TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT COMMITTEE MEETING

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

November 12, 2015
9:00 a.m.

MEMBERS:

LESLIE BINGHAM ESCAREÑO, Chair
T. TOLBERT CHISUM
TOM H. GANN
**INDEX**

<table>
<thead>
<tr>
<th>AGENDA ITEM</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>CALL TO ORDER, ROLL CALL, CERTIFICATION OF QUORUM</td>
<td>3</td>
</tr>
<tr>
<td>Item 1: Presentation, Discussion and Possible Action to Approve the Audit Committee Minutes Summary for July 30, 2015</td>
<td>3</td>
</tr>
<tr>
<td>Item 2: Presentation, Discussion and Possible Action to Approve the Fiscal Year 2016 Internal Audit Work Plan</td>
<td>4</td>
</tr>
<tr>
<td>Report Items:</td>
<td></td>
</tr>
<tr>
<td>1. Discussion of Recent External Audit Activity</td>
<td>10</td>
</tr>
<tr>
<td>2. Discussion of Internal Audits and Consulting Activity</td>
<td>15</td>
</tr>
<tr>
<td>3. Update on the Fraud, Waste and Abuse Statistics</td>
<td>18</td>
</tr>
<tr>
<td>PUBLIC COMMENT ON MATTERS OTHER THAN ITEMS FOR WHICH THERE WERE POSTED AGENDA ITEMS.</td>
<td>none</td>
</tr>
<tr>
<td>EXECUTIVE SESSION</td>
<td>none</td>
</tr>
<tr>
<td>ADJOURN</td>
<td>22</td>
</tr>
</tbody>
</table>
MS. BINGHAM ESCAREÑO: Good morning. Welcome to the Audit Committee for the Texas Department of Housing and Community Affairs.

We'll start with roll call. Mr. Chisum?

MR. CHISUM: Present.

MS. BINGHAM ESCAREÑO: Mr. Gann?

MR. GANN: Present.

MS. BINGHAM ESCAREÑO: Very good. I'm here, so that's three members present, none absent. Thank you for being here today.

We'll start with agenda item 1 which is the presentation, discussion and possible action to approve the Audit Committee meeting minutes from the last meeting in July. Is there any discussion? Has everybody had a chance to review the minutes? I'll entertain a motion to approve.

MR. GANN: I so move.

MR. CHISUM: Second.

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

(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)

MS. BINGHAM ESCAREÑO: Motion carries. We'll
approve the minutes.

       Al right. Moving on to agenda item 2, presentation, discussion and possible action to approve our 2016 internal audit plan. Good morning, Mark.

       MR. SCOTT: Good morning.

       MS. BINGHAM ESCAREÑO: Would you like to review the plan with us.

       MR. SCOTT: Yes, ma'am. My name is Mark Scott. I'm the Internal Audit director.

       The Texas Internal Auditing Act requires that an annual audit plan be prepared using risk assessment techniques. The audit plan was prepared based on a risk assessment done in a standard matrix format. The function that rated highest on the list was Fair Housing because of the high public interest and the importance to the agency mission. The real estate analysis function rated high on the risk assessment because it has not been audited. The review of this area may look at financial analysis techniques such as discounted cash flow models.

       The compliance monitoring section of the Compliance Division was the next highest ranked unit. This section of the Compliance Division is different from the subrecipient monitoring which we have talked bout at length during our other Audit Committee meetings. The section of compliance we are proposing to audit this year

ON THE RECORD REPORTING
(512) 450-0342
checks to make sure that low income properties are actually used in accordance with affordable housing rules, along with other monitoring compliance issues.

And then four and five, the next two items are somewhat interrelated the Multifamily Finance Division ranked high as an organizational unit, while the Tax Credit Program is a program also rated high. Both of these have a high level of interest from the development community and intensive competition for resources that the programs provide is evident from the discussions at most Board meetings.

During the course of the year we can also accommodate requests from management and the Board. During the course of fiscal year 2015 there were requests for Internal Audit to assist with subrecipient monitoring and the new grant guidance, including the indirect cost provisions. Also, the Board chair asked for a review of audit and internal control activity for all of the various functions of the agency.

There's one carryover project from the audit plan that was approved last October, the program income audit. We are trying to have that done by the end of December.

So with that, I would like to ask for approval of the 2016 internal audit plan that is included in the
Audit Committee materials.

MS. BINGHAM ESCAREÑO: Great. Thank you, Mark. Did the committee have a chance to look at the plan as presented, and do you have any questions or any other thoughts?

MR. GANN: I thought it was very aggressive for him to take on such a load, and I told him that earlier. Also, each one of those is a lot of heavy weight for any group, and so if you need some help, I want you to holler quick and early because those are very aggressive selections you've made.

MR. SCOTT: Okay. I appreciate that.

MR. CHISUM: Well, I concur. And also, getting it done by the end of December, one of those items, that too is aggressive.

MS. BINGHAM ESCAREÑO: Getting the program income audit?

MR. CHISUM: Right.

MR. SCOTT: We'll have to be kind of selective in what we dig into on that.

MR. CHISUM: That's important. I accept the presentation and I make a motion that we approve.

MS. BINGHAM ESCAREÑO: Very good. Motion by Mr. Chisum to approve the audit plan as presented.

MR. GANN: Can I have a question for you?
MS. BINGHAM ESCAREÑO: Absolutely.

MR. GANN: Do we approve it or do we agree to pass it on to the Board for their approval? I think that's the case, isn't it?

MS. BINGHAM ESCAREÑO: I think it is too, to recommend approval to the full Board. Would you like to amend your motion?

MR. CHISUM: Yes, I do.

MS. BINGHAM ESCAREÑO: Very good.

MR. GANN: And I second that.

MS. BINGHAM ESCAREÑO: Very good. So we have a motion by Mr. Chisum to recommend approval to the Board, and a second by Mr. Gann.

Any comments from management, Mr. Irvine?

MR. IRVINE: Thank you very much. Tim Irvine.

First of all, we really appreciate the academic rigor of constructing and populating the matrix which was done with input from me and my teammates. I think it's a great way to approach this creation of a plan. We think it is a well targeted plan, and as you've all acknowledged, it's a pretty aggressive plan. These are a lot of big meaty issues.

The only caution there a note that I would roll out is with regard to activity on the Multifamily programs. We are in the throes of recovering from a lot
of personnel loss, and we've got some great new people in key positions but we still have some open positions. Obviously, Marni Holloway is our new director of Multifamily Finance, she's brand new in that area, and she's up to her eyeballs in QAP at the moment. And we have got some continuity, we've got a great strong lead with Theresa Morales, but we currently do not have a 9 Percent Program administrator, and we have also lost some key support on the side of housing finance programs.

So our ability to accommodate and work through audit issues is going to be, at least for the near term, limited, and I think that also, as Mark has established he's very capable of doing with his fantastic team is providing useful ideas on ways to make programs better and to minimize risk and perhaps as we work through those issues, at the appropriate stage in this cycle we can be mindful of those kinds of objectives. I think that the combination of Audit's insights and recommendations, along with a brand new and very receptive leadership core, that there can be some really great improvements to the programs.

MS. BINGHAM ESCAREÑO: Great. Good comments. Thank you, Tim.

So Mark, what do you think about that? So what the committee hears the director saying is because of some
personnel transition, some people are juggling more than a couple of balls, we have at least one key position that's still vacant. Do you see an opportunity to try to accommodate or modify either the order in which you do the audits scheduled for next year, if the plan is approved, or other opportunities to accommodate to make sure that you get what you need but we're not putting unnecessary, untimely strain due to just internal deliverables?

MR. SCOTT: Yes, I'll definitely work with management on that. We, as Audit, also have to juggle schedules, so we don't want to be doing something at a bad time because that will put us behind schedule also.

MS. BINGHAM ESCAREÑO: Great, very good. And just an individual note, I'm noticing great communication and interaction between management and the audit function which I think is so helpful, and I think what we're seeing, and especially with Mr. Irvin's optimistic comments about what can be accomplished through the audit function in years to come, it sounds like there's a good line of communication to ensure that you guys are doing what you need to do as the audit function but being open to the internal operational needs of the Department.

MR. SCOTT: Yes. And as far as me being the director of Internal Audit, it helps to have input from management on a continuous basis. That helps us to audit
the things that need attention.

MS. BINGHAM ESCAREÑO: Good, great. Any other questions from the committee members?

(No response.)

MS. BINGHAM ESCAREÑO: So we have a motion and a second to recommend approval of the 2016 audit plan to the full Board. All those in favor, aye.

(A chorus of ayes.)

MS. BINGHAM ESCAREÑO: Opposed?

(No response.)

MS. BINGHAM ESCAREÑO: Motion carries unanimously, so we'll make that recommendation.

MR. SCOTT: Thank you very much.

MS. BINGHAM ESCAREÑO: Thank you.

So agenda item number 3 would be the discussion of our recent external audit activities. Mark, do you want to update us?

MR. SCOTT: Yes. The external audits of TDHCA underway now are the annual audit of the Housing Trust Fund accounts and the KPMG audit of the HOME Program. HHS is also going to come out to review the LIHEAP Program in January.

The Trust Fund audits are performed by the State Auditor's Office. They do this every year and the audits are pretty routine. They audit the financial
statements and also audit for TDHCA's compliance with the Public Funds Investment Act.

The KPMG audit, KPMG is auditing the HOME Program as part of the statewide audit, and an issue has arisen over whether KPMG is going to use the new grant guidance as criteria or the old OMB circulars. And the contracts that KPMG is auditing that TDHCA has with the subrecipients were made under the old circulars, but KPMG wants to use the new grant guidance as criteria which would pretty much automatically result in numerous findings of noncompliance. TDHCA's position is that the new grant guidance does not apply for the current KPMG audit and HUD has stated that they agree with TDHCA's position. That situation is being monitored closely because a bad audit report from KPMG could harm the agency. And I'll answer any questions on that that there may be.

MS. BINGHAM ESCAREÑO: Great. So does the committee have any questions for Mark relative to that external audit activity or specifically where we are with KPMG?

(No response.)

MS. BINGHAM ESCAREÑO: So do you want to just quickly, for our own clarification, where is that? So we've gotten HUD's support for using the circulars. Where
are we, Mr. Irvin, in terms of that process and finalizing it?

MR. IRVINE: Sure. Tim Irvine again.

It is not a situation that has been definitively resolved one way or the other in my mind, and because of the way that an independent auditor functions, in effect, without definitive resolution one way or the other, the tie goes to the auditor. I think that KPMG is pretty locked in on its approach right now. The folks at HUD with whom we've spoken, I believe are understanding of and receptive of our position but the question is whether this can be escalated to a level in HUD that can speak definitively and clearly in a manner that KPMG would accept.

Just for a little more in-depth understanding of the issue -- and folks that are more knowledgeable are welcome to come up and chime in -- in typical contractual language there is often a provision that says this includes these laws and rules as now in effect or as they may hereafter exist. And when you have language like that, KPMG is of the view, and apparently has spoken with someone at HUD who was of the view that that meant that if there was a midstream change in grant guidance, such as there was when 2 CFR 200 was adopted, that that language automatically pulls it into existing contracts.
So you had old HOME award contracts that were created referencing the old A-133 provisions that predated 2 CFR 200, and it was always contemplated that that was the way that they would be administered. To the best of my knowledge, we've never received properly adopted federally promulgated regulations from HUD creating new requirements and specifying when they take effect and how they take effect. In other words, we haven't received the necessary HUD guidance to implement 2 CFR in the administration of our HOME awards.

So for those old HOME awards, everybody agreed, everybody thought, I believe our HUD local office thought that they were going to be administered in accordance with A-133, and that's the way they're playing out. And now for a late-breaking retroactive application of 2 CFR 200 to those contracts, we would be in a position where even though there is a lot of congruity between A-133 requirements and preexisting OMB requirements and 2 CFR 200, it's not a perfect match and we would be at risk of findings.

MR. SCOTT: And I'll add in addition to the A-133 there's the cost circulars that would be a problem if they used the new grant guidance.

MS. BINGHAM ESCAREÑO: Okay. Thank you, Tim. So Mark, let's say that KPMG does use the new
grant guidance and there are findings, what happens after that?

MR. SCOTT: What happens after that, they issue a report that has findings of noncompliance. With each finding of noncompliance they have an associated questioned cost, and in theory, by virtue of them putting that in the audit report, there is a mechanism whereby the federal funding agency would either say no, we don't agree with that finding or that the agency has to pay back the government for those questioned costs. So given the fact that HUD seems to be on our side for the most part, I would say that the net negative of it would just be having a very bad looking audit report. Chances are they wouldn't require any payback of questioned costs.

MS. BINGHAM ESCAREÑO: Okay. Thank you. That would be my thought too. I'm assuming part of the agency's response would be that under the new guidance that there hasn't really been operational guidance from HUD on how to go about making historical agreements comply with new grant guidance.

MR. SCOTT: Correct. And the new guidance has things like you have to put into the contracts the amount and the indirect cost rates and things like that, so to the extent that all of that stuff wasn't in all of the existing contracts, those would be findings.
MS. BINGHAM ESCAREÑO: Understood.

Any questions from the committee or any other comments from management?

(No response.)

MS. BINGHAM ESCAREÑO: So we'll accept that report. Thanks for the clarification. And we'll move on to report item 2, discussion of internal audits and consulting activity.

MR. SCOTT: Yes. The audits on the 2015 TDHCA Internal Audit plan, which was approved at the October 2014 Audit Committee included payroll, records retention, process, the HOME Program audit, and the program income audit. The payroll audit and the records retention process audit were presented at the April Audit Committee meeting. The audit of the HOME Program Single Family was taken off the plan because KPMG is auditing that program, and at the time that the 2015 Internal Audit plan was prepared, it was not known that KPMG would be doing that audit. And just by the way, dealing with KPMG has ended up taking substantial time. The program income internal audit is in progress and should be done by the end of December.

So I'll answer any questions on that section.

MS. BINGHAM ESCAREÑO: Any questions from the committee members on discussion of internal audits and
consulting activity this year? Any other comments from management?

(No response.)

MS. BINGHAM ESCAREÑO: Great. Thanks, Mark.

MR. CHISUM: I've got a question.

MS. BINGHAM ESCAREÑO: Mr. Chisum.

MR. CHISUM: What happens if we don't make the December deadline?

MR. SCOTT: I guess I miss my deadline.

MR. CHISUM: What are the repercussions?

MR. SCOTT: There really aren't any because the Internal Audit Act says that you have to have an annual audit plan. It doesn't even specify really the year you have to use, so we use a fiscal year just because it's kind of convenient and make sense, but the fact that an audit takes a little longer than we thought, there's not any repercussions really. The State Auditor, if there was an audit on the plan that didn't get done, then there would be repercussions, they'd be calling me saying where's this audit. But on this audit we pretty much have our arms wrapped around what the issues are at this point, we're just going to do some more testing a little bit and then get the report out.

MR. CHISUM: Okay. Well, I looked through the material and I didn't see any penalties or anything that
were associated with it, and so that's why I asked that question.

MR. SCOTT: Okay. Thank you.

MS. BINGHAM ESCAREÑO: Mr. Irvin.

MR. IRVINE: And I would like to chime in on that subject that it's incredibly useful and valuable, not only to management but to you in carrying out your responsibilities, to have the independence and knowledge and thoroughness of an independent process, but I want to assure you that management is always looking at all of its activities, all of its programs, all of its support functions and so forth to identify ways that operations may fall short of what they need to be or ways that they can be improved, and that's a process that never stops. So to the extent that we identify issues in our day-to-day work, we generally sit down as a team, caucus on them, incorporate Internal Audit so that they know what's going on, and try to fix them.

MR. CHISUM: Thanks you, Tim.

MS. BINGHAM ESCAREÑO: Thank you.

Any other questions on Internal Audit activity?

(No response.)

MS. BINGHAM ESCAREÑO: Great. Thanks, Mark.

Would you like to update us then on fraud, waste and abuse?
MR. SCOTT: Yes, ma'am. The Audit Committee materials include an update on the fraud, waste and abuse statistics. The numbers are high, and from what I understand, there was recently issued a handbook to the housing developments and that has some information in there that may facilitate them making these calls, so that could explain why the numbers are high, or partly. All the allegations have been or are being addressed, and there are regular meetings of the fraud, waste and abuse task group, and this group includes audit, legal and programmatic perspectives in deciding how to deal with the various allegations.

And that concludes my presentation. I'll be happy to answer any questions there may be.

MS. BINGHAM ESCAREÑO: Thank you, Mark. Does the committee have any questions? In our committee packet we had the table that shows the large number of complaints that came in, how many were relevant and how many are ongoing with investigation and research. Any questions about those numbers? Anything that poses concern to the committee members?

MR. CHISUM: I was just surprised that 93 percent were not related to the Department.

MR. SCOTT: Well, yes. The thing is out in these housing developments they may have a complaint that
doesn't address a project that we funded. That's usually the case. But the one entity they know to call is us. I'm kind of two minds on that. One is that it's kind of time-consuming to deal with them, but at least we kind of a way -- it's kind of cheap monitoring.

MR. CHISUM: It's almost a clearinghouse.

MS. BINGHAM ESCAREÑO: Yes.

MR. SCOTT: So in a way it serves a useful purpose to just know what people are saying.

MS. BINGHAM ESCAREÑO: Mark, would you remind the committee members, so when we receive off the hotline or any of the other means of communication complaints that aren't directly relevant to the agency's work, what do we do with those. Are the complainants, if they're not anonymous, are they redirected back to the appropriate source, or do you continue to trend?

MR. SCOTT: If they're not anonymous then -- a lot of these have to do with law enforcement issues, so we just inform them to contact local law enforcement. That's probably the majority of the cases. We try not make too much of an interpretation for them if it's not something that's related to us, but if it's something that's obviously law enforcement or if it's something that by law we know has to be specifically directed to another agency, we do that.
MS. BINGHAM ESCAREÑO: Good point. Great.

Thank you very much.

Any other questions relative to fraud, waste and abuse activities?

(No response.)

MS. BINGHAM ESCAREÑO: Good. Then we will accept that presentation.

That ends, I think, the formal agenda. Are there any other items to be discussed from Audit Committee or from management? Mr. Irvine.

MR. IRVINE: I think that while I've got a few minutes here, I think it would be useful to give you sort of a generalized view of how the fraud, waste and abuse task force approach actually functions. The moment somebody is aware of allegations of fraud, waste or abuse, not necessarily proven, whatever, a group is convened that includes Internal Audit, me, Legal, our ethics advisor, our chief of external affairs, and the program leadership, and we sit down and we say what do we have, what do we need to know, what do we know, and how are we going to go about addressing this, how are we going to flesh out the story if the story is missing pieces, or how are we going to go through an investigative process, or is this something that is really within our purview.

Whenever these kinds of issues are identified,
the state law requires that if there is suspicion of
criminal wrongdoing or matters involving a loss of a
thousand dollars or more that required reports must be
generated and sent to the State Auditor's Office. So
often one of the first marching instructions from a
meeting like that is please generate that letter for my
signature right away and we get that over to the State
Auditor's Office.

While it's great that the State Auditor's
Office knows about those things, they're pretty busy too
and often it's just as important to make sure that the
cognizant federal funding agency knows what's going on,
and sometimes even that other law enforcement authorities
are brought into the loop.

So anyway, in a privileged setting where we're
talking through these issues with our counsel, a working
plan is devised an executed and tracked, and the handling
of the matter is documented, and we continue to follow up
on them until they're put to bed.

MS. BINGHAM ESCAREÑO: Good. Thank you, Tim.

MR. CHISUM: Thank you.

MS. BINGHAM ESCAREÑO: Any other questions? So
this will probably be our last Audit Committee meeting for
this year, this calendar year.

MR. SCOTT: Yes, ma'am.
MS. BINGHAM ESCAREÑO: Some transition in your
department. We're glad that you've joined us and your
team has done an excellent job. I just want to recognize,
Mark, your department and your team members for carrying
us through this year of transition. It sounds like it's a
good aggressive plan for next year, but doable. I think
I'll speak for the committee, and I'm sure you'll hear
from the Board later on this morning, about how grateful
we are. It's a good relationship. I think it's a good
accountable clean relationship. Audit's responsibilities
to the State are very clear, but I think we've noticed a
real impact that being collaborative and working well
together, respecting and honoring responsibilities has
really been noticeable this year, so we appreciate you and
your team's efforts.

MR. SCOTT: Well, thank you very much.

MS. BINGHAM ESCAREÑO: Good. That will
conclude the Audit Committee meeting. Thank you all for
your attendance. We stand adjourned.

(Whereupon, at 9:25 a.m., the meeting was
adjourned.)
CERTIFICATE

MEETING OF:    TDHCA Board Audit Committee
LOCATION:      Austin, Texas
DATE:          November 12, 2015

I do hereby certify that the foregoing pages, numbers 1 through 23, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Nancy H. King before the Texas Department of Housing and Community Affairs.

11/16/2015
(Transcriber)         (Date)

On the Record Reporting
3636 Executive Cntr Dr., G22
Austin, Texas 78731