyance until we can get an assessment from Mr. Gaines as to the scope of

the additions to the 2007 Audit Plan.

MR. BOGANY: Okay. I will second that so we have got it on the floor for discussion. Mr. Gerber, I would like to get your thought process. Is it any detriment, holding it off or is it something that we can -- because when I talked to David about it, I think one of the big things were resources, resources.

MR. GAINES: I would like to speak to that, also.

MR. BOGANY: Okay.

MR. GAINES: A large part of any audit is developing enough of an understanding to assess what it is you want to include within the scope of the audit. So the actual budgeting process can be quite time consuming in itself. Having said that, I would suggest include it in the Plan and there is really nothing that precludes -- I had two projects roll over from last year.

I just reported or will be reporting on one of them right now. So even though you plan on an annual basis, as long as we are in close communications and we are talking about the status on a regular basis, and you are satisfied with the progress I am making. And I am not losing too much hair over the process in trying to meet goals and targets. I think it is okay. And I think it is

okay to amend your plan, as you see warranted.

MR. GERBER: And I would just add to what David said. We have been in close contact about the need for additional staff resources, particularly as it relates to the Housing Tax Credit audit. That is going to be a significant undertaking, and I think we want that of sufficient complexity and scope to really give good feedback to management about what process improvements we might need to make.

In many respects, that program has evolved over many years. And I think if we had big problems, we would know them because we would be hearing about them.

But nonetheless, I think that the kinds of information that David is going to delve into and hopefully explore in a cover force, I think will be very useful. So that might require an additional skill set. And that might require an additional staff member. And from management's perspective we are prepared to provide David, and be sure that David has sufficient resources to hire an additional staffer to handle that task.

With respect to the HOME program procedures, I think that on that task, we have talked about how that really is an ongoing thing, as that program really comes into -- as the reconstituted HOME Division comes together,

and its SOPs take shape. That is really important; technical assistance and audit guidance, that I think we really could greatly use now. And one of the great things about our relationship is that internal audit really is so much a part of our team. We understand the importance of independence.

But we would really value that input now, as we are building that program, so that we have internal audit throwing a flag now on the front end, if we have a problem with any of those SOPs. So that we can get those procedures changed and in shape, so that we avoid problems. And I don't think that from our discussion, David, that that was going to present too much of an additional burden, given the way you were going to approach that task.

The Housing Tax Credit audit, however, was going to go be a much more significant staff intensive undertaking. And luckily, we weren't envisioning that really taking place until this tax credit cycle was done.

So starting in August or September. So it really rolls into the '08 Audit Plan as well.

MR. BOGANY: Okay.

MR. GERBER: So there is some time to do that staff ramp up and do amendments to the Audit Plan, were

they needed.

MR. GAINES: And as we -- as far as the tax credit, for example, several of those milestones have been already met, and they are behind us at this point. So as time permits, we would probably go ahead and start on that way before August. Way before the end of this cycle, for the purposes of, for management to get real value out of this, they need it before the next cycle. Which pretty much starts up after this cycle. Certainly by December.

And just finally, resource wise, I spoke briefly with Executive on this, too. You can help minimize a lot of those concerns by having staff be very involved in the audit and in helping us accumulate information and things such as that. I feel the commitment from Executive. I will have that support, and staff will appreciate the priorities, and help us with accumulating a lot of that information also.

MR. BOGANY: Okay. Ms. Ray?

MS. RAY: Mr. Bogany, given the discussion and given the acceptance by the Internal Audit Division of adding this to the Plan, I withdraw my motion and replace that motion with a motion to accept these two areas; the Housing Tax Credit program, the HOME program procedures, to be a part of the 2007 Audit Plan.

MR. BOGANY: Second. If that is appropriate, Mr. Hamby, I will --

MR. HAMBY: Is that the Plan year?

MR. BOGANY: She is adding the two.

MS. RAY: That it exist as a part of the Plan.

MR. BOGANY: All those in favor, aye.

(A chorus of ayes.)

MR. BOGANY: Okay. We are going to add these to the internal audit and we will continue to consider the internal -- the whole plan.

MR. GAINES: Thank you, I think. Okay, the next item 2(c)(1). This is a report on recently completed external quality assurance review of the -- I am sorry. I am being interrupted here.

(Pause.)

MR. HAMBY: This is the second item. Correct? It is not the Plan?

MR. GAINES: No, it is not the Plan.

MR. HAMBY: You still need the motion to accept the overall Plan. That is the reason I asked if that was in your first motion.

MS. RAY: So moved.

MR. BOGANY: Second. All those in favor of accepting the total plan, including the two amendments

which we have already voted on, in favor.

(A chorus of ayes.)

MR. BOGANY: Is that okay, Mr. Hamby?

MR. HAMBY: Yes.

MR. GAINES: Thank you.

MR. BOGANY: We are going to move to -- David is going to continue with 2(c)(1).

MR. GAINES: Right. It is 2(c)(1). And this is recently completed external quality assurance review of the Internal Audit Division and since this report has been released to you previously, I am not going to go into a lot of detail here about professional standards are required to undergo a review once every three years. This review is completed in October of 2006.

And in summary, the review team concluded that the division, the Internal Audit Division fully complies with required professional standards. This is the highest of three possible ratings, and means that basically, adequate controls are in place to ensure compliance with professional standards, independence, objectivity and proficiency of the internal audit function.

I will just touch on the independence and objectivity stuff. So much of that comes from the Governing Board and Executive and the support that you

provide that allows that objectivity and independence.

The review team did have one recommendation relating to hiring a new staff person to replace the senior person. Kelly Crawford assumed the Director position at Portfolio, Management and Compliance. And as I introduced to you earlier today, that position has been filled as of this morning.

Okay. The next agenda item, Item 2(c)(2) is an internal audit on the Energy Assistance, Weatherization Assistance Program, subrecipient monitoring. You all are with me on that? Again, this report has previously been released to you. This was in December. So I will keep my comments fairly summarized.

Energy Assistance has generally had strategies in place to provide reasonable assurance of compliance with laws, regulations and provisions of contracts and that performance goals are achieved. We did note various conditions and they preclude EA from achieving these objectives.

And of course, we reported on those, made our recommendations, management agrees with those issues we noted. Agrees with our recommendations, and have agreed to take corrective action. I have provided a summary for you in your request, in your summary behind the tab, and I

will be glad to touch on each of those, if it is the pleasure of the Board or not.

MR. BOGANY: Ms. Ray, are you okay with that?

MS. RAY: I --

MR. BOGANY: Okay.

MR. GAINES: I am sorry?

MR. BOGANY: I am okay with it, and Ms. Ray is okay with it. So we don't have to hear the details on it, because you have given us the summary.

MR. GAINES: Very good.

MR. GERBER: Mr. Chairman?

MR. BOGANY: Mr. Gerber.

MR. GERBER: I just have one note. When management received the report, we take it very seriously, and we have worked very closely. Amy Ailert [phonetic], who is our manager for the Energy Assistance area reviewed that report, and is working through improving procedures to monitor subrecipient compliance. We admit that we have gotten a little bit lax in some respects that this audit pointed to.

And we are working very aggressively with those subrecipients to ensure that we address the procedures, and have the procedures in place to do appropriate monitoring and to make sure that those subrecipients know

that we have higher expectations of them to report to us on a regular basis, so that we can keep our -- to make sure that our requirements are being met, and that we can run a program that is the way we want to --

MR. GAINES: And I would like to say that one of the reasons this audit came up is it has been awhile since it had been audited. We were having changes in management and I believe Amy over here showed up a few weeks before we started the audit and her and staff were great to work with; cooperative, interested in recognizing these problems and interested in dealing with them.

MR. BOGANY: Well, it seems as though we have come a long way from when I came on the Board and nobody was even talking about an energy audit. I guess my thought is that we have come a long way. And Mr. Gerber's thought, we have got a ways to go, and we'll make it there.

MR. GERBER: Well, we do great work in that area, and we serve a lot of people. And it is just, you know, we want a very good program with some of the process improvements that have been recommended to us -- we will be running a great program. And Amy and Mr. Fariss who heads up Community Affairs are just the leaders to make that happen.

MR. BOGANY: Okay.

MR. GAINES: The next item, 2(c)(3) is the status of prior audit issues. Speaking of great progress, I am having a hard time remember exactly how long you have been with us, Mr. Bogany. But I have been here longer than that. And I remember this report then, 38 pages long.

MR. BOGANY: It is 14 now.

MR. GAINES: More findings than that. And the only reason it is this long, is because of some recently released audits. Management has been very good about recognizing the importance of these issues, and dealing with them. And again, the -- maybe what is measured is what is performed. But I think that it as much as that, it is the interest expressed by the Board and Executive in resolving these issues.

For the sake of Ms. Ray here, I am going to touch on exactly what this report is all about in the first place. It provides an overview of the current status of prior audit issues that have been noted either by the internal auditor, or the Internal Audit Division, the external auditors, funding source monitors.

External auditors will include the State Auditor's Office, KPMG, Deloitte and Touche, state

oversight agencies, any kind of oversight comment we include on this report. And they are removed from the report, once they are reported to you, and once management reports to you that they are implemented.

Now, while they are removed from the report, they are maintained in a database until through independent verification, either by internal audit or external audit, they are independently verified, and they verify managements reporting that they have been implemented. So once they are independently verified, then they are removed from the database.

So with that, we have 13 issues being reported. Management has reported one of these issues resolved. Progress on addressing the remaining issues. It appears to be moving forward in a satisfactory manner. There are a couple of issues that I have summarized for you that are probably worth mentioning now, and mentioning.

The first bullet relates to an issue that we are waiting on HUD's approval. So in some instances, timely correction of these things is kind of in a third party's hands. And it is difficult to move forward on.

So that is just -- I just wanted to bring that to your attention. That might be one reason why things take a while. Other reasons may be information systems

that can take a long time to develop. So there are reasons at times for considerable delays.

I wanted to bring to your attention the second bullet on your summary there. These are four issues relating to the OCI program contract for deed, relating to subrecipient monitoring.

And as management discussed these issues and considered our recommendations, and one of the recommendations was consider alternatives, including third party monitors, including our existing infrastructure, Portfolio Management and Compliance. And they have decided that the best strategy would be to move these responsibilities to Portfolio Management.

And so I wanted you all to be aware of that, that the monitoring function of the contract for deed programs is moving to PMC on a forward basis. There is a similar issue relating to the self-help centers.

And there has been some discussions on that. And I believe forward movement at this point is pretty much pending Executive's comfort with the right strategy.

And they have been discussing those, the value of doing it in-house versus maybe contracting it out. Up to this point, ORCA has been doing it. But it has been a real informal arrangement. And so there has been discussions

on formalizing that.

MR. GERBER: And I would just add to Mr. Gaines' comment, that we would very much like to do it in-house. The issue really stems from the capacity of PMC.

We have put an awful lot of expectations on them in addressing outstanding issues, and now we are adding -- we have already added one set of tasks to them.

They are playing a role increasingly with the CDBG funds. And so the question is, where would this monitoring function be best placed, given our staff resources. And we are going to have some discussions about that, I think, we also need to report to you at the next meeting.

MR. GAINES: The last item is the status of internal external audits. There has been a whole lot going on here, because we are kind of in between projects, starting new projects. And internal audit has begun Phase One of the project, you approved previously. So we have begun on that.

The Energy Assistance monitoring audit was just presented to you. As I previously spoke of, there has been some delays in the Manufactured Housing Divisions Homeowners Recovery Trust Fund. And in agreement with the Executive Director, we are going to review some corrective actions they have taken since some of our field work.

The statewide, the federal single audit -- well, I have also listed the external audits, which were of course, just presented to you. The statewide federal single audit is the next big audit that will be released.

This has been going on since last May, probably. And it is again, the statewide federal audit at the Department of Housing and Community Affairs.

They have focused the major programs being reviewed for the HOME program and Community Services program. They are expecting to release that audit this month, in February. So as that is released, I will bring that back to you.

MR. BOGANY: Okay. I had a question for you. And Ms. Ray mentioned it earlier. What do you recommend to us, as far as meeting?

MR. GAINES: As meetings?

MR. BOGANY: Based on what you know what we are doing right now, and what you have on the table at this point in time.

MR. GAINES: I would recommend a good time to meet would be after Phase One on that project. Because we will have a report then. There will be the KPMG audit will have been released by then. That will allow enough time, I think, for us to get a better handle on these

other projects to report to you. And that is anticipated for completion in April. So maybe May?

MR. BOGANY: For our next meeting? Mr. Gerber?

MR. GAINES: We have really dealt with it, those meetings, the frequency is based on the pleasure of the Board. And when there is a lot of audit issues going on, a lot of audit findings. In the past, we have met monthly. And we can, as you have trouble sleeping at night, we need to meet more frequently.

MR. GERBER: Mr. Chairman, I have trouble sleeping at night with the CDBG funds. And so, I would -- I might wish to report out to you before then. May would be fine, but if we could be flexible about perhaps March or April.

MR. BOGANY: Okay.

MR. GERBER: Or April. April or sooner if needed.

MR. BOGANY: So the CDBG funds is really the priority of the -- that we have got coming down, because there is so much money coming through.

MR. GAINES: Based on the interest expressed by the Board in awarding those funds, based on discussion with Executive, I believe of those projects, that is where our priorities need to lie. And we'll be focusing on

that. And if necessary, at the expense of other projects, if I can say so.

MS. RAY: Mr. Bogany, I think what I hear is, we need to be flexible, and the process needs to be more static rather than fixed, based on the dynamics of the business. And I feel comfortable with that, rather than setting a fixed schedule.

MR. BOGANY: One question I had for David, with the monies that are coming in, and I guess Mr. Gerber, with the monies coming in, are we going down to these subrecipients and telling them, this is what we are going to be looking for? So they understand what you as an auditor is going to be looking for, and what we are going to be judging everything on.

MR. GAINES: About three weeks ago, went out to the affected regions, hurricane disaster affected regions.

Really at the request of Mr. Gerber and several of us went out. And the purpose of that review was to put together a questionnaire of what I considered to be some of the higher risk areas. It had to be pretty general and high level, because our goal was to meet four subs in three days. And so just that questionnaire alone is giving them some idea of what we are looking at.

Beyond that, the Department has provided them

an implementation manual of materials we expect them to comply with. It looks about like that. And they are aware that we have a monitoring function within the Department and that they are subject to monitoring.

This week, there has been a field monitoring visit by Portfolio, Management and Compliance. And I'm wondering if any of them are here, because I was thinking they might be back by today. But I think they are fully aware of what we are reviewing, and monitoring what they are doing, as draw requests come in, we are reviewing supporting documentation. And so, yes, they are aware that there will be those reviews.

MR. GERBER: And Mr. Chairman and Ms. Ray, I would just add that -- and our friends from Southeast Texas Regional Planning Commissioner here, Mr. DuBose, and Councilwoman Simmons, and Pete De La Cruz as the acting Executive Director. Of course, we are always pleased to be joined by Representative Deshotel. Thanks for joining us.

We have intended to go at it early again, much as with the HOME program. We want to get into the nits of how they have designed their program, so that if there is a process problem, we can throw a flag early, and change it before large sums of money have gone out the door. We

also want to put an emphasis, though, on getting those dollars out the door as quickly as we can. So we have committed to partnering really with internal audit, understanding again, that importance of independence, but being sure that we are communicating.

And David has done a great job in pointing out to us some things that we might need to be doing in terms of technical assistance to the Councils of Government and to the subrecipients, the City of Port Arthur, the City of Beaumont, with respect to that first tranche of money. And so we are working through that.

Part of this is that Kelly Crawford, who again, used to be our deputy internal auditor is now the head of PMC, was doing, when she was out there, was again to really work through the financial processes, and following up on some of the things that David had learned three weeks ago.

And we are going to continue to have those kinds of visits and have a -- hopefully, a robust feedback loop of what David is finding, that we can add technical assistance to, to tweak and improve. But ultimately at some point, audit findings come about. And the reporting needs to be very clear. Certainly, to this Committee and to management. And so we are working hard to make sure

that that is in place. But it has been very cooperative.

MR. BOGANY: Okay.

MR. GERBER: And I think the expectations from the subrecipients is well known at this point.

MR. GAINES: I would just like to add to that.

I have also been in communication with the HUD OIG to solicit concerns, particular problems they have been noting in their consideration of the funds. I intend to do the same with the HUD monitoring section. That hasn't borne a lot of fruit up to this point, but most of us receiving the information they have been asking for different things. So that hadn't worked out real well, finally.

They are wanting to know what our plans are. But maybe what that will lead to is, I will share with them, this is what I think we need to be focusing at. If they have other particular concerns or higher risk areas, hopefully that information, that feedback will come back to me, and we can address those, too.

MR. BOGANY: Okay. Ms. Ray, do you have any other questions for Mr. Gaines?

MS. RAY: No, I don't. Thank you, Mr. Gaines.

MR. GAINES: Thank you.

MR. BOGANY: All right. If there are no

further questions, can I entertain a motion to adjourn?

MS. RAY: So moved.

MR. BOGANY: Second. All those in favor, aye.

(A chorus of ayes.)

MR. BOGANY: The Audit Committee meeting is
over.

(Whereupon, the meeting was adjourned.)

C E R T I F I C A T E

IN RE: TDHCA Audit Committee Meeting
LOCATION: Austin, Texas
DATE: February 2, 2007

I do hereby certify that the foregoing pages, numbers 1 through 49, 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) 2/07/2007
(Date)

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