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

March 22, 2018
7:30 a.m.

MEMBERS:

SHARON THOMASON, Chair
PAUL A. BRADEN, Member
ASUSENA RESENDIZ, Member
LEO VASQUEZ, Member

ON THE RECORD REPORTING
(512) 450-0342
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### Action Items:

1. **Item 1:** Presentation, Discussion and Possible Action to Approve the Audit Committee Minutes Summary for December 14, 2017

2. **Item 2:** Review and possible acceptance of State Auditor's Office audit of the TDHCA financial statements

### Report Items:

1. **1.** Internal Audit of TDHCA Bond Finance Program's processes and controls

2. **2.** Discussion of Recent External Audit Activity

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PROCEEDINGS

MS. THOMASON: Good morning. I'd like to welcome you to the March 22 meeting of the TDHCA Audit and Finance Committee. I will take roll at this time. Paul Braden?

MR. BRADEN: Here.

MS. THOMASON: Asusena Reséndiz?

MS. RESÉNDIZ: Present.

MS. THOMASON: Leo Vasquez?

MR. VASQUEZ: Here.

MS. THOMASON: All right. We have a quorum.

So the first item will be the approval of the minutes from the December 14, 2017 Audit and Finance Committee meeting. At that meeting, Mr. Scott, our Director of Internal Audit -- he presented as an action item the external peer review of the internal audit, and then Ernie Palacios presented the unencumbered fund balance as an action item for approval also.

This Committee recommended both items for approval by the full Board. Mr. Scott went over the internal audit for the Contract Deed Conversion Program, as well as upcoming external audits. The minutes are included in your notebook for the Audit and Finance Committee.

Could I have a motion to approve the minutes...
from the December Audit and Finance Committee meeting?

MR. BRADEN: So moved.

MS. THOMASON: Okay. Second?

MR. VASQUEZ: Second.

MS. THOMASON: All right. All in favor?

(A chorus of ayes.)

MS. THOMASON: Our second action item is the presentation by the State Auditor's Office of their audit of the TDHCA financial statements. Mark, could you please introduce our auditors?

MR. SCOTT: Yes. This is the State Auditor's staff. They do the audit of the financial statements for the Revenue Bond Program. And this is Sarah Puerto

MS. PUERTO: Hi. Sarah -- good morning.

MS. THOMASON: Good morning.

MS. PUERTO: Sarah Puerto with the State Auditor's Office. I'm here to present the financial reports that the SAO did at the Department of Housing. I first wanted to start off by thanking the staff of the Department of Housing for being extremely cooperative and making this audit run as smooth as possible.

So thank you. The State Auditor's issued several reports as part of this audit. On December 20, 2017, we expressed unmodified opinions -- excuse me -- on the Department's fiscal year 2017 basic financial
statements, Revenue Bond Program Enterprise Fund financial statements, and the computation of unencumbered fund balances at the Housing Finance Division.

We also issued a report on compliance with the Public Funds Investment Act and also we issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards.

We did not find any material weaknesses in internal control over financial reporting or any noncompliance in laws or regulations that materially affected the financial statements. We previously issued two reports earlier in the audit.

On September 11, 2017, we issued a report that concluded the financial data schedule prepared by the Department was fairly stated in all material respects in relation to the fiscal year 2016 basic financial statements taken as a whole.

On September 26, 2017, we issued a report that concluded that the Department electronically submitted a financial data schedule to the U.S. Department of Housing and Urban Development Real Estate Assessment Center agreed with related hard-copy documents.

And finally, on December 20, we emailed to the Board a document entitled, "Required Communication with
Those Charged with Governance" that includes several items we are required to communicate to the Board. And that concludes my presentation. I'll be happy to answer any questions.

MS. THOMASON: Thank you.

MR. VASQUEZ: So is fairly stated the best rating we can get?

MS. PUERTO: Yes.

MR. VASQUEZ: Okay. All right. Thanks.

MS. THOMASON: Any other questions?

MS. PUERTO: Thank you.

MS. THOMASON: All right. Our first report item will be the internal audit of the Bond Finance Program, and Mark will present that for us.

MR. SCOTT: Thank you. The internal audit report on the bond program begins on page 200 in the committee book. The program administers mortgage revenue bonds which provide below-market loans for lower-income housing needs.

The goals of the program include facilitating a fluid market for mortgage bonds and mortgage-backed securities. The internal audit focused on the bond program's internal processes and controls. The program functions with TDHCA as the issuer of mortgage revenue bonds; Idaho Housing and Finance Association as the master
servicer; and with Ehousing as the program administrator. Ehousing does the compliance work such as verifying loan documentation, and TDHCA conducts on-site monitoring reviews of Ehousing's records.

We recommended desk reviews of Ehousing in the years that site visits are not conducted, and management agreed to implement the recommendation. We also conducted testing of the mortgage lenders in the program, as described beginning on page 7 of the internal audit report.

We also tested the controls over wire transfers from TDHCA to Idaho Housing to reimburse Idaho Housing for mortgages purchased. The controls were in place and working as intended. The rest of the audit report describes the bond program's processes and the external parties, as well as some of the terminology used in the program.

Also, I'd like to point out that the notes to the financial statements beginning on page 56 of the committee book are included in the SAO audit and the notes provide good information on the bond program as well. And I'll pause for any questions.

MS. THOMASON: Are there any questions?

MR. BRADEN: I had a couple.

MR. SCOTT: Yes, sir.
MR. BRADEN: So this report is just of the single-family mortgage, not the multifamily mortgage program?

MR. SCOTT: It was focused on the single-family. Yes, sir.

MR. BRADEN: And I understand why, but that's -- can somebody sort of explain why we did that focus, as opposed to the multifamily?

MR. SCOTT: Well, that's where most of the process is and most of the controls points were --

MR. BRADEN: And it's a much more complex process, and you probably have independent reviews of the multifamily because of the nature of the revenue bonds for that?

MR. SCOTT: Right. That would be a much more massive undertaking.

MR. BRADEN: And historically, have the bond yields themselves, which go to the Board, of course, ever gone through this Committee before they go to the Board?

MR. SCOTT: No, sir. This is -- as far as I know, this is the first internal audit that was done on the bond program.

MR. BRADEN: Okay.

MR. SCOTT: So this audit, by necessity, was kind of an exercise in mapping the program and the
controls. The State Auditor, of course -- they do a really good job on the financial statements, but as far as the internal process -- is in controls within the program. This was the first audit.

MR. BRADEN: And I thought it was a very useful exercise.

MR. SCOTT: Thank you very much.

MR. BRADEN: That's all I had right now.

MS. THOMASON: So in the -- now that you have this baseline audit, in the future, we would have a similar -- maybe -- matrix for other audits that would show the scope and the testing and --

MR. SCOTT: Yes, ma'am, absolutely.

MS. THOMASON: Any other questions? Okay. The next item will be the recent external audit activity, and Mark will present that as well.

MR. SCOTT: Let's see. TDHCA is included as part of the statewide audit of the State's financial statements and the State's compliance with federal program rules. This was conducted by the SAO and KPMG, and their 2017 report was issued on February 28, 2018.

There were no findings on TDHCA, but there was a follow-up on a finding from 2016. The finding had to do with reporting in the Low-Income Home Energy Assistance Program, or LIHEAP. The documentation for household level
data was not being maintained precisely according to HHS requirements. A temporary solution was implemented and there is a new information system for LIHEAP slated for 2019.

And then there was also an HHS, Health and Human Services, review of LIHEAP. In January, TDHCA received a report on a review that had been conducted in 2016 by the federal HHS program monitors of the LIHEAP program.

HHS also noted issues related to LIHEAP reporting and also addressed TDHCA monitoring of subrecipients. There were two said subrecipients of LIHEAP funds where the subrecipients could not produce documentation to show proper expenditure of funds.

These findings had already been identified by TDHCA monitors and they may result in TDHCA having to refund money to HHS. And then there was an HHS review of the Community Service Block Grants, CSBG, and this review was also conducted in 2016, and the report came out in January.

This review, like the HHS LIHEAP report, noted an instance related to Northeast Texas Opportunities, or NETO, where some employees of NETO were indicted. At the time, TDHCA had notified SAO and -- the State Auditor's Office and the Office of Inspector General at the federal
level.

The HHS program monitors noted that program staff at HHS should also have been notified, which TDHCA has agreed to do going forward. This review also noted something of a gap in services provided to Dallas-area residents while a replacement was being found for Dallas Urban League.

And TDHCA provided responses to both HHS reviews and agreed to address the issues. And that concludes my presentation. I'd be happy to answer any questions.

MS. THOMASON: Any questions?

MR. VASQUEZ: Just briefly. So how are we going to go about monitoring, other than those things you just described, that are totally under our control?

MR. SCOTT: You're asking about the monitoring that takes place by our Compliance Division?

MR. VASQUEZ: Well, just what you were talking about on --

MR. SCOTT: Okay.

MR. VASQUEZ: -- reviewing those outside groups.

MR. SCOTT: Okay, okay. We -- all -- we have all these subrecipients that we pass money through for things like LIHEAP and CSBG, and on an ongoing basis, the
Monitoring Division goes out and monitors and sometimes they'll find questioned costs.

And what happened in this instance was -- the HHS -- they also send monitors out at the federal level. And they were saying that we should have notified them of certain things that we had notified OIG of. And so as far as we knew, that was -- Tim is shaking his head.

MR. IRVINE: Good morning. Tim Irvine, Executive Director. With respect to the issues that were identified at two agencies that administered LIHEAP and/or CSBG, there were significant identified disallowed costs. These were identified in the usual monitoring process conducted by our Compliance Division.

We initiated efforts to try to get the local agencies to repay those funds. Those efforts so far have been unsuccessful, and as required by law, these matters have now been referred to the Office of the Attorney General.

When the monitors arrived from HHS to perform an on-site monitoring, right about the same time, news broke about some indictments at one of these agencies, and the staff understandably felt blind-sided, and they said, why didn't you tell us about this?

And from our perspective, all we knew had really occurred so far was, disallowed costs. We were
equally surprised that this escalated like that to a criminal indictment. So we monitor all of our recipients pretty aggressively. Patricia Murphy and her team are good about identifying those costs issues.

One of the problems, though, that we do encounter is, from time to time, people do have either de minimis or significant disallowed costs. When they are de minimis, usually people are very good about promptly reimbursing us with documented non-federal funds, as required by federal law.

However, when the dollars get significant, these are very thinly-capitalized organizations for the most part. The only meaningful program activity that they run is usually federal programs that do not provide for profit opportunity.

They certainly cover administrative costs, but not profit, and when the dollars add up to big-ticket items, there's a real challenge in exacting payment from them. So --

MR. VASQUEZ: But systematically, we're relying on -- we're reviewing their account -- internal accounting and what they present to us as --

MR. IRVINE: We review a lot of things. First of all, they're almost always going to be subject to the single audit requirements under 2 CFR Part 200, and in
that respect, their independent auditor is going to be required to come in and provide a compliant opinion.

One of the aspects of that opinion -- the folks from SAO can educate you -- if I'm going to get this wrong -- that as I understand it, the auditors are required to review and reach conclusions about general programmatic compliance issues.

I'm not saying that they perform detailed programmatic audits. It's primarily a financial audit, but if they find evidence of systemic noncompliance, that's supposed to be addressed in their reports. In these particular agencies, one in particular -- large disallowed cost issues, improper accounting practices, had not been identified as compliance issues.

It subsequently turned out that they did not even have a compliant audit. So we do rely, though, heavily, on the single audits. We also have our Compliance Division, the contract-monitoring people from the Compliance Division, go and they look at all kinds of things.

They test expenditures, and they look at the documentation of the people served, the household level served, to ensure that they are in fact eligible. They tick and tie sampled expenditures and make sure the expenditures line up and that they are in fact for
allowable costs.

   It's a pretty detailed thing, and
unfortunately, with regard to some of these agencies, they
are administering our programs, but they're also
administering other programs, such as Head Start and
things like that.

   And it gets difficult, frankly, sorting out
multiple programmatic expenditures, especially when
agencies at the local level aren't crisp about keeping
those programs completely separate. And that was one of
the issues that did occur at one of these agencies.

   But we've got folks in the Compliance Division
that in fact include former staff of the internal audit
shop, and they are very competent and good at sorting this
stuff out. But --

   MR. VASQUEZ: Someone's challenging --

   MR. IRVINE: -- yeah, but the problem is, once
you've found it, it's -- the money's out the door, and you
know, now you're trying to exact repayment from someone
who may or may not have the ability to repay.

   MR. VASQUEZ: All right. Thanks, Tim. Done.

   MR. SCOTT: Any questions? Anything? Any
others?

   (No response.)

   MS. THOMASON: Okay. I don't think we have any
other items for this meeting. So if no one has anything else, our meeting is adjourned. Thank you.

(Whereupon, at 7:47 a.m., the meeting was adjourned.)
CERTIFICATE

MEETING OF:     TDHCA Audit & Finance Committee
LOCATION:     Austin, Texas
DATE:     March 22, 2018

I do hereby certify that the foregoing pages, numbers 1 through 17, 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.

DATE:     March 26, 2018

/s/ Adrienne Evans-Stark
(Transcriber)

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