TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

AUDIT AND FINANCE COMMITTEE MEETING

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

June 29, 2017
7:58 a.m.

MEMBERS:

SUSAN THOMASON, Chair
PAUL A. BRADEN, Member
ASUSENA RESENDIZ, Member
LEO VASQUEZ, Member
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PUBLIC COMMENT ON MATTERS OTHER THAN ITEMS FOR WHICH THERE WERE POSTED AGENDA ITEMS. --

EXECUTIVE SESSION --

OPEN SESSION --

ADJOURN 20

ON THE RECORD REPORTING (512) 450-0342
MS. THOMASON: Welcome to the June 29 meeting of the TDHCA Audit and Finance Committee. I'm Sharon Thomason. We have new Board members, new committee members, so we have Leo Vasquez and Asusena Reséndiz, who should be joining us shortly, Paul Braden, and I'd like to thank you all for your service.

We have several action items, the first of which is to approve the minutes. I guess I need to do roll call; got out of line there a little bit.

Paul Braden?

MR. BRADEN: Here.

MS. THOMASON: Asusena?

(No response.)

MS. THOMASON: Sharon Thomason, here.

Leo Vasquez?

MR. VASQUEZ: Here.

MS. THOMASON: So we have a quorum.

So the first item that we need to address is approving the minutes from the January 26, 2017 Audit Committee meeting. At that meeting the staff reported from the State Auditor's Office and went over their annual audit of the TDHCA financial statements. The committee recommended approval of the State Auditor Office report to the full Board. The committee also recommended for the
approval to the full Board of a new Internal Audit Charter at that time. The director of Internal Audit, Mark Scott, went over the internal audit of the Compliance Monitoring Division. Mr. Scott also went over the self-assessment that was prepared by Internal Audit for the peer review, as well as the net claims contract and the recent internal and external audit activity.

The minutes were included in our notebook for the Audit and Finance Committee. Can I have a motion to approve the minutes from the January Audit Committee meeting?

MR. VASQUEZ: So moved.

MR. BRADEN: Second.

MS. THOMASON: Approval. We have a vote for approving the minutes for the January 26 Audit Committee meeting. All in favor?

(A chorus of ayes.)

MS. THOMASON: Any opposed?

(No response.)

MS. THOMASON: So we have approval of those minutes. Thank you.

So then the next item on our agenda will be the internal audit of the Low Income Housing Tax Credit Program, and Mark will present that to us.

MR. SCOTT: Good morning, Madam Chair and
members. Thank you for agreeing to serve on the Audit Committee.

This audit of the Low Income Housing Tax Credit Program was a base or framework audit of the program. It covered activities in the TDHCA Multifamily Division and the Asset Management Division. Future audits may delve deeper into the various areas. This was the first comprehensive internal audit of the program.

We described the costs of the program and the returns to the investors in order to facilitate understanding of the program. This program is financed by tax credits which are claimed after the properties have been constructed and placed in service.

The next part of the audit dealt with the policies and procedures. Testing policies and procedures is a basic internal audit step. Multifamily's SOPs were in progress and Asset Management's were in place. We tested the applications process by the Multifamily Division, as described in Section F of the audit report. As for the attributes we tested, we found that the applications were processed accurately. We did note some errors in filing and posting of information, and management has agreed to a process improvement in order to address that. We also visited several of the tax credit properties. They looked pretty good overall and we
discussed that with management.

The next sections of the audit report had to do with cost certifications and the IRS forms. The attributes we tested were in compliance with procedure, including the receipt of the CPA certifications on the costs. As noted, this was an overview audit, and cost certifications are one area where more detailed work in the future may be appropriate or may be done by Internal Audit.

And so I'll stop and see if there's any questions on the Tax Credit audit, or if anybody from the audits wants to speak.

(No response.)

MR. SCOTT: Okay. Moving right along. So the format of these Audit Committee meetings is I go over the recent audit reports and then I go into other recent audit activities as far as internal audit and external audit.

So the annual audit is based on a risk assessment where we use a matrix to score auditable units. We're doing currently a comprehensive audit of IT which will also be used as a base audit. From our preliminary work, it looks like project scheduling and user training are areas where Internal Audit could do some value added work.

The other two audits on the 2017 audit plan are
Bond Finance and the Contract for Deed programs, and those two should not be too hard. They are smaller than the Tax Credit audit and the Information Systems audit. We had talked at the last Audit Committee, as you noted from the minutes, about procuring a peer review, and that RFQ has been posted to the agency website and the Texas Register.

Since this is a new Audit Committee, I'll note that Internal Audit also conducts various consulting activities and participates in agency workgroups but in an ex officio manner. The consulting work we do, a large part of it has to do with our subrecipients and they are subject to the Single Audit Act and I perform ongoing consultation on that. I'm also on the Fraud, Waste and Abuse Committee within the agency.

So I'll stop there. Those are the recent internal audit and consulting activities.

And then I like to give an update on any external audits that are ongoing or getting ready to come out, that way you'll have a heads-up when they do come out. We have an ongoing statewide audit that takes place and TDHCA is part of that audit, and they also do an annual audit of our financial statements which is a stand-alone audit, and in that they audit the funds that are outside the State Treasury.

On the federal compliance part of the statewide
audit this year, KPMG did not select any major programs at
TDHCA to audit, but they are going to do followup work on
the LIHEAP program which is the Low Income Home Energy
Assistance Program. They had a finding from 2016.

And HUD auditors were out here earlier this
year and they will issue a report on their review of
Davis-Bacon compliance at some point in the next few
months.

Are there any questions on the external audits,
or any of the activities or the audit report?

MS. THOMASON: That concludes our audit portion
of the meeting.

The next items on the agenda are related to the
Financial Administration Division, so Mr. David Cervantes,
the TDHCA CFO, will begin his presentation.

MR. CERVANTES: Good morning, Madam Chair,
members of the committee. I'm David Cervantes, chief
financial officer for the Department.

And I'd like to begin with addressing just a
couple of items, making a couple of remarks to get us
going, and the first thing I'd like to do is introduce the
key staff that has been involved in the budget process and
the coordination throughout the Department. So I'd like
to begin with that, and to my left are the key members.
First off, Ernie Palacios, who is our director of
Financial Administration. And then next to him is Kristina Vavra, or Krissy, as we know her, and she's the manager for budget for the travel that we do throughout the agency and assisting you in traveling to headquarters and so on, and then payroll operations. And then the most recent member, who has been with us a short time, is Paul Ford, sitting next to Krissy. And he's been with the Department for several years but most recently, I think it's been probably less than a year, he joined our team to serve in the role of senior financial analyst for us. So Paul is the one that kind of crunches the numbers and is getting acquainted with the financial operations of the Department, and we look forward to getting him more involved as we move through the upcoming years.

Ernie will be walking you through the items that are on your agenda today, but one of the things I'd like to do is provide a little context as to where we are in the broader budget process. I guess I'd begin by informing you that the statewide budget process is a two-year process that takes place throughout state government, and in the odd years the legislature finds their way to Austin to deliberate a budget for the next biennium.

And so back I think in August of '16, the Department submitted a required document which is known and referred to as the legislative appropriations request,
and the purpose of the legislative appropriations request is intended to provide you a five-year window, some history regarding the Department. In this case it went from 2015 and it walks us all the way to the future biennium of 2018-19. So we submitted that document to the LBB, the Governor's Office, other oversight offices that we're required to submit this document to.

And then subsequent to that is the legislative session that we've just been through, 140 days of session, and during that process joint budget hearings were held, we were called to participate and provide testimony at joint budget hearings. And in relation to the budget, the Senate Finance group is the one that handles the budget on the Senate side, and then there's the Committee on House Appropriations. And as you well know, May 29 was the semi-close of session because, as you well know, there's still a pending special session ahead of us.

But one of the acronyms of the references that you'll hear as we're discussing the budget, or as you're talking to your colleagues and so on, is what's referred to as the General Appropriations Act, the GAA is what it's called, and this particular one will be referred to as Senate Bill 1. And the purpose of Senate Bill 1, obviously it's the statewide budget as a whole but within that TDHCA has a component. We're an Article 7 agency and...
the Article 7 is business and economic development, and that's where our agency sits in terms of the statewide placement of our agency and the budget for TDHCA.

So one of the outcomes of this particular session is the bill known as Senate Bill 1, and so today what we're bringing to you are the budget items dealing with the operations of the Department, and so in that whole scheme of what got approved in Senate Bill 1, we're bringing you the internal component today to recommend a budget that coincides with the General Appropriations Act and what we know Senate Bill 1 to be at this point.

I'll put a little disclaimer because should something happen during special session that in some way would impact Senate Bill 1, more than likely we would find our way back to you to modify or something along those lines if necessary.

So those are, I guess, my brief remarks this morning just to put some color on where we're headed this morning and give you a little history as to where we've been and where we are today. And with that, I'll turn it over to Ernie who will walk you through the items you have on your agenda.

MR. VASQUEZ: David, just a quick question. Is there anything on the call for the special session that specifically we know directly impacts our budget.
MR. CERVANTES: We are not aware of anything in particular to Senate Bill 1. Obviously around it there's business to be done, but technically the governor has signed Senate Bill 1 right now, but the call could be reopened at any point in time so there's still that possibility. And we're monitoring the whole situation to see what's going to take place, but at this point we believe it's intact and we believe we're pretty close to what will be a final budget position for the agency.

Any other questions before I turn it over to Ernie to walk you through the rest of it?

(No response.)

MR. CERVANTES: Well, thank you so much for your time, and welcome.

MS. THOMASON: Thank you.

MR. PALACIOS: Good morning, Madam Chair, committee members. For the record, I'm Ernie Palacios, director of Financial Administration for the Department.

Over the last four months we've been meeting with division directors and managers to develop an internal operating budget for fiscal year 2018. Behind item 2 is the internal operating budget which includes a comparison report with the 2017 operating budget. I would like to provide you information related to the amount of the budget, the expenditure categories of where this money
will be used, and lastly, the financing associated with recommending this budget for the upcoming fiscal year.

The proposed budget is $27.8 million. This represents a $1.5 million, or 5.8 percent increase from the current budget. The increase is primarily attributed to a $1.2 million increase in our capital budget as approved by the legislature for the 2018-2019 biennium. The budget also includes eight newly funded FTEs, totaling $471.5 thousand in the areas of affirmatively furthering fair housing, cybersecurity, Section 811, and continued compliance efforts.

Also included in the budget is a one percent line item that we put in for potential salary increases for employees such as merits, reclasses and items that the Department may want to consider throughout the fiscal year. Capital budget aside, the budget reflects a net savings of $198,000 in other budget categories. The Department's cap FTEs is 313, the budget has 312 FTEs; 248 are TDHCA personnel and 64 are Manufactured Housing Division staff, one less than appropriated.

The method of finance was effected as follows: general revenue decreased 5.7 percent, primarily related to the 4 percent reduction mandated by the legislature; federal funds increased $763,000 or 12.6 percent, and included in that amount is a $600,000 capital budget.
project for Community Affairs; and finally, appropriate receipts had an increase of $828,000 or a 14 percent increase, primarily due to the capital budget items and a redirection of resources to fund the new FTEs that I mentioned earlier.

Also, I would like to note for the record, in accordance with the Internal Auditing Standards and the Board's Internal Audit Charter, the budget includes the Internal Audit Division's annual operating budget.

This concludes my remarks on this item, and I'm available for any questions that you may have.

MS. THOMASON: Thank you.

MR. PALACIOS: Now I would like to turn your attention to item 3, the Housing Finance Division budget. This particular item is a subset of the larger budget. It is in relation to the Housing Finance budget that we are required to submit under Texas Government Code and in compliance with the General Appropriations Act. This subset of the budget is specific to the fees that we generate, typically referred to as the Housing Finance budget of the Department.

At this time we are prepared to certify this budget as well, and I'm available for any questions on this item.

MR. VASQUEZ: What's the comparison between
last year's and this year's budget?

MR. PALACIOS: For the Housing Finance?

MR. VASQUEZ: Right.

MR. PALACIOS: It increased by $828,000.

MR. VASQUEZ: What was the primary driver of the increase?

MR. PALACIOS: The capital budget and the FTEs.

MS. THOMASON: So at this time we will take a vote and recommend approval to the full Board. So all in favor?

(A chorus of ayes.)

MS. THOMASON: Any opposed?

(No response.)

MS. THOMASON: So we have a vote to present the recommended approval to the full Board.

Do we have any other items?

MR. PALACIOS: And that's for both budgets?

MS. THOMASON: For both budgets, yes. I apologize.

MR. PALACIOS: Thank you.

MS. THOMASON: Thank you.

MR. IRVINE: Good morning. Tim Irvine, executive director. Madam Chair, members.

So cool to see a newly reconstituted Audit and Finance Committee. I think just as Mark said that it was
a baseline audit of the Low Income Housing Tax Credit Program, I think this is sort of a baseline meeting for this committee, and I think that it's very important to understand not just the details but conceptually what we're doing with our budget.

We've got a phenomenally complex array of funding sources and they each come with their own unique restrictions and so forth, safe to say probably over two dozen different funding sources, and these guys do an incredible job of tracking not only where the money is going but that it is going in a manner that is compliant, that you're not using dollars that were appropriated for this to pay for an employee who's doing something else.

Krissy oversees a very complex timekeeping system that manages the recordkeeping that our cognizant federal agencies will look to whenever they audit us, just as we look at the recordkeeping of our subrecipients when we go and audit them. So it's a very complex situation.

There are a couple of things about state funding that are very different from the business world funding. If you're running a business and you need to raise more cash to pay more costs, you increase prices and you raise more cash if people buy your product or service. When we assess and collect fees, we cannot use the additional money that we collect unless it has been
appropriated to us. Our budget is driven primarily by a component of our different funding sources that's available for administration but also by appropriated receipts.

And what that means is that we collect fees for things like underwriting applications, issuing tax credit commitments, performing monitoring, all these different things, and we collect those fees and keep them outside of the state treasury in the Texas Safekeeping account. We move them back into the treasury as we need to use them, and these processes are really closely tracked by the comptroller, they make sure that we're not inappropriately moving things.

But I think that in terms of the baseline lesson for today, I think it's going to be appropriate in a subsequent meeting to give you a little bit more of a detailed understanding about our funds outside of treasury and how we manage our fee collections to target the right balance. You want to have enough money available in those accounts that before your annual cyclical fee collection kicks in, you can pay the bills, but you don't want to build those balances up so high that people are, in effect, paying more for state government than they should be paying. So this is a very complex situation.

Going back to Mr. Vasquez's questions about
comparing to last year, I think year-in/year-out, our
budgets are fairly flat. We have volatility on the
funding side for our federal programmatic activities,
sometimes they're up, sometimes they're down. In my
tenure here, for example, Weatherization Assistance
Program by DOE has been as high as $327 million and as low
as about $3 million. So there is volatility.

But in terms of the core operation, we need a
fundamental nucleus of people to do the work and we want
to organize them as efficiently as possible, and we want
to use our compensation structure to provide some
stability. Stability of our employees is a big challenge
for us, especially in areas like compliance where people
are paid well and they are given phenomenally challenging
duties to keep up with this gigantic ever growing
portfolio and to travel a lot, and people on the other
side would love to pirate them away and pay them even more
and not make them travel.

So that little over one percent that is in
there for salary and equity adjustments, reclassifications
and merit adjustments, is actually very small relative to
the challenge. We have a very hard time prioritizing when
we make merit increases and salary adjustments. That is
probably the most important discretionary piece for you to
look at and understand, and I would hope that at a future
meeting we can get a little bit into some of our philosophy about compensation, and frankly, draw on your ideas for ways to improve our compensation structure.

Also, I'll say with regard to Internal Audit, the consulting engagements that Mark and his team provide are just phenomenally valuable. We are big-time audited, we are so transparent that everything we do is scrutinized by literally hundreds of very knowledgeable people, in addition to the audits by the State Auditor's Office and KPMG and so forth. I'm not downplaying the importance of internal audits but I'm saying you should be very comfortable that we are extensively audited and everything we do has been scrubbed and re-scrubbed.

But I think that internal audit is a unique creature and it really does add a ton of value to have somebody who is independent and reports to you, not to me, not to them, but someone who reports to you and has that security but also is in there shoulder-to-shoulder with us every day and hears about the scuttlebutt and the issues and the concerns or whatever and can really jump on things.

That's all I've got.

MR. SCOTT: Thank you.

MS. THOMASON: Thank you.

Are there any other comments or questions?
(No response.)

MS. THOMASON: If not, then this concludes our Audit and Finance Committee meeting. Thank you.

(Whereupon, at 8:23 a.m., the meeting was adjourned.)
CERTIFICATE

MEETING OF:    TDHCA Audit & Finance Committee

LOCATION:    Austin, Texas

DATE:    June 29, 2017

I do hereby certify that the foregoing pages, numbers 1 through 21, 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 & Community Affairs.

7/7/2017
(Transcriber) (Date)

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