TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

John H. Reagan Building
Room 140
105 West 15th Street
Austin, Texas

January 23, 2014
8:30 a.m.

COMMITTEE MEMBERS:

LESLIE BINGHAM ESCAREÑO, Chair
TOM GANN, Member
J. MARK McWATTERS, Member

SANDY DONOHO, Secretary of the Committee

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

### CALL TO ORDER, ROLL CALL

### CERTIFICATION OF QUORUM

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**ON THE RECORD REPORTING**  
(512) 450-0342
Item 8  Presentation and Discussion of the Status of the Fraud, Waste, and Abuse Hotline and Other Fraud Complaints

EXECUTIVE SESSION

Public Comment on matters other than items for which there were posted agenda items. Public comment may include requests that the committee place specific matters on future agendas for consideration.

ADJOURN
MS. BINGHAM ESCAREÑO: Good increasingly chilly morning. I'm very glad to see you guys bright and early. Welcome to the Audit Committee meeting of the Texas Department of Housing and Community Affairs. I'm Leslie Bingham, the committee chair, and we'll start with roll call. Other committee members, Mr. Gann?

MR. GANN: Here.

MS. BINGHAM ESCAREÑO: Mr. McWatters?

MR. McWATTERS: Here.

MS. BINGHAM ESCAREÑO: Okay. I think we can do business then.

Sandy, I'll turn to you as we go through the agenda. The first agenda item is the approval of the September minutes. If the committee members have had a chance to look at those and if there are no recommended revisions, then I'll entertain a motion to approve.

MR. GANN: I so move.

MS. BINGHAM ESCAREÑO: Mr. Gann moves.

MR. McWATTERS: Second.

MS. BINGHAM ESCAREÑO: Mr. McWatters seconds.

All those in favor, aye.

(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)
MS. BINGHAM ESCAREÑO: Motion carries. Great.
Let's move to item 2 which is: Presentation, discussion and possible action on the acceptance of the 2013 audit results from the State Auditor's Office.
Sandy.

MS. DONOHO: For the record, I'm Sandy Donoho, director of Internal Audit.
As you know, the Department's governing statutes require an annual audit of the Department's books and accounts and an annual audit of the Housing Trust Fund and an audit of the financial statements of the Housing Finance Division and the supplemental bond schedules. These are required by the Department's bond indentures. This year, as the last couple of years, the State Auditor's Office performed these audits under contract with the Department. Verma Elliott, audit manager, and Amadou N'gáide, managing senior auditor, are here from the State Auditor's Office to discuss the results of this work.

MS. BINGHAM ESCAREÑO: Good morning.
MS. ELLIOTT: Good morning. For the record, my name is Verma Elliott. It's nice to be here again.
The SAO is required by auditing standards to communicate with those charged with governance, which would be the Board, about various things. This is that
communication. In addition to this, we also emailed the entire Board, on December 30, a written communication detailing specific things about the audit, and so without further ado, Amadou is going to go and talk about the deliverables we did during the audit.

MS. BINGHAM ESCAREÑO: Thank you. Good morning.

MR. N'GÁIDE: Good morning, Chairman, members.

For the record, my name is Amadou N'gáide, and I was the project manager of the State Auditor's Office team that audited the financial statements for fiscal year 2013.

In our audit report, dated December 20, 2013, we concluded that the Department's basic financial statements and the Revenue Bond Program Enterprise Fund financial statements for fiscal year 2013 were materially correct and presented in accordance with accounting principles generally accepted in the United States. We also concluded that the Department's computation of the unencumbered fund balance of its Housing Finance Division complies with the Texas Government Code, specifically Sections 2306.204 and 2306.205.

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those we believe are trivial, and communicate them to management, and management has
corrected all such mistakes.

We also issued a report on interim controls over financial reporting and on compliance and other matters, as required by auditing standards. In that report we identified that the Department has an application on a server that uses an operating system that the vendor no longer supports. As a result, the Department can no longer update the operating system with software patches necessary to fix known vulnerabilities. Servers using unsupported operating systems do not receive any update patches from the vendor and vulnerabilities from the lack of patches may leave the Department's servers susceptible to internal or external attacks which could lead to unauthorized access and compromise the Department's sensitive data.

We communicated this issue on the security of the Department's server to management in fiscal year 2011 and 2012, and in the past few days, management has contacted me to let me know that the operating system has been upgraded and the patches have been applied, but that occurred after the audit so we have not performed any auditing procedures to verify that.

Additionally, we concluded that the Department's financial data schedule prepared by the Department was fairly stated in all material respects in
relation to the financial statements of the fiscal year 2012 as a whole. We also issued a report on the Department's compliance with the Public Funds Investment Act and we determined that the Department complied with the Act.

We also performed agreed upon procedures to assist the Department in determining whether the electronic submission of certain information to the U.S. Department of Housing and Urban Development Real Estate Assessment Center agreed with the related hard copy documents. Our procedures determined that the Department electronically submitted information to the U.S. Department of Housing and Urban Development Real Estate Assessment Center agreed with the related hard copy documents.

The Department management was very cooperative during the course of the audit and we did not encounter any disagreements, and we appreciated working with them.

This concludes my presentation, and I'll be happy to answer any questions that you have.

MS. BINGHAM ESCAREÑO: Thank you, Amadou.

Any comments, Sandy?

MS. DONOHO: No. I did want to mention, though, that Curtis Howe, our IT director is here if you have any questions about the IT finding.
MS. BINGHAM ESCAREÑO: Very good. Pretty self-explanatory. Committee members, any specific questions?

Any other comments from management?

(No response.)

MS. BINGHAM ESCAREÑO: Thank you very much for the time you spent with our team. It sounds like overall it was a really favorable audit, and we appreciate the energy that you put into it.

MR. N'GÁIDE: Thank you for having us.

MS. BINGHAM ESCAREÑO: Thank you very much, Amador.

We need a motion to accept.

MR. GANN: I make the motion that we accept the State Auditor's report as presented here today.

MS. BINGHAM ESCAREÑO: Thank you. Mr. Gann moves.

MR. McWATTERS: Second.

MS. BINGHAM ESCAREÑO: Second by Mr. McWatters.

Any other discussion?

(No response.)

MS. BINGHAM ESCAREÑO: All those in favor, aye.

(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)

MS. BINGHAM ESCAREÑO: Motion carries. Thank
you very much.

Item number 3: Presentation, discussion and possible action on the 2014 Internal Audit Charter and Board Resolution No. 14-012.

MS. DONOHO: The audit standards require we have an annual discussion regarding the definition of internal auditing, our auditing standards, our code of ethics and auditor independence. The issues are addressed in the charter and the Board resolutions which are up for your approval today.

Let's first talk about the definition of internal audit. Internal audit is an independent objective assurance and consulting activity. It's designed to add value and improve the organization's operations. It helps the agency accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management control and governing processes. That's the definition from the Institute of Internal Auditors.

The Internal Audit Division follows the Institute of Internal Auditors international standards for the professional practice of internal auditing and the U.S. Government Accountability Office's Government Auditing Standards on every audit we do. The standards are required by the charter and by the Internal Auditing Act,
which is the state law that governs internal audit, to ensure that the division's work is independent, thorough, accurate, reliable and objective.

The Internal Audit Division has adopted and complies with the institute of Internal Auditors Code of Ethics. This is also required by our charter. The code of ethics requires all of the auditors to uphold the principles of integrity, objectivity, confidentiality and competency, as well as twelve rules of conduct related to those principles. Organizational independence requires Internal Audit to report to a level of the Department that allows us to fulfill our responsibilities without interference from management and to be free of operational and management responsibilities that would impair our ability to independently review the Department.

Our charter assures our organizational independence by requiring that I report to the chair of the audit Committee, as well as to the entire Board. Individual independence requires that each member of the audit staff have an impartial unbiased attitude and avoid any conflicts of interest. The Internal Audit Division meets the independence requirements. The Internal Auditing Standards require an annual approval of the charter and the Board resolutions, so that's why we're doing that this year. We have been doing that every
January for the last couple of years since the standards started requiring that.

The content of the charter and the resolutions has not changed since their last approval in January 2013.

I think we finally got it right. So unless the standards change, we don't change the charter, for the most part. There are copies of both the charter and the Board resolutions in your book. They're also on the consent agenda for the full Board meeting. Are there any questions about the charter or the Board resolution, internal auditing, code of ethics, independence?

MS. BINGHAM ESCAREÑO: Does the committee have any questions?

(No response.)

MS. BINGHAM ESCAREÑO: So this is an annual approval item up for action. I'll entertain a motion to approve the charter and the resolutions and the definitions, everything together? Motion?

MR. GANN: I'll make the motion.

MS. BINGHAM ESCAREÑO: Mr. Gann moves. Second?

MR. McWATTERS: Second.

MS. BINGHAM ESCAREÑO: Mr. McWatters seconds.

Any other discussion on this item?

(No response.)

MS. BINGHAM ESCAREÑO: All those in favor, aye.
(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)

MS. BINGHAM ESCAREÑO: The motion carries.

Thank you very much, Sandy.

We'll move on to item number 4: Presentation and discussion of the status of the FY 2014 Internal Audit Work Plan.

MS. DONOHO: There are six audits on the plan this year. There's a copy of the plan in your book with our current status on them. There's also one contingency audit. We've completed one of the six audits which is the audit of the ethics program, as well as our carryover audit from last year's audit plan which is the loan processing audit. We'll talk about both of those under agenda item number 5.

We're wrapping up field work on the audit of the Low Income Housing Energy Assistance Program, also called LIHEAP, and we're in the planning phase of the audit of the Manufactured Housing Division's titling process. You won't hear about that because they have a separate board, but we do want to keep you advised of our status in terms of where we're at on that work.

Since we're almost five months into this fiscal year, we're a little behind schedule. We have one staff
who was out for about three months and we have another
staff who will be out for about three months this summer.
Although we're excited about the pending arrival of the
baby auditor, with only three auditors on staff, having
anybody out for any length of time is a challenge and
losing six months of audit work is like losing half of one
of my staff members this year.

I really don't want to modify the plan yet, I
want to see how much progress we can make, and maybe in
May we'll talk about whether we need to drop something off
or maybe shorten the scope on an audit or something like
that. As usual, I'm doing some of the audit work myself,
as time allows. For example, I'm the only IT auditor in
Internal Audit, so I'm going to be performing most of the
IT work on the Manufactured Housing audit.

In addition to the audits on our plan, we've
completed a couple of our non-audit requirements that
aware also in our plan, including our quality assurance
self-assessment review, which we'll also talk about under
item number 5, and our annual revision of the charter and
Board resolutions that we just discussed.

Are there any questions on the status of the
2014 Audit Plan and the work we've performed so far?

MS. BINGHAM ESCAREÑO: We had one carryover
also, or no? Were we wrapping up one from the prior year
too?

MS. DONOHO: Yes, and that's the loan processing one that I talked about.

MS. BINGHAM ESCAREÑO: Okay. Very good. Does the committee have any other questions about the plan? It's still aggressive. Thank you guys for your work. You work really well together as a team.

This isn't an action item so if no other questions, we'll move on to item number 5 which is: Presentation and discussion of recent Internal Audit reports.

MS. DONOHO: As we just talked about, we have completed two audits and we have two special projects that we've also completed since the last Audit Committee meeting. The first one was an internal audit of loan processing, and this was the carryover audit. We felt like the Department should ensure that it receives trailing documents required as evidence that a loan is valid and properly secured. The title companies don't always send the trailing documents back to the Department and the Department doesn't consistently run the reports needed to identify the missing documents.

We looked at 90 loan files and found that ten, or 11.1 percent, didn't contain evidence that the Department received a recorded deed of trust, five or 5.6
percent, were missing evidence of a title policy, and two, or 2.2 percent, were missing evidence of a final HUD-1 settlement statement. I do want to qualify that this doesn't mean those documents don't exist, it just means that the Department doesn't have a copy of them, and if something were to happen and we needed a copy of them and the title company closed down, we couldn't find a copy, it could present a problem. So we wanted to point out that our policies say that we should have those documents on file, that we should make sure we have them.

In addition, the Department should ensure it has a current title commitment before closing a loan. HOME Program rules in the Texas Administrative Code require a current title commitment prior to the execution of loan closing documents. Of the 90 files we looked at, 13, or 14.4 percent, were closed after the title commitment had expired.

Other documents for which evidence was missing was the truth in lending disclosure required by the Truth in Lending Act and the loan servicing disclosure required by the Real Estate Settlement Procedures Act, or RESPA. Six or 6.7 percent of the 90 files we looked at were missing at least one of these disclosures. The Department should maintain copies of the disclosures to verify they were provided to the borrower as required by federal
rules, so these documents are provided to the borrower to
tell them about their rights under various federal laws.

Management has indicated they agree with the
recommendations in this report and they're working to
implement them. Are there any questions?

MS. BINGHAM ESCAREÑO: Any questions?

MR. GANN: Do they have a checklist or anything
that they go by when the office receives them in?

MS. DONOHO: Yes, they do.

MR. GANN: If they have a checklist, it seems
like that would show up.

MS. DONOHO: I think that they do, but the
length of time that it takes for some of the trailing
documents to come in, you know, they move on to other
stuff and they can run a report that tells them what's
missing but they don't do that often enough, and then it
sort of gets lost in the shuffle. But they do have
checklists for everything.

MR. GANN: Good.

MS. BINGHAM ESCAREÑO: Any other questions?

(No response.)

MS. DONOHO: The next audit is an internal
audit of the ethics program. Although the Department has
an ethics policy and they provide staff with periodic
reminders regarding the policy, we felt like there were
opportunities to enhance the ethics program. Some of the opportunities we identified include considering conducting an ethics risk assessment, which I believe has already been completed, requiring periodic ethics training, requiring written acknowledgment that employees have received ethics training, increasing communication of the ethics policy, posting examples of ethical dilemmas and appropriate responses on the Department's intranet site, maintaining a complete log of gifts received and their disposal, and keeping a consistent record of any ethics opinions issued by the ethics officer, who is Jeff Pender. Management has indicated they agree with the recommendations in this report and they're working to implement them. Are there any questions on the ethics audit?

MS. BINGHAM ESCAREÑO: Any questions on the ethics audit?

(No response.)

MS. BINGHAM ESCAREÑO: Any comments from management?

MR. IRVINE: No.

MS. BINGHAM ESCAREÑO: Thank you.

MS. DONOHO: The next thing I want to talk about is one of our non-audit projects which is the quality assurance and improvement program. We call it the
QAIP because in state government we always have to have an acronym.

(General laughter.)

MS. DONOHO: And it's a self-assessment. Every three years we do a peer review, as you know, and we had a peer review last year. In the years when we don't have a peer review, we're required by standards, Internal Auditors International Standards for the Professional Practice of Internal Auditing requires us to develop and maintain a quality assurance and improvement program, and part of their requirement is that we evaluate the Internal Audit's activity and our compliance with the definition of internal auditing and the standards and the code of ethics. So when we don't have a peer review, we do an annual self-assessment and we use the same peer review tool that is used during the peer review itself.

To perform this self assessment, we review the working papers for all the reports we release during the fiscal year, so this was fiscal year 2013. This review was performed by the staff who didn't work on the audits they reviewed, so say for example, Betsy did an audit, then Derek or Nicole would do the review on that audit. I also review every working paper that's done in the Department.

The results from the most recent self-
assessment is we believe we're fully compliant with the standards. We didn't find any audit work that was non-compliant. So it feels a little weird to say, well, we did a self-assessment and we think we're in compliance, but a peer review every year is not a reasonable thing, so we do try to diligently do that and we have had self-assessments where we felt like there were areas where we could improve, but this year we really didn't find anything where we felt like we could improve.

Are there any questions on our self-assessment?

MS. BINGHAM ESCAREÑO: Do the committee members have any questions?

MR. GANN: No.

MS. BINGHAM ESCAREÑO: You didn't want to put an I and an A in front of it so it would be IAQAIP?

(General laughter.)

MS. BINGHAM ESCAREÑO: It's a good practice in the off years.

If there are no other questions on item 5, we'll move to item 6 which is: Presentation and discussion of the status of external audits.

MS. DONOHO: It's been pretty quiet, surprisingly. I mean, usually by this time we've had several visits from our federal partners and other auditors, but surprisingly, it's been pretty quiet. I
think with ARRA going away and things like that, there just haven't been a lot of audits going on. That probably makes everybody at the Department, but me, happy.

So have two that are on our table for this year: the SAO audit that you just heard about, and KPMG finished work on the Department's portion of the statewide audit of federal funds. This year they looked at LIHEAP as well, which is the same program that we're auditing, but we're looking at different things than what they looked at in the LIHEAP program. That report will be issued in March, so we'll be talking about it in May. And the last I heard, things were looking pretty good. I think they had one finding that had to do with some paperwork or something, but nothing significant.

MS. BINGHAM ESCAREÑO: So we don't need any action on this item either today. Right? We'll revisit in May.

Any questions from the committee members on the two external audits?

(No response.)

MS. BINGHAM ESCAREÑO: Then we'll move on to item 7: Presentation and discussion of the status of any prior audit issues.

MS. DONOHO: Well, I'm happy to report that at this point we have five, so that's good news. We had 30
this past fall. That number changes on a regular basis, so as long as it's not in the 100s, I'm good with that. How this works is that every time we do an audit we report on it to you and then we add them to the list. So for example, the ones that we just talked about the, ethics audit and the loan processing audit, now those findings will be added to the list and that number of five will go up. Of the five that we have, four were recently reported by management as implemented. They're on the attached list. We'll verify and close those once we have received the supporting documentation and have time to sit down and take a look at it. All four were for the Compliance Division.

We have one issue that's still pending, and it's on the list. We'll verify and close that once it's reported as implemented and that's also for the Compliance Division from the compliance audit we did last year. So then once they have been verified and closed, they roll off the list.

Also, it should be noted that HUD recently closed several audit findings related to a June 2012 monitoring of the HOME Program. The letter from HUD closing these findings is also in your Board book, and we took those off of the list as well, because they closed them.
MS. BINGHAM ESCAREÑO: And we're kind of at their mercy, so it hangs on our list until they clear it, and then we take it off of ours.

MS. DONOHO: Right.

MS. BINGHAM ESCAREÑO: Even though we have notes saying that we've done what we needed to do, we're just waiting for validation from HUD.

MS. DONOHO: Right. The way HUD does it, it seems like they want to close their own, and so they send a letter saying we've verified this and it's been closed, and so we wait for that. Also, if I worry about timeliness in Internal Audit, it's nothing compared to the timeliness of the federal audits. So we have one audit in the weatherization area from the ARRA days that we're still waiting to see, and I think that dates back to 2010, the final audit report.

MS. BINGHAM ESCAREÑO: Very good. This item doesn't require action, but does the committee have any other questions relating to the things pending on the list, or now the thing, really, this snapshot in time?

(No response.)

MS. BINGHAM ESCAREÑO: Very good. Okay. So if no other comments, we'll move on to agenda item 8 which is: Presentation and discussion of the status of our fraud hotline and fraud waste and abuse complaints.
Sandy, do you want to go over the fiscal year?

MS. DONOHO: It's been busy so far this fiscal year. Through December 31, 2013 are these numbers. We received 24 fraud complaints. Of these, 21 were received on our hotline, four were related to the Department's programs or staff, two were tax credit, one was multifamily and one was a personnel issue.

Seventeen were not related to the Department's programs or staff. These callers were referred to the appropriate agency for assistance. Generally, when we get those types of calls, it's a Section 8 and it's like City of Dallas or something where they have a participating jurisdiction and the funds flow directly from HUD to them, so we give them the local housing authority's number and ask them to call there.

There were three complaints that we received from other sources. All were related to the Department's programs. One was CEAP or WAP, weatherization, one was compliance, one was tax credits, two came from TDHCA staff, one came from the public.

The seven complaints that we had for TDHCA were resolved as follows: three were referred to the State Auditor's Office; two were investigated and closed, were unfounded; two are pending, and both of the pending complaints we received in December so they're really
current.

Are there any questions regarding the fraud hotline calls or fraud complaints?

MS. BINGHAM ESCAREÑO: Do the committee members have any questions about any of the specific notes on the report?

(No response.)

MS. DONOHO: Okay. Then that concludes our agenda items. That's all I have.

MS. BINGHAM ESCAREÑO: That was quick. Do we have any issues for executive session, anything that you want to bring up? There's no items for executive session, so we'll not have an executive session.

I'll open the floor for any public comment, except that it's getting colder outside.

(No response.)

MS. BINGHAM ESCAREÑO: Very good. Well, then I'll entertain a motion to adjourn, but before I do that, just wanted to thank Nicole and Derek and Betsy again for their hard work and good leadership. Thank you, management, thank you for your cooperation. It looks really collaborative, it looks like there's good communication going on, no major issues or concerns at this point, but the committee appreciates the work of the entire team. With that, I'll entertain a motion for

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adjournment.

MR. McWATTERS: So moved.

MR. GANN: Second.

MS. BINGHAM ESCAREÑO: Mr. McWatters moves, Mr. Gann seconds. All those in favor, aye.

(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)

MS. BINGHAM ESCAREÑO: Thank you very much. Motion carries, we're adjourned. Thank you very much.

(Whereupon, at 9:00 a.m., the meeting was concluded.)
MEETING OF:  TDHCA Audit Committee
LOCATION:  Austin, Texas
DATE:  January 23, 2014

I do hereby certify that the foregoing pages, numbers 1 through 27, 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.

01/28/2014
(Transcriber)         (Date)

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