

**AUDIT COMMITTEE  
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**

July 15, 2009  
5:00 pm

TDHCA Headquarters  
221 East 11<sup>th</sup> Street  
Austin, TX 78701

**AGENDA**

**CALL TO ORDER, ROLL CALL** Gloria Ray, Chair

**CERTIFICATION OF QUORUM** Gloria Ray, Chair

**PUBLIC COMMENT**

The audit committee of the board of the Texas Department of Housing and Community Affairs will solicit public comment at the beginning of the meeting and will also provide for public comment on each agenda item after the presentation made by the department staff and motions made by the committee.

The audit committee of the board of the Texas Department of Housing and Community Affairs will meet to consider and possibly act on the following:

**REPORT ITEMS** Sandy Donoho, Dir Internal Audit

Item 1 Presentation, Discussion, and Possible Approval of Audit Committee Minutes for February 5, 2009

Item 2 Presentation, Discussion and Possible Approval of the Revised Audit Plan

Item 3 Presentation and Discussion of Status of External Audits

Item 4 Presentation and Discussion of Status of Prior Audit Issues

Item 5 Presentation and Discussion of Internal Audit Reports

Item 6 Presentation and Discussion of External Audit Reports

**EXECUTIVE SESSION**

The Board may go into Executive Session (close its meeting to the public) on any agenda item if appropriate and authorized by the Open Meetings Act, Texas Government Code, Chapter 551 and under Texas Government Code §2306.039

**ADJOURN** Gloria Ray, Chair

*To access this agenda and details on each agenda item in the board book, please visit our website at [www.tdhca.state.tx.us](http://www.tdhca.state.tx.us) or contact Nidia Hiroms, TDHCA, 221 East 11th Street Austin, Texas 78701-2410, 512-475-3934 and request the information.*

*Individuals who require the auxiliary aids, services or sign language interpreters for this meeting should contact Gina Esteves, ADA Responsible Employee, at 512-475-3943 or Relay Texas at 1-800-735-2989 at least two days before the meeting so that appropriate arrangements can be made.*

*Non-English speaking individuals who require interpreters for this meeting should contact Nidia Hiroms, 512-475-3934 at least three days before the meeting so that appropriate arrangements can be made.*

*Personas que hablan español y requieren un intérprete, favor de llamar a Jorge Reyes al siguiente número (512) 475-4577 por lo menos tres días antes de la junta para hacer los preparativos apropiados.*

**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Presentation, discussion and possible approval of the February 5, 2009 audit committee meeting minutes.

**Required Action**

Review and approve the minutes of the February 5, 2009 audit committee meeting.

**Background**

None.

**Recommendation**

Staff recommends approval.

AUDIT COMMITTEE  
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

February 5, 2009, 8:30 AM

Robert E. Johnson Building, Central Conference Room  
1501 North Congress, Austin, Texas 78701

SUMMARY OF MINUTES

**CALL TO ORDER, ROLL CALL ; CERTIFICATION OF QUORUM**

The Audit Committee Meeting of the Texas Department of Housing and Community Affairs of February 5, 2009 was called to order by Chair, Gloria Ray, at 8:32 a.m. It was held at the Robert E. Johnson Building, Central Conference Room, 1500 North Congress, Austin, Texas. Roll call certified a quorum was present.

**Members Present:**

Gloria Ray, Chair  
Tom Cardenas, Member  
Leslie Bingham-Escareño, Member

**PUBLIC COMMENT**

The audit committee of the board of the Texas Department of Housing and Community Affairs will solicit public comment at the beginning of the meeting and will also provide for public comment on each agenda item after the presentation made by the department staff and motions made by the committee.

**No public comment..**

The audit committee of the board of the Texas Department of Housing and Community Affairs will meet to consider and possibly act on the following:

**REPORT ITEMS**

AGENDA ITEM 1 Presentation, Discussion, and Possible Approval of the Internal Audit Division's Revised Audit Charter and Board Resolution #09-028  
**Motion by Ms. Bingham to approve staff recommendation; seconded by Mr. Cardenas; passed unanimously**

AGENDA ITEM 2 Presentation and Discussion of the Audit Standards, Code of Ethics, Definition of Internal Auditing, and the Internal Audit Division's Independence Statement  
**Report item. No action taken.**

AGENDA ITEM 3 Presentation and Discussion of Audit Results from Deloitte and Touche, CPAs, FYE 8/31/08:

- Communications with Audit Committee Letter
- Opinion Audit on FY 2008 Basic Financial Statements
- Opinion Audit on FY 2008 Revenue Bond Program Financial Statements
- Opinion Audit on FY 2008 Computation of Unencumbered Fund Balances
- Report to Management (Management Letter)

**Julia Petty, director, Deloitte and Touche, provided testimony.**  
**Motion by Ms. Bingham to approve audit report seconded by Mr. Cardenas; passed unanimously.**

AGENDA ITEM 4 Presentation and Discussion of Recent External Audits:

- HUD's Review of the Emergency Shelter Grants Program
- HUD's Disaster Voucher Program Validation Review
- Comptroller of Public Accounts Post-Payment Audit
- HUD OIG's Review of the Department's CDBG Supplemental I Disaster Funds.

**Report item. No action taken.**

AGENDA ITEM 5 Presentation and Discussion of Recent Internal Audit Reports:

a) Office of Colonia Initiatives' Bootstrap Program Report #08-1027 Office of Colonia Initiatives' Self-Help Center Program Report # 08-1026

**Report item. No action taken.**

AGENDA ITEM 6 Status of Prior Audit Issues

**Report item. No action taken.**

AGENDA ITEM 7 Presentation and Discussion of the Status of the Internal Audit Division's Fiscal Year 2009 Audit Plan

**Report item. No action taken.**

AGENDA ITEM 8 Status of External Audits

**Report item. No action taken.**

#### **EXECUTIVE SESSION**

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#### **ADJOURN**

Since there was no further business to come before the board, Gloria Ray adjourned the meeting of the Audit Committee at 9:05 a.m. on February 5, 2009.

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Mr. Timothy K. Irvine, Board Secretary

For a full transcript of this meeting, please visit the TDHCA website at [www.tdhca.state.tx.us](http://www.tdhca.state.tx.us).

**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Presentation, discussion and possible approval of the revised fiscal year 2009 audit plan.

**Required Action**

Review and approve the revised fiscal year 2009 audit plan.

**Background**

Revisions were made to the fiscal year 2009 audit plan as a result of external audits, changes in the Department's plans and additional responsibilities assumed by internal audit.

**Recommendation**

Staff recommends approval.

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS  
INTERNAL AUDIT PLAN  
FISCAL YEAR 2009 (REVISED)**

<b>INTERNAL AUDITS</b>		
<b>Project</b>	<b>General Objectives</b>	<b>Estimated Completion Date</b>
<p>CDBG Disaster Recovery Program (carryover from FY2008)</p>	<p><u>Phase II: Testing of Set Ups and Draws</u> To assess whether the Department's payment and draw processing provides reasonable assurance that sub-recipient requests for reimbursement of expenditures:</p> <ul style="list-style-type: none"> <li>➤ comply with applicable laws, regulations, policies, and contract provisions,</li> <li>➤ are adequately supported (including support for allowable activities, costs and eligibility to participate in the program),</li> <li>➤ are properly posted to the accounting and program systems, and</li> <li>➤ are properly authorized or approved.</li> </ul> <p><i>(Note: This project was delayed from FY 2007 in order to have a sufficient number of payments to test.)</i></p>	<p>CANCELLED – The State Auditor's Office tested set ups and draws as part of their follow-up audit of the Disaster Recovery Program.</p>
<p>HOME Program – Loan Servicing and Recycling of Program Income</p>	<p>To determine:</p> <ul style="list-style-type: none"> <li>➤ if loan servicing results in the maximum affordability period,</li> <li>➤ loans are completed in compliance with relevant laws, regulations, and policies, and</li> <li>➤ the amount of program income that has been recycled over the past three years.</li> </ul>	<p>Completed in April 2009</p>
<p>CDBG Disaster Recovery Program (carryover from FY2008)</p>	<p><u>Phase III: Sub-recipient Monitoring</u></p> <ul style="list-style-type: none"> <li>• To evaluate the sub-recipient monitoring procedures, processes and on-site visits to assess whether the program ensures that sub-recipients: <ul style="list-style-type: none"> <li>➤ comply with applicable laws, regulations, program rules, and contract terms,</li> <li>➤ operate within expenditure budgets and limits,</li> <li>➤ expend administration and program funds at allowable rates, and</li> <li>➤ meet contract performance goals.</li> </ul> </li> <li>• To assess whether monitoring results are communicated to sub-recipients and any findings or exceptions are noted, tracked and monitored until resolved.</li> </ul>	<p>CANCELLED – The State Auditor's Office tested sub-recipient monitoring as part of their follow-up audit of the Disaster Recovery Program.</p>

INTERNAL AUDITS		
Project	General Objectives	Estimated Completion Date
Self-Assessment of the Internal Audit Division's Quality Assurance Program	<p>To conduct the self-assessment of the internal audit division as required by the <i>International Standards for the Professional Practice of Internal Auditing (Standards)</i> and to determine if the internal audit division:</p> <ul style="list-style-type: none"> <li>➤ Completes audit working papers in accordance with the <i>Standards</i>,</li> <li>➤ Has developed and implemented policies and procedures that comply with the <i>Standards</i>, and</li> <li>➤ Performs ongoing quality assurance and monitoring as required by the <i>Standards</i>.</li> </ul> <p><i>Note: This project was added as a result of the January 2009 revision to the Standards and is a requirement for all internal audit functions.</i></p>	Completed in May 2009
4% Non-Competitive Housing Tax Credit Program	<p>To review the 4% Non-Competitive Housing Tax Credit Program for the 2008 tax application cycle to:</p> <ul style="list-style-type: none"> <li>➤ identify significant risks,</li> <li>➤ evaluate whether there are adequate controls in place to address the risks, and</li> <li>➤ determine whether the Department has complied with all program requirements.</li> </ul>	Moved from June 2009 to August 2009 to allow the Multifamily staff additional time to complete the tax credit cycle
Section 8 – Housing Choice Voucher Program	<p>To review the Section 8 Housing Choice Voucher Program to determine if:</p> <ul style="list-style-type: none"> <li>➤ The revised rules, policies and procedures adequately address the significant risks and compliance requirements associated with the program,</li> <li>➤ The program is operated in compliance with the newly revised rules, policies and procedures,</li> <li>➤ The processes for awarding local provider contracts and distributing Section 8 vouchers results in a fair and equitable process, and</li> <li>➤ the program is functioning as intended.</li> </ul>	Cancelled - The Section 8 Housing Choice Voucher Program rules, policies and procedures have not yet been revised.
Follow-up on the Fall 2008 Audits of the Bootstrap and Self Help Center Programs	<p>To follow-up on the fall 2008 internal audits of the Bootstrap and Self-Help Center Programs to determine the progress made by the Office of Colonia Initiatives in implementing the audit recommendations.</p> <p><i>(Note: This audit was requested by the board at the December 2008 audit committee meeting.)</i></p>	July 2009

**OTHER ACTIVITIES**

**These are required activities that are part of Internal Audit's overall responsibilities.**

Follow-Up on Status of Prior Internal Audit Issues	To independently verify corrective actions taken by management in response to prior internal audit issues. Follow-up projects will be pursued during the course of current related audits when the issues have been reported as implemented by management. We will also prioritize and evaluate issues that have been reported as implemented on an ongoing basis (as time allows.)	Ongoing
Tracking the Status of Prior Audit Issues	To track the status of prior audit issues for management/board reporting purposes.	Ongoing
Fraud Hotline	To provide tracking, follow-up and disposal of issues identified as a result of fraud hotline communications.	Ongoing
FY 2009 Annual Audit Plan	To develop an annual audit plan for FY 2010 as required by the Texas Internal Auditing Act.	September 2009
FY 2008 Annual Internal Audit Report	To prepare an annual internal auditing report for FY 2008 pursuant to the Texas Internal Auditing Act.	November 2008 - Completed
Internal Audit Charter	To revise the Internal Audit Division's charter to comply with new standards set by the Institute for Internal Auditing.	January 2009 - Completed
Coordinate External Auditors	To coordinate and assist external auditors. This includes attending entrance and exit conferences, providing information, audit reports and working papers, and coordinating with management to ensure a prompt and accurate response to draft audit reports.	As Needed
Prepare for Peer Review	To complete the peer review self-assessment and prepare for the required fall 2009 peer review of the internal audit division.	October 2009
Support ARRA Efforts	To provide support for the Department in reviewing issues related to the American Recovery and Reinvestment Act (ARRA) funds, and to support and advise the Department's management in developing internal controls over the ARRA funds. This includes serving as the point of contact for the Government Accountability Office (GAO) in their review of the ARRA funds.	Ongoing



**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Status of external audits.

**Required Action**

None, information item only.

**Background**

The status of external audits provides an overview of the status of all external audits currently in progress, recently completed, or anticipated in the near future.

**Recommendation**

No action is required.

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**  
**INTERNAL AUDIT DIVISION – STATUS OF EXTERNAL AUDITS**  
**June 25, 2009**

Internal Audits/Activities	Scope/Description	Stage	Comments
State Auditor's Office	Follow-up on 2007 audit, and consideration of all matters related to the administration of the two awards of Community Development Block Grant Funds for Hurricane Recovery.	Reporting	Fieldwork is complete. Report anticipated in July 2009.
State Auditor's Office	A review of the Department's Program Specialist job classification.	Reporting	Fieldwork is complete. Report anticipated in July 2009.
U.S. Department of Housing and Urban Development	<p>Monitoring the fundability documentation, subrecipient management and policy controls for fraud, waste, and mismanagement for the department's CDBG Supplemental II Disaster Funds.</p> <p>The following program areas and functions will be reviewed:</p> <ul style="list-style-type: none"> <li>• Houston and Harris County Public Service and Community Development</li> <li>• Homeowner Assistance</li> <li>• Rental Housing Stock Restoration</li> <li>• Environmental Reviews</li> </ul>	Fieldwork	Fieldwork is underway, report date is unknown.
U.S. Department of Housing and Urban Development – Office of the Inspector General	Review of the Department's CDBG Supplemental II Disaster Funds.	Fieldwork	Fieldwork is underway, report date is unknown.
Texas Workforce Commission – Subrecipient Monitoring of UI Data Sharing	Review of access controls over Unemployment Insurance Data to ensure compliance with rules and regulations.	Reporting	Fieldwork is complete, report date is unknown.
Government Accountability Office (GAO)	To monitor the Department's plans and controls over the American Reinvestment and Recovery Act (ARRA) funds.	Fieldwork	The GAO is conducting an ongoing monitoring process that includes periodic reporting. The first report covered Texas but did not specifically address any issues at TDHCA.

**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**  
**INTERNAL AUDIT DIVISION – STATUS OF EXTERNAL AUDITS**  
**June 25, 2009**

Internal Audits/Activities	Scope/Description	Stage	Comments
U.S. Department of Housing and Urban Development	Technical Assistance and Financial Review of the HOME Multifamily Program	Reporting	Report received April 17, 2009. TDHCA will provide responses on June 30, 2009.
KPMG	The scope of the financial portion of the Statewide Single Audit includes an audit of the state's basic financial statements for fiscal year 2008 and a review of significant controls over financial reporting and compliance with applicable requirements.	Completed	Report released in March 2009.
U.S. Department of Housing and Urban Development – Office of the Inspector General	Testing of the Department's CDBG Supplemental I Disaster Funds.	Completed	Report released in January 2009.
Deloitte and Touche	Annual opinion audits: <ul style="list-style-type: none"> <li>• Consolidated Financial Statements for the FYE August 31, 2008.</li> <li>• Revenue Bond Enterprise Fund for the FYE August 31, 2008.</li> </ul>	Completed	Report released December 18, 2008.
Comptroller of Public Accounts	A post-payment audit of certain payroll, purchase and travel transactions.	Completed	Report released December 22, 2008.
U.S. Department of Housing and Urban Development	Disaster Voucher Program validation review to identify reporting errors, and to provide guidance and technical assistance to improve the Voucher Management System and the Disaster Information System.	Completed	Report released October 15, 2008.
U.S. Department of Housing and Urban Development	Review of the Community Affairs Division's Emergency Shelter Grants Program.	Completed	Report released October 3, 2008.

**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Presentation and discussion of the status of prior audit issues.

**Required Action**

None, information item only.

**Background**

Audit standards require auditors to follow-up on the implementation status of their audit recommendations. Internal audit recently developed a new data base of prior audit issues to track the findings and recommendations from both internal audits and external audits.

**Of the 91 current prior audit issues:**

- 1 issue was reported as “not implemented”.
- 24 issues were reported as “pending” or “action delayed”. We will verify and close these issues when they are reported as “implemented.”
- 50 issues have been reported by management as “implemented” and are reflected on the attached list. We will verify and close these issues as time allows.

**Recommendation**

No action is required.

# Texas Department of Housing and Community Affairs - Detailed Audit Findings

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
6	4/20/2008 State Auditor's O	Management Controls at the TDHCA Report No. 98-037 Review of Mangement Controls	Px	04/20/98 12/31/1998

**Division:** HOME

**Section:** Housing Trust Fund

**Issue:** The Department needs to ensure that policies and procedures affecting the Housing Trust Fund award processes are implemented and enforced.

**Status:**

- 06/03/09 - The HOME & HTF Programs Division has finalized all of the Division's Standard Operating Procedures (SOPs), which include those policies and procedures affecting the Housing Trust Fund award process. These SOPs are available electronically to all staff and lead staff have been identified to maintain and update SOPs, as necessary.
- 01/05/09 - From review of the supporting documentation provided to Internal Audit, it was determined the audit issue is not implemented because the Standard Operating Procedures have not been finalized.
- 04/20/98 - The state Legislature of Texas clarified organizational and operational issues concerning the TSHAC. With the seating of the new Board of Directors in January 1998, TSHAC is now in position to finalize implementation of the new legislation. Full implementation of the legislation, fully staffing TSHAC and finalizing its polices and procedures will effectively result in implementing your recommendations.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
7	12/10/1999 KPMG	Letter on internal Controls and Accounting Procedures 8/31/99 Annual Independent Audit of Department's General Purpose Financial Statements for FY 19	Px	12/10/99

**Division:** Financial Administration

**Section:** Financial Services

**Issue:** During the internal control testing over cash receipts, we noted the following deficiencies. Although two mail clerks are required to open mail and lock up all checks or cash received, neither of these clerks are required to immediately log in the cash receipts. Instead, one of the clerks takes all of these cash and check receipts and locks them in a drawer until a later time when a different clerk logs them in. At this point, the cash receipts are still unrecorded and the control over the drawer key where the receipts are maintained is lacking as the clerk who opened the mail has access to the drawer key.

We recommend that the Department require at least two persons, having no access to cash receipts or accounts receivable records, open the mail and list the receipts simultaneously. Both persons should sign off the cash receipt log-in control sheet. Also, restrictions should be placed on access to drawer keys used for control of cash receipts.

**Status:**

- 06/12/09 - The Department requires at least two persons, having no access to cash receipts or accounts receivable records, open the mail and list the receipts simultaneously. Both persons sign off on the cash receipt log-in control sheet. Restrictions have also been placed on access to drawer keys used for control of cash receipts.
- 12/19/08 - After review of the standard operating procedures provided to internal audit, it was determine the audit issue was not cleared. The standard operating procedures are lacking statements about :
  - the two persons that open the mail, having no access to cash receipts or accounts receivable records
  - the two person opening the mail are required to list the receipts simultaneously.
  - both persons should sign off the cash receipt log-in control sheet
  - what restrictions are placed on access to drawer keys used for control of cash receipts
- 10/01/00 - Reported to the Board as implemented at 10/00 Audit Committee meeting.
- 08/31/00 - The Department has implemented enhanced procedures to ensure sound internal controls. The enhancements include a mainframe cash receipts system, a dual individual log-in process, and a segregated process for the recording of cash receipts/accounts receivable.
- 12/10/99 - The Department will work with Internal Audit to develop and implement better controls over cash receipts as they are initially received in the mailroom to address the concerns raised by this comment. We have begun work on reviewing the current process and on developing enhancements to controls. The department expects to have this implemented by April 14, 2000.

Px	12/10/99	4/14/2000
Ix	08/31/00	
Ix	10/01/00	
Px	12/19/08	
Ix	06/12/09	

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
9	12/6/2000 KPMG	Letter on Internal Control and Accounting Procedures - 8/31/00 Annual independent audit of department's general purpose financial statements for FY 1999.	Px	12/06/00

**Division:** Financial Administration

**Section:** Budget/Travel/Payroll

**Issue:** OMB Circular A-87, Cost Principles for State and Local Governments

Px 12/06/00  
Ix 09/10/01  
Px 01/05/09  
Ix 06/12/09

Background:

The Office of Management and Budget (OMB) Circular A-87 establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments. Attachment B of the circular states that where employees work on multiple activities (programs) or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. The personnel activity reports must (1) reflect an after-the-fact distribution of the actual activity of each employee and (2) be prepared at least monthly and signed by each employee. Budget estimates or other distribution percentages determined before the services are performed do not qualify as support.

An audit done by the Housing and Urban Development Department (HUD) and our procedures disclosed that the Department did not always maintain the required documentation to support payroll costs allocated to the HOME Investment Partnership (HOME) Program. Instead, the Department charged payroll costs for employees working on multiple activities in divisions other than the HOME program office based on budget estimates. Ultimately, HUD accepted the Department's payroll charges based on alternative documentation methods.

In addition, according to OMB Circular A-87, a cost is allocable if the goods and services involved are chargeable or assignable to the activity in accordance with relative benefits received. All governments claiming overhead costs must develop a cost allocation plan in accordance with the requirements described in OMB Circular A-87 and maintain the plan and related supporting documentation in their files for support.

An audit done by HUD and our procedures disclosed that the Department did not strictly follow OMB Circular A-87 in the allocation of overhead costs such as rent, utilities, travel, office equipment and supplies to the HOME program for activities or costs that supported the multiple programs. The Department based its budget for these non-payroll costs on available funding from the programs the activity supported. The Department then allocated the cost of these programs based on the established budgets.

Recommendation:

We recommend that the Department implement procedures to insure compliance with OMB Circular A-87 by (1) insuring that staff working on multiple programs maintain time sheets based on their actual time worked for each program and (2) developing an overhead cost allocation plan to insure that expenditures charged or allocated to the HOME program are allowable and adequately supported.

**Status:**

- 06/12/09 - Procedures have been implemented that include a reconciliation and adjustment of federal payroll costs from estimated to actual based on employee timesheets signed and approved by supervisors. The annual federally approved indirect cost rate is applied to direct federal salaries, as supported by timesheets. The collections from all federal grant sources are pooled and used to fund indirect central administration general revenue appropriations. For 2008, \$624,750 was collected for indirect overhead from the HOME grant.
- 01/05/09 - From review of the supporting documents provided to Internal Audit it was determined that the audit issue is still in process because there is no indication of developing an overhead cost allocation plan to insure that expenditures charged or allocated to the HOME program are allowable and adequately supported.
- 09/10/01 - Reported to Board as implemented, per management, at 8/21/01 Audit Committee meeting.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
12/06/00 -		Since the issuance of the HUD IG audit report, the Department has established a policy for staff who work on multiple programs, which requires that they keep timesheets that reflect actual time worked by individual federal program. Those timesheets are then summarized and adjustments to payroll entries are made on a quarterly basis to reflect a proper charge to the proper program. The Department will develop as part of its budget process an overhead cost allocation plan. This plan will ensure that all non-payroll costs allocated to the HOME program are allowable and adequately supported. The Department has worked diligently with HUD staff to resolve the audit findings and the process is near a conclusion.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
10	1/7/2002 Internal Audit	Controls Over Single Family Loans; Report No.1.05 Review of controls over single family loans serviced by the Department.	Px	01/07/02

**Division:** Financial Administration

**Section:** Loan Servicing

**Issue:** Improve Collection of Loan Documentation Procedures

Documentation supporting loans being serviced by the Department's Loan Administration Division was generally adequate to protect the Department's financial interests. However, an audit sample of 59 loans recorded on LSAM noted the following loan documentation exceptions (e.g., missing and/or unrecorded loan documents):

- \* Five occurrences of the original or certified documents (e.g., Transfer of Lien, Warranty Deeds) being on file, but no evidence of formal recording in the applicable county official property records.
- \* Three instances of required original or certified copies of documents (e.g., Transfer of Lien and Mechanic Lien Contracts) not on file, although photocopies were on file.
- \* One instance of a "Transfer of Lien," documented in the file by staff in 1996 as being needed, not on file.
- \* One instance of a warranty deed relating to the Office of Colonia initiative contract for deed conversion program was not on file.

Reasons for the documentation exceptions include the lack of formal policies and procedures, including supervisory review procedures, designed to ensure that the necessary loan documentation is obtained for all loans being serviced by the Department. Additionally, the use of the document control checklists by program staff to ensure complete loan documentation was lacking in several respects. Of the 59 sample files reviewed, twelve instances of the document control checklists not being completed or used were noted. In two other instances, the document control checklist was not completed but it was signed off as being reviewed by a supervisor; however, in these instances, the necessary loan documents were on file.

Recommendation - To improve quality control processes over the collection of loan documentation and to ensure that documentation is in place to protect the Department's financial interests, we recommend management develop and implement written formal standard operating procedures regarding required loan documentation. Procedures should include the use of the checklist, as intended by management, and the supervisory review process to ensure compliance with prescribed procedures.

**Status:**

- 06/12/09 - All involved divisions are now following the approved Standard Operating Procedure for the Single Family Special Loan Portfolio.
- 12/19/08 - After review of the Standard operating procedures provided to internal audit, it was determine the audit issue was not cleared. Write-off procedures have not been developed..
- 02/17/04 - Issue reported to the Board as implemented at the Dec. 2003 meeting.
- 11/21/03 - All involved divisions are now following the approved Standard Operating Procedure for the Single Family Special Loan Portfolio.
- 09/22/03 - Loan Servicing has trained Asset Management staff on utilization of the MITAS servicing system to generate delinquency reports and loan level detail of delinquent loans. Loan Servicing continues to coordinate efforts with OCI staff to work with delinquent Single Family Special Loan Portfolio Borrowers. Draft policies have been completed and will be finalized with OCI and Single Family Production by October 3, 2003.
- 05/06/03 - Management continues to expect issue resolution by 06/01/03.
- 03/28/03 - The Asset Management staff is being trained on the loan servicing system to generate delinquency reports and loan level detail of delinquent loans. The process of developing procedures outlining methods of delinquency management and foreclosure proceedings is being coordinated with Legal and OCI staff.

Px	01/07/02	
Px	04/22/02	7/1/2002
Px	07/22/02	11/1/2002
Px	11/05/02	2/1/2003
Px	01/28/03	6/1/2003
Px	03/28/03	6/1/2003
Px	05/06/03	6/1/2003
Px	09/22/03	10/3/2003
Ix	11/21/03	
Ix	02/17/04	
Px	12/19/08	
Ix	06/12/09	

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
01/28/03 -	Loan Servicing staff is working with staff in newly formed areas (Operations Divisions/Asset Management-Early Intervention and Real Estate Analysis/Workout), a product of the Agency-wide restructure, to identify all delinquent single family loans and formulate standard plans of action.	
11/05/02 -	Loan Administration has started to draft Standard Operating Procedures for the delinquent Single Family Loans. Due to the uniqueness of the programs funded under Single Family, we will continue to meet with the originating program area for guidance.	
07/22/02 -	Loan Administration has begun to prepare draft SOPs with regard to loan collections and resolutions that will fit all types of loans being serviced by the Department. This draft will be based on historical processes and industry standards. Program areas will then need to review the draft SOP to see how it might impact their applicants, borrowers, etc.	
04/22/02 -	In order to develop an SOP on loan collections and resolutions for all loans serviced by the Department, a group of Directors and Managers will meet to discuss how loan delinquencies and collections should be administered. Loan Administration will provide a basic template to start from based on historical processes and industry standards.	
01/07/02 -	Management will work on developing formal procedures for collection efforts, workouts, foreclosures and deed-in-lieu, real estate owned after foreclosure and write-offs. Some of these procedures will require policy directives from Executive Management as well as the opinions of other Directors affected so that the Department will be in agreement on the collection of Department debt.	

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
11	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/07 1/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** The date and time the pre-application documentation is received is not consistently documented. The pre-application form and the payment receipt are date and time stamped by the Department when the application is received. However, we found that:

- 1 of the 79 pre-application files tested did not have the date and time stamp on either the pre-application or the pre-application fee receipt.
- 4 of the 79 pre-application files tested did not have the date and time stamp on the pre-applications forms, but a date was located on the fee receipt.

In addition, there were several instances where the date and time was hand-written onto the pre-application and/or fee receipt. These instances were not counted as errors in the numbers above.

Of the 19 pre-applications reviewed where an administrative deficiency was discovered by the Department during the completeness review, there were two instances in which the date the deficiency response was received from the applicant was not documented on the response itself.

All pre-applications, fee receipts, applications, and responses to administrative deficiencies should be date and time stamped with an electronic clock to document when these items were received by the Department. This will provide evidence that applicants submitted their documents within the allotted timeframe, and reduce the opportunity for employees to fraudulently back-date applications.

**Status:**

06/12/09 -

10/07/07 - The Multifamily Division will reinforce the importance of using the electronic date and time stamps during the pre-application intake training of all Multifamily staff.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
12	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/07
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Proper site control documentation was not collected from the applicant in 3 of the 79 files tested, but the pre-application passed the completeness review completed by the Department.

We found that:

- 2 of the 79 files tested had a copy of the warranty deed submitted as documentation of site control. However, the warranty deed was not in the name of the applicant, nor expressed the ability to transfer the rights to the development owner.
- 1 of the 79 files tested had a copy of the property contract submitted as documentation of site control. However, the property information documented on the contract was unreadable, making in difficult to prove the contract was for the same property listed on the pre-application.

The 2007 QAP states evidence of property control should be in the name of the development owner or reflect an expressed ability to transfer the rights to the development owner.

The Department should ensure all requirements of the pre-application process included in the QAP are reviewed and documented. Site control should be verified prior to an applicant moving forward in the application process.

**Status:**

06/12/09 -

10/07/07 - The audit recommendation will be addressed with staff and will be emphasized in the application review trainings for the 2008 HTC cycle. Two of the site controls in question were in the name of the general partner instead of the applicant. However, this was not known until the threshold review at full application. The applicant with the non-readable site did not file a full application. However, this issue will still be addressed. The review sheets will clarify improved procedures to address these findings and the issues will be addressed with staff in the training meetings for the 2008 HTC cycle.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
13	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/07
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** We found errors in the following pre-applications; however, no deficiency was noted by the pre-application reviewers. One pre-application was missing the second contact fax number, but the review item on the review sheet was checked indicating all of the required information was located in that section of the pre-application.

In addition, we found instances where the pre-application completeness review sheets were not completed correctly:

- 2 of the 79 pre-application completeness review sheets tested did not document review of the pre-application data form. This form is a printout of the information contained in the Department's database, and is reviewed for accuracy. These forms are marked when errors are discovered, and are then submitted for database correction. However, the forms are not consistently retained to document the changes made to the database.
- 2 of the 79 pre-application completeness review sheets tested did not have the certification of notification section completed by the first reviewer, however no deficiency was documented.

The Department should complete the pre-application review sheets correctly and ensure any deficiencies or blanks are explained and documented. In addition, the Multifamily Finance Production Division should develop a procedure to include all pre-application data forms in the application files. This will ensure documentation exists for any changes made to the Department's database from the time of initial data entry to the time the tax credits are awarded.

**Status:**

06/12/09 -

10/07/07 - The audit recommendation will be accepted and implemented. The Multifamily Division currently conducts training on the review sheets prior to the beginning of the cycle. This training, for the 2008 Cycle, will instruct and clarify with staff how to complete the form correctly and reinforce the importance of filling out the pre-application review sheet correctly. Additionally, the Multifamily Director will reinforce to supervisors that a thorough review of these review sheets be performed. A space for the notification date will be added to the review sheet and date form so staff will have to write out the date. The Multifamily Division will also keep all the data forms from each application file, even after changes have been made to the database.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
14	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/07
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** The written notifications the Department is required to send to elected officials are not kept in the application file nor documented on the communication log. In an effort to streamline the process and reduce the use of paper in the application files, a decision was made to not retain paper copies of the notification letters. However, no compensating process was added to ensure electronic documentation was retained.

Without documentation showing letters were sent to the elected officials as required, the Department can not prove all required parties were notified and provided with a chance to express their support of, or opposition to, the proposed development.

The Multifamily Finance Production Division should develop a process to document compliance with the written notification requirements. This will ensure the Department can refute any challenges by other developers, public officials, or members of the general public that a development did not meet all of the requirements of the program prior to being awarded tax credits.

**Status:**

06/12/09 -

10/07/07 - The audit recommendation will be implemented. Multifamily staff will begin keeping a hardcopy of the letters and emails sent to elected officials until another system of notification is created.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
15	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/08
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** There were 22 applications for which the Department received opposition to the development and all 22 applicants were notified by the Department of the opposition to their development; however, the documentation supporting these notifications was not consistently retained. In 6 of the 22 files, the Department could not find a copy of the e-mail notification sent to the applicant. In order to provide this documentation, the Department contacted the applicants and asked them to send the Department a copy of the email notification originally sent to them. Two of the 6 missing e-mails received from these applicants included sufficient information to support the Department's notifying the applicant as required.

The Multifamily Finance Production Division should develop a process that documents compliance with notification of opposition rules of the LIHTC program. This will ensure the Department can refute any challenges by developers, public officials, or members of the general public that a development did not meet all of the requirements of the program prior to being awarded tax credits.

**Status:**

06/12/09 -

10/07/08 - The audit recommendation will be implemented. Multifamily staff will begin keeping hardcopies of the letters and emails sent until another system of notification is created.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
16	10/5/2007 Internal Audit	Internal Audit Report on the 9% Competitive Housing Tax Credit Program - Compliance Revi The scope included consideration of the pre-application and notification processes of the ho	Px	10/07/07
			Nr	06/12/09

**Division:** Multifamily

**Section:**

**Issue:** The Multifamily Finance Production Division has not followed up on their RP-36 Risk Assessment by developing a risk mitigation action plan to document the controls in place to address unmitigated high and medium risks, nor a monitoring plan to document how they will test the operating effectiveness of the identified controls. The division has not documented how 28 unmitigated risks (23 high risks, 5 medium risks) identified as 'mission critical' will be mitigated with compensating controls.

The Multifamily Finance Production Division should follow Department requirements by developing a risk mitigation action plan to address the 28 unmitigated 'mission critical' risks identified during the Division's risk assessment. In addition, a monitoring plan should also be developed documenting how the Division plans to assess the operating effectiveness of the documented controls on an on-going basis.

**Status:**

06/12/09 -

10/07/07 - Multifamily was one of the first divisions to complete the RP-36 Risk Assessments. The Action Plan needs to be put into the Enterprise format, which will be done.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
30	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 3/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter1-A:  
Errors Were Identified in Applications that Should Have Resulted in Deficiency Notices

At least one error was identified in five of the seven applications tested that should have resulted in an administrative deficiency notice and may have resulted in the application being disqualified, depending on the response to the deficiency. This indicates a lack of adequate review of the application files. However, auditors did not identify any applications that should not have been awarded tax credits because the deficiencies we found could have been corrected.

The most serious deficiency overlooked by Division staff involved a certification made by an architect who is listed on the development's organizational chart. The QAP §49.9(h)(6)(G) requires that the certifying architect or engineer must be a third-party. This should have been documented as a deficiency, and if not corrected within seven business days, the application should have been terminated.

Other examples of deficiencies overlooked include incomplete forms, financing amounts on the application not matching source documents, and other missing information such as no second contact, inaccurate square footage, and incomplete financing narratives. Some review sheets show both reviewers signing-off on a section as completed, but a deficiency was found; others show both reviewers listing the item as 'not applicable' when it was determined during the course of our audit that the section applied to the application, however, we did not note any deficiencies for these items.

**Recommendation**

Two independent reviews should be completed on each application. To help facilitate this process, reviewers should have separate checklists, so the second reviewer is not influenced by the first reviewer's assessment. After two independent reviews have taken place, discrepancies between their reviews should be resolved.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendation and conduct independent reviews.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
31	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 2/29/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 1-B:  
Individuals Under Indictment Were Recommended for Tax Credit Awards

As required by program rules, individuals involved with an application must certify that they are not subject to any pending criminal charges. However, two individuals were indicted after submitting an application and the required certification, but the development they were involved with was still recommended to receive an award.

The Department does not require the applicant to disclose any indictments the related parties of the application may be under from the time of their certification to the time awards are made by the Board.

In one instance, the charges brought against the individual were dropped, and the development was awarded a forward commitment from the 2008 credit ceiling. In the second case, the person under indictment was removed from the development and the development was awarded a forward commitment from the 2008 credit ceiling; however, the name of the individual under indictment still appeared on the forward commitment letter. This individual did not sign the forward commitment.

**Recommendation**

The Department should revise its certification requirement to include a requirement that the applicant should notify the Department if the applicant, development owner, developer, guarantor, or any of their related parties is subject to any criminal proceedings during the course of the tax credit cycle. The notification may not disqualify the development for an award; however, the information should be presented to the Board for their consideration prior to the issuing of awards. The Department should retain documentation of this information in the application file.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendation and include this requirement in the Uniform Application and the application review forms, and/or the QAP for the 2009 Tax Cycle.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
32	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 3/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 2-A:  
A Lack of File Organization Results in Inconsistent Applicant Information

Department staff is not organizing or referencing documents in the application files which makes it difficult to find the most recent documentation, or to determine if documents have been removed.

The applicant's responses to deficiencies are not linked or referenced to the original documents within the application file. This results in incomplete documents being accepted simply because they address the deficiency, while other required information on the original document may be omitted from the revised version. All updated documents are required to stand on their own. This issue is further complicated when subsequent deficiencies are found on the new document and yet another document must be submitted to provide the required information.

Department staff removes documents from the application files without noting when they removed the documents or where they are now located. For example, support and opposition letters are removed from the application file as they are received, and filed together awaiting a separate review. The lack of staff documentation regarding when and where the documents have been removed results in the appearance that documents are missing or were never provided.

There were also instances noted where Real Estate Analysis staff removed copies of the financial statements from the application files, but failed to note they had removed them. This resulted in the appearance that the documents were never provided by the applicant. In addition, one current forward commitment file could not be located.

Recommendation

The Department should:

- highlight and flag information used as support for items within the various checklists. Cross-referencing checklist items to where the information is located in the application file may help in this process,
- develop a system, by which deficiency responses can be easily linked or referenced to the original document,
- develop a chronology sheet to document changes to the file, requests made of the applicant, or other information not readily apparent in the file,
- include time and date stamps on all documents received, and
- consider the use of software, like the TeamMate Audit Management System, that can be used to automate and link documents for ease of review.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendations and create a system to track deficiencies and changes to the application.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
33	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 3/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 2-B:  
Deficiency Responses Do Not Always Contain All of the Required Information

When a response to an administrative deficiency notice is received, the reviewer who issued the notice reviews the documents and determines if the response is adequate. If the reviewer determines the response is adequate they write an "R" on the checklist to indicate the deficiency was resolved.

In three instances, the checklist indicated the deficiency was resolved, but the updated information or documentation could not be found in the file. In four other instances, the response was insufficient to address the original deficiency, yet the review sheet was marked as "resolved".

**Recommendation**

The Department should ensure the information submitted to resolve deficiencies is complete and correct, and is linked to the part of the application file where the deficiency was noted, so subsequent reviewers can easily locate the new information.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendation and create a system to document deficiencies and changes.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
34	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 3/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 3-A:  
Review Sheets Do Not Capture All QAP Requirements

There were twenty-six QAP requirements not included in the selection, threshold, and QCP review sheets used during the application review process. Information missing from the review sheets could result in an application that does not meet all the requirements of the QAP being recommended for an award.

Examples of QAP requirements missing from the review sheets include:

- The QAP requires that, "The commitment of funds (an application alone will not suffice) must already have been received from the third-party funding source", but this is not reviewed on the selection review sheet to determine if the funds have already been received.
- The QAP requires the applicant to provide a unit floor plan for each type of unit showing special accessibility and energy features; however, the review sheet only requires the reviewer to ensure unit floor plans are submitted for each unit type and that the net rentable area matches Vol. 1 Tab 2.
- The QAP states that all community amenities must exist, or if under construction must be at least 50% complete, by the date the application is submitted, but there is no indication on the review sheet that this is considered.
- The QAP requires entities that have not been formed and entities that have been formed recently but have no assets, liabilities, or net worth to submit a statement with their application to this effect, but this requirement is not listed on the review sheet.

Recommendation

The Department should ensure that the application review sheets include all of the QAP requirements.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendation and ensure all requirements of the QAP are included in the application materials as well as the review materials.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
35	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit cycle applicatio	Px	12/11/07 7/31/2008
			Nr	06/12/09

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 3-B:  
Application Log Does Not Meet All Statutory Requirements

While the Department posts most of the required application and award information on its website within various reports, there is no application log, as defined in statute, posted to the website. In addition, some of the information required by statute is not posted to the Department's website. Items required as part of the application log that are not posted to the website include: names of the related parties to the applicant, the score of the application in each scoring category adopted by the Department under the QAP, any decision made by the Department or Board regarding the application, the names of persons making these decisions, including the person scoring and underwriting the application, and a dated record and summary of any contact between the Department staff, the Board, and the applicant or related parties.

In addition, scoring sheets providing details of the application score are not posted as required by the Texas Government Code §2306.6717 (2). A log of all application scores is posted (application scoring log); however, this log only contains summary information, and does not contain details as required by statute. Texas Government Code §2306.6717 (a) (2) states, "Subject to §2306.67041, the department shall make the following items available on the department's website: before the 30th day preceding the date of the relevant board allocation decision, except as provided by Subdivision (3), the entire application, including all supporting documents and exhibits, the application log, a scoring sheet providing details of the application score, and any other document relating to the processing of the application." Subdivision (3) states, "not later than the third working day after the date of the relevant determination, the results of each stage of the application process, including the results of the application scoring and underwriting phases and the allocation phase."

In addition, the Texas Government Code §2306.6709 states, "APPLICATION LOG. (a) In a form prescribed by the department, the department shall maintain for each application an application log that tracks the application from the date of its submission.

(b) The application log must contain at least the following information:

- (1) the names of the applicant and related parties;
- (2) the physical location of the development, including the relevant region of the state;
- (3) the amount of housing tax credits requested for allocation by the department to the applicant;
- (4) any set-aside category under which the application is filed;
- (5) the score of the application in each scoring category adopted by the department under the qualified allocation plan;
- (6) any decision made by the department or board regarding the application, including the department's decision regarding whether to underwrite the application and the board's decision regarding whether to allocate housing tax credits to the development;
- (7) the names of persons making the decisions described by Subdivision (6), including the names of department staff scoring and underwriting the application, to be recorded next to the description of the applicable decision;
- (8) the amount of housing tax credits allocated to the development; and
- (9) a dated record and summary of any contact between the department staff, the board, and the applicant or any related parties."

Recommendation

The Department should post the application log information, or a map or spreadsheet that references the location of the information required by the Texas Government Code. If some of the information is not available by the statutory deadline, the Department should post the information available on the deadline, and amend the application log as needed when additional required information comes available. In addition, the Department should post the scoring sheets as required.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendations.

36	12/11/2007 Internal Audit	Multifamily 9% Housing Tax Credit Program - Application and Award Processes Consideration of the 9% Housing Tax Credit Program for the 2007 tax credit applicatio
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	<u>Status</u>	<u>Target Date</u>
Px	12/11/07	9/30/2008
Nr	06/12/09	

**Division:** Multifamily

**Section:** 9% Housing Tax Credit Progra

**Issue:** Chapter 4-A:  
Requirements Listed In the QAP are Not Included in the Commitment Review Sheet

In comparing the commitment review sheet to §49.13 of the QAP, several items were missing from the review sheet. This could result in reviewers not verifying the submission of required items. The most important missing QAP requirement is that if a certificate of account status is not available because the entity is newly formed, a statement to that effect and a certification of organization from the Secretary of State's Office is required. This requirement is not included on the commitment notice checklist. In most instances, the certificate of organization and a statement that the applicant is newly formed is not included in the commitment file.

In addition, several other requirements are not included on the review sheet.

- The QAP requires copies of the entity's governing documents, including, but not limited to, articles of incorporation, articles of organization, certificate of limited partnership, bylaws, regulations and/or partnership agreements submitted when the commitment notice is executed; however the only documents included on the checklist are the partnership agreement or the certificate of limited partnership.
- The QAP requires "evidence that the entity has the authority to do business in Texas," but this requirement is not on the checklist.
- The checklist includes a statement 'evidence of zoning', but only one of the options for zoning requires evidence to be submitted with the commitment notice. This is not clear on the checklist.

Recommendation

The Department should ensure all documentation required by the QAP is included in the commitment notice checklist, and that reviewers are verifying that all of the required documentation is received.

**Status:**

06/12/09 -

12/11/07 - Staff will implement the audit recommendations.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
38	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/30/2008
			Ix	12/01/08

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 1-B:  
The Department Should Seek Guidance on the Requirements for the Timely Expenditure of Administrative Funds

The Department's Financial Administration Division does a good job of ensuring that the 5% limit on administrative funds is not exceeded; however, these funds are not expended on a timely basis. After the Department receives an award letter for the CSBG grant, they calculate the 5% that can be used for administrative purposes under the grant rules and these funds are tracked separately in order to ensure that the Department does not exceed the 5% limit. In program year 2007, the Department's 5% limit for administrative funds was \$1,510,432.

As of February 2008, the Department is still using administrative funds received for program year 2006 and has not yet expended any administrative funds for program year 2007. The CSBG act, Sec. 675©(a)(2) states that, "Funds distributed to eligible entities...shall be available during that fiscal year and the succeeding fiscal year." However, administrative funds retained by the state are dealt with in a separate provision, (SEC. 675©(b)(2)), that does not have a similar 2-year obligation limit. The 2007 Notice of Grant Award Letter implies that the 2-year limit also applies to the Department's administrative portion of the grant. It states that, "If the grantee is on an accrual accounting system, services must be provided on or before September 30, 2008 and liquidated on or before December 29, 2008." An analysis of the CSBG administrative funds shows that there is approximately \$1 million left over at the end of each program year.

**Recommendation**

The Department should seek guidance from the U.S. Department of Health and Human Services regarding whether administrative funds should be liquidated within the two-year period. In addition, the Department should consider whether it is retaining administrative funds, and if so, consider re-allocating any un-liquidated funds to subrecipients for use in serving clients.

**Status:**

- 12/01/08 - The Department received guidance from the U.S. Department of HHS Office of Community Services that State administrative funds could be used to provide funding to CSBG eligible entities. The Department provided additional funding to eligible entities and assistance to low income families impacted by hurricanes Dolly, Gustav and Ike in 2008.
- 06/11/08 - The Department will seek guidance from the U.S. Department of Health and Human Services to determine if the two-year time limit applies to State CSBG administrative funds and to confirm if any of the unspent administrative funds can be allocated for activities other than administrative costs, such as services for clients. Based on the guidance received from USHHS, the CA Director will work with the Executive Director and the Financial Administration Director to develop a plan to expend the unspent funds

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
39	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/1/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

Px 06/11/08 10/1/2008  
Px 12/01/08 2/20/2009  
Ix 06/15/09

**Issue:** Chapter 2-A  
The Contract System Should Track Budget Information for Subrecipients

The budgets that subrecipients submit at the beginning of the program year are not included in the automated contract system used to track the subrecipients' expenditure reports. In addition, the percentage of actual funds expended is not calculated and compared to the budget. This causes a problem because once a budget is approved, subrecipients can spend money from any budgeted line item as long as they do not exceed the total amount they were awarded. As a result, there is less accountability for the accuracy of budget projections and for actual expenditures compared to budgeted amounts. In addition, the "other" category of expenses includes direct services and many other types of expenses that should be further separated into line items. The purpose of comparing budgeted amounts to actual expenditures is to help program staff assess the ongoing status of the subrecipient contracts, not to identify unallowable expenditures.

The Community Affairs Division's Comprehensive Energy Assistance Program utilizes an expenditure report that includes budget information.

**Recommendations**

- o Budgets should be entered into the contract system at the budget line item level in order to ensure that subrecipients are not exceeding their approved budget amounts for any of the budgeted line items.
- o The percentage of actual funds expended should be calculated in the contract system and compared to the budgeted amount for each line item.
- o Line items should be created to address the most common expenditures now included in the "other" category.

**Status:**

- 06/15/09 - CS staff currently enters the CSBG budget category information in the note section of the CSBG contract system. Documentation related to expenditures reviews, which may have excess cash issues, are filed in T:\ca\all ca scanned\cacs scanned\Monitoring & Working Files\CSBG\2009\Expenditure Reviews. CSBG statute allows flexibility in the use of funds to support operations and has no restrictions or caps on specific budget categories.
- 12/01/08 - Community Services staff will enter the CSBG budget category information in the Community Affairs Contract System in the "Notes" section beginning in FY 2009. Documentation related to expenditures reviews, will be filed: T:\ca\all ca scanned\cacs scanned\Monitoring & Working Files\CSBG\2008\Expenditure Reviews. The CSBG statute allows great flexibility in the use of funds to support operations and has no restrictions or caps on specific budget categories.
- 06/11/08 - Management agrees that the existing system and processes used to monitor CSBG expenditures needs to be altered to address these recommendations. It is important to note that the Department has limited ability to disapprove CSBG expenditures or deny requests to modify the CSBG budget if the activities are defined as allowable in the CSBG Act. Staff will expand the existing monitoring instrument to address this concern and provide training and technical assistance to subrecipients regarding budget preparation for those subrecipients that repeatedly change the CSBG budget.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
40	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/31/2008
			Px	12/01/08 2/20/2009
			Ix	06/15/09

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 2-B  
Community Services Staff Should Ensure Subrecipients Do Not Receive More Than a 30-day Supply of Funds

The expenditure reports in the contract system track projected expenditures for the next month, the prior month's expenditures and the cumulative expenditures of each subrecipient. The contract system uses this information to calculate the subrecipients' cash on hand. However, from our review of a sample of seven expenditure reports and five monitoring files which contain information on subrecipients' bank accounts, it appears that some subrecipients are receiving or retaining more than a 30-day supply of funds. The State of Texas Plan and Consolidated Application and the CSBG contract limit subrecipients to a 30-day supply of cash on hand. The contract specialist is responsible for reviewing the monthly expenditure reports and alerting the program officers if a subrecipient appears to have requested more than a 30-day supply of cash.

However, as long as the funds requested do not exceed 1/12 of the total annual allocation, funding requests are approved. As a result, subrecipients may be able to maintain higher balances of cash on hand. This increases the risk that the excess cash could be converted to non-CSBG uses.

**Recommendations**

During the monthly review of expenditure reports, Community Services staff should review the prior month's advances for specific line items and compare them against the actual expenditures reported by line item to ensure that the most recent funding request is reasonable.

The funding requests should be compared to the budget to determine a percentage of the total budget and to determine the reasonableness of the request.

**Status:**

- 06/15/09 - CS staff reviews monthly expenditure reports to determine the reasonableness of the request. Documentation related to expenditures reviews, which may have excess cash issues, will be filed in T:\ca\all ca scanned\cacs scanned\Monitoring & Working Files\CSBG\2008\Expenditure Reviews. Subrecipients with issues related to advanced payments will receive training and technical assistance.
- 12/01/08 - Community Services staff will continue to review monthly expenditure reports to determine the reasonableness of the request for advance payments. Documentation related to expenditures reviews will be filed in T:\ca\all ca scanned\cacs\_scanned\Monitoring & Working Files\CSBG\2008\Expenditure Reviews. Subrecipients with issues related to projections and excessive advanced payments will receive training and technical assistance from Department staff.
- 06/11/08 - Procedures will be instituted to thoroughly ensure that funding requests are reasonable as noted in the recommendation, and controls put in place to be sure that the procedures are followed. Staff will provide training and technical assistance to subrecipient staff, as needed, to improve the process to project expenditures and request advance payment.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
41	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 8/15/2008
			Px	12/01/08 3/31/2009
			Ix	06/15/09

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 3-A:  
Inconsistencies in the Disposition of Monitoring Issues Should Be Addressed

We reviewed the monitoring files for fiscal years 2006 and 2007 for a sample of five subrecipients and found that there were inconsistencies in how errors were identified and categorized by the program officers who monitor the subrecipients. The program officers document the issues they identify during on-site monitoring visits in one of three ways: findings, recommendations or notes. Findings identify actions that do not comply with grant requirements and must be addressed by the subrecipient and resolved to the satisfaction of Community Services. Recommendations are preferences suggested by Community Services, but do not necessarily require a change in the subrecipient's procedures. Notes are used to document a condition, but do not include a recommendation for resolution.

There are inconsistencies in the assignment of the status of findings, recommendations or notes. For example, the CSBG does not allow the payment of late fees using grant funds. For one subrecipient we reviewed, the payment of late fees was reported as a finding. For another subrecipient, it was not reported at all. Prior findings identified during a previous on-site monitoring visit that were still outstanding during the next on-site monitoring visit were reported as a finding for one subrecipient, and as a note for another.

**Recommendation**

Community Services management should provide program officers with a guide for the designation and disposition of common issues to generate more consistent reporting.

**Status:**

- 06/15/09 - Staff has developed a Monitoring Guide which includes standard language for common monitoring issues. The Monitoring Guide was reviewed by Energy Assistance Section, Community Services Section, and Portfolio Management and Compliance Division. Program officers received training May 14, 2009 on the Monitoring Guide. The Texas Administrative Code was revised to include the definition of a finding, recommendation and note. The Monitoring Guide is currently being reviewed by Executive Management.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management and Compliance Division. Annually, program officers will receive training on the Monitoring Guide.
- 06/11/08 - Management will develop a uniform definition for what constitutes a Finding, a Recommended Improvement and a Note that will be included in a Monitoring Guide Book for monitoring that outlines standard language for most commonly identified issues. The Project Manager for Monitoring will provide training to the Program Officers prior to each monitoring cycle to ensure a clear understanding of the Monitoring Guide Book. During the review of draft monitoring reports, the Project Manager will ensure adherence to the Monitoring Guide Book

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
42	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 1/1/2009

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 3-B  
The Review of Subrecipient Financial Information Should Be Improved

Px	06/11/08	1/1/2009
Px	12/01/08	3/31/2009
Ix	06/15/09	
Px	06/17/09	7/30/2009

The program officers who monitor the subrecipients for compliance review some financial information, but the information they gather, review and retain is not sufficient to formulate a complete picture of the subrecipient's financial condition. Subrecipients who receive in excess of \$500,000 in annual grant funding are required to submit an audited annual financial report (AFR) to the Department no later than nine months after the end of their fiscal year. The AFR also includes opinions rendered on the major programs and the internal controls, as well as a schedule of expenditures of federal awards to comply with the Office of Management and Budget's (OMB) Circular A-133 Compliance Supplement. The AFRs are reviewed by the Department's Portfolio Management and Compliance Division (PMC), but the program officers do not compare the financial information in the AFRs to the other financial documents gathered during monitoring.

In at least one case, we noted that a subrecipient's annual audit resulted in a separate management letter addressing potential problems with the subrecipient's financial operations. This management letter provided important information that should have been used in the monitoring process, but the management letter was not obtained on a timely basis and may not have been reviewed by the program officer. Not obtaining and reviewing all of the results of the AFR increases the likelihood that fraud, waste or abuse could go undetected.

Program officers review financial documentation, but generally have not retained all of the documentation needed to verify assertions about bank account and general ledger fund balances. For example, the program officer may collect data on the income statement accounts (revenue and expenditures.) They may also review bank account data (bank statement, bank reconciliation, and accounting records such as the general ledger detail of the bank account activity.) However, the documents copied and retained are often missing one or more of these. If bank reconciliations are not completed timely or are not available during the on-site monitoring visit, the request for "the most recent" bank reconciliation will not tie to the data already collected, and is not of any significant value.

**Recommendations**

Subrecipients should be required to submit to the Department any management letters resulting from their AFR audit when submitting the AFR.

Program officers should obtain and review a copy of the most recent audited AFR and any associated management letters prior to conducting an on-site monitoring visit. This information should then be compared to the financial documents reviewed during monitoring.

A complete general ledger printout for the month(s) reviewed (including the asset, liabilities and equity accounts in addition to revenue and expenditures) should be obtained along with the banking account data. This document would allow the program officer to verify that the accounting records are complete and in balance, verify the timely posting of account activity and provide the opportunity to determine whether any inter-fund activity occurred. Any general journal adjustments to the accounts would be easily identified.

**Status:**

06/17/09 - Community Affairs "Monitoring" Standard Operating Procedure will be revised to require that Program Officers review the latest copy of the Audited Financial Report (AFR) and any related management letters on file. The general provisions of the TAC were revised to require subrecipients to submit a copy of the AFR to the Community Affairs Division and to Portfolio Management and Compliance Division (PMC) 10 TAC §5.16 (b). Program Officers review documents and determine if follow-up is needed. FY 2009 contracts include the requirement that a copy of the AFR be sent to the Community Affairs Division.

Monitoring instruments have been revised to address review of general ledger and bank account data to verify complete accounting records and review account activity.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
06/15/09 -		The Community Affairs "Monitoring" Standard Operating Procedure Has been revised to require that Program Officers review the latest copy of the Audited Financial Report (AFR) and any related management letters on file. The general provisions of the TAC were revised to require subrecipients to submit a copy of the AFR to the Community Affairs Division and to Portfolio Management and Compliance Division (fMC) 10 TAC §5.16 (b). Program Officers review documents and determine if follow-up is needed. FY 2009 contracts include the requirement that a copy of the AFR be sent to the Community Affairs Division.  Monitoring instruments have been revised to address review of general ledger and bank account data to verify complete accounting records and review account activity.
12/01/08 -		The Community Affairs "Monitoring" Standard Operating Procedure will be revised to require that Program Officers review the most recent copy of the Audited Financial Report (AFR) and any related management letters on file. The proposed general provisions of the TAC will require subrecipients to submit a copy of the AFR to the Community Affairs Division and to Portfolio Management and Compliance Division (PMC) 10 TAC §516 (b). Program Officers will review documents and determine if follow-up is needed. FY 2009 contracts will include the requirement that a copy of the AFR be sent to the Community Affairs Division. Monitoring instruments will be revised to address review of general ledger and bank account data to verify complete accounting records and review account activity.
06/11/08 -		The Community Services Block Grant (CSBG) and Emergency Shelter Grants Program (ESGP) Monitoring Standard Operating Procedures will be revised to require that Program Officers obtain a copy of the latest Audited Financial Report (AFR) and any related management letter on file within the Portfolio Management and Compliance Division (PMC). The CA Director will recommend updates to the CSBG and ESGP rules and contracts during the next rules and contract cycle to specify the requirement of submission of the AFR and management letters to CA in addition to PMC. The Program Officer will review the AFR and management letter to determine if follow up is needed. Processes will also be changed regarding review of general ledgers and banking account data to verify that the accounting records are complete and in balance, verify the timely posting of account activity and provide the opportunity to determine whether any interfund activity occurred. Staff will be trained in this area.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
43	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 11/1/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 3-C  
Criteria for Cost Reimbursement Should Be Identified

Px	06/11/08	11/1/2008
Px	12/01/08	1/31/2008
Nr	06/12/09	
Px	06/17/09	7/30/2009

Community Services has not defined the criteria used to decide what sanctions to apply to subrecipients who have significant or repeated monitoring findings, or who do not comply with the CSBG grant requirements. An example of non-compliance is the failure to submit an audited AFR as required. The most significant sanction available to CSBG program staff is to place a subrecipient on cost reimbursement. This means that instead of receiving their grant funds in advance, the subrecipients placed on cost reimbursement must submit their receipts, invoices and check stubs for actual expenses in order to be reimbursed by the Department with CSBG funds. Without clear criteria for cost reimbursement or other sanctions, the Department could be left open to allegations of favoritism, inequities, or discrimination.

**Recommendations**

Community Services should define the range of sanctions that can be used for the various types of monitoring findings or issues of non-compliance. The following issues should be included:

- o Fiscal mismanagement, fraud, waste and abuse,
- o Repeated findings from previous monitoring reports that show a pattern of noncompliance (special attention should be paid to repeat financial findings),
- o Issues with the composition of the subrecipient's governing board, including issues concerning board member attendance and representation, and general management failures, and
- o Unresolved findings outstanding for a given period of time. For example, findings that are not resolved within a designated period of time should immediately prompt a decision regarding sanctions.

**Status:**

- 06/17/09 - The TAC rules have been revised to address "sanctions" in §5.17 "Sanctions and Contract Close Out". The Sanctions SOP will be revised to incorporate the TAC revisions.
- 06/12/09 -
- 12/01/08 - The Texas Administrative Code Rules have been revised to address "Sanctions" in §5.17 "Sanctions and Contract Close Out". The TAC Rules will be codified in January 2009. The Sanctions SOP will be revised to incorporate the TAC revisions.
- 06/11/08 - The existing Sanctions Standard Operating Procedure will be revised to define the range of sanctions that can be used for the various types of monitoring findings or issues of non-compliance and how and when the sanctions will be applied.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
44	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/30/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

Px 06/11/08 9/30/2008  
Px 12/01/08 5/31/2008  
Ix 06/15/09

**Issue:** Chapter 3-D  
Monitoring Reports Need to Be Completed on a Timely Basis

Community Services' monitoring policies and procedures require that subrecipients receive a written monitoring report within 30 days for CSBG on-site monitoring visits or within 45 days for joint CSBG and Comprehensive Energy Assistance Program (CEAP) on-site monitoring visits. For the 31 on-site monitoring visits performed in fiscal year 2007, 18 reports (58%) were not sent out within the required timelines. The subrecipients are required to respond to the monitoring findings within 30 days, or 45 days for joint monitoring visits. If additional responses are needed, the subrecipient has 15 days to submit their follow-up responses. However, these responses are often not received for months.

For the 31 on-site monitoring visits performed in fiscal year 2007:

- One notification letter was not sent to the subrecipient, and 11 of the 31 required notification letters were sent late (35%) and did not provide the suggested 30 days notice prior to a monitoring visit;
- Review of the report was not documented on a review coordination sheet for five of the 31 visits (16%); and
- Twelve of the 31 reports (39%) were not sent to the subrecipients' governing boards as required.

Recommendation

Community Services' policies and procedures should be reviewed, revised and followed to ensure that monitoring reports are timely, are reviewed internally and are communicated to the subrecipients' governing boards as required.

**Status:**

- 06/15/09 - Staff developed a Monitoring Guide which includes standard language for common monitoring issues. Staff finalized the Monitoring Guide May 2009. The Guide thoroughly addresses documentation standards. The Monitoring Guide was reviewed by Energy Assistance Section, The Community Services Section, and Portfolio Management and Compliance Division. Community Services monitoring tracking system was updated to allow staff to enter the contract numbers. Additional modifications to that system are still needed. Program officers received training on the Monitoring Guide in May 2009. Monitoring procedures have been revised to allow 45 days. Instead of 30 days for the Department to issue the monitoring report and 45 days for the subrecipient to respond. Energy Assistance and Community Services will continue to work with Information Systems to modify the monitoring tracking systems so that more useful reports such as tracking deadlines are developed.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. The Guide will more thoroughly address documentation standards. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management' and Compliance Division. The Monitoring Tracking System will be updated to generate more useful reports to alert staff about approaching deadlines. Information Systems anticipates modifications to be completed 5/31/09. Annually, Program officers will receive training on the Monitoring Guide. Monitoring procedures have been revised to allow 45 days, instead of 30 days for the Department to issue the monitoring report and 45 days for the subrecipient to respond.
- 06/11/08 - Management will review and revise the Monitoring Standard Operating Procedure to more thoroughly address the recommendations in regards to timeliness of reports and correspondence, documentation of internal reviews, and communication with subrecipients' governing boards. Consistency between policies will be improved and controls will be put in place to ensure these processes are followed. Additionally, the existing monitoring tracking system will be updated to generate more useful reports to alert staff about approaching deadlines.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
45	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008
<b>Division:</b> Community Affairs			Px	12/01/08 3/31/2009
<b>Section:</b> Community Services - CSBG			Ix	06/15/09

**Issue:** Chapter 3-E  
All Program and Expenditure Requirements Need to Be Reviewed During Monitoring Visits

Generally, all program and expenditure requirements are considered during on-site monitoring visits. However, we compared the contract, rules, grant requirements and monitoring instruments used by the program officers during on-site monitoring visits and noted the following issues:

- One of the questions on the monitoring instrument, "Does the subrecipient maintain procedures which conform to the uniform administrative requirements?" has "not applicable" for the CSBG program. However, the CSBG contract states, "Except as expressly modified by law or the terms of this contract, subrecipient shall comply with the cost principles and uniform administrative requirements set forth in the Uniform Grant Management Standards, 1 T.A.C. Sec. 5.141 et seq."
- The monitoring instrument does not prompt program officers to ensure that the expenditures submitted by subrecipients as support for costs are expenditures that were incurred during the contract period. Section 4 of the contract states that the "Department is not liable to Subrecipient for any cost incurred by Subrecipient which is not incurred during the Contract period."
- A review is not performed to determine if the subrecipient's board-approved travel policies were provided to Community Services prior to the subrecipient incurring travel costs.
- Program officers do not review to ensure that the programs and services listed in the subrecipients' CAP plan are actually provided.
- There is no standard form for the program officers to use in documenting the results of their expenditure review.

**Recommendations**

Program officers should review programs and expenditures during on-site monitoring visits to ensure that subrecipients are complying with the Uniform Grant Management Standards, costs are incurred during the contract period, and subrecipients are providing the programs detailed in their CAP plan.

The program officers should ensure that subrecipient's board-approved travel policies are provided to Community Services prior to incurring any travel costs.

A standard form should be developed to document the results of the expenditure review

**Status:**

- 06/15/09 - Section 6A of the 2008 ESGP contract has been revised to include reference to the Uniform Grant Management Standards (UGMS) and to address inconsistencies in references. The monitoring instruments were revised to address time period of expenditure reviews. Management will institute controls to ensure that the monitoring instrument is properly completed. 10 TAC §5.2 was codified in March 2009, and states that subrecipients must comply with UGMS and the OMS circulars. Subrecipients were requested to submit a current board approved travel policy and are on file.
- 12/01/08 - Section 6A of the 2008 ESGP contract has been revised to include reference to the Uniform Grant Management Standards (UGMS) and to address inconsistencies in references. The monitoring instruments will be revised to address time period of expenditure reviews. Management will institute controls to ensure that the monitoring instrument is properly completed. The Texas Administrative Code Rules 10 TAC §5.2 which will be codified in January 2009 state that subrecipients must comply with UGMS and the OMS Circulars. Subrecipients will be requested to submit a current board approved travel policy by 3/31/09.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
06/11/08 -		<p>Management acknowledges inconsistencies in the CSBG and ESGP contracts and the corresponding monitoring instruments. The current contracts reference the Uniform Grant Management Standards (UGMS) and the Office of Management and Budget (OMB) Circulars and the monitoring instruments only reference the OMB Circulars. Management will update the contracts and monitoring instruments to include references to UGMS and the OMB Circulars.</p> <p>The Department will continue to review the monitoring instrument and consider strengthening the review process. The monitoring instrument will be revised to indicate that expenditures reviewed are within the contract period and other changes to the instrument made so that wording of questions better addresses risks and that appropriate follow up occurs for questions. Staff will be trained on the instrument and its changes. Further, controls will be put in place to ensure the monitoring tool is being properly completed (i.e. peer reviews or similar solution.)</p> <p>Management will request a board-approved travel policy from each CSBG subrecipient to maintain in an electronic file at the Department. If a subrecipient changes their travel policy, the subrecipient will be required to submit a new policy to the Department. A standard form, or similar effective tool, will be developed to document the results of the expenditure review.</p>



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
46	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/31/2008
			Px	12/01/08 5/31/2009
			Dx	06/15/09

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 3-F  
The Monitoring Tracking System and the Risk Assessment Process Should be Updated and Improved

All subrecipients are required to have an on-site monitoring visit at least once every three years, and Community Services does a good job of ensuring that these reviews take place. Community Services uses a risk assessment process to determine which subrecipients to monitor each year. They use the Department's standard risk assessment module and rely on an automated monitoring tracking system to track the number, type, and status of findings reported as a result of on-site monitoring visits. The information from the monitoring tracking system is used to complete the risk assessment module. However, the monitoring tracking system is not being kept up to date. As a result, the system can not be relied upon in completing the risk assessment process, and staff must manually go through monitoring reports to determine the information they need for the risk assessment. In addition, the risk assessment does not capture all of the information needed to accurately determine risk.

In comparing the information contained in the monitoring tracking system to the information gathered from manually reviewing monitoring reports and responses, of the 65 on-site monitoring visits performed over the past two years:

- The information contained in the system matches the information in monitoring reports and responses for 16 visits (24.6%),
- The information contained in the system is incomplete when compared to the monitoring reports and responses for 34 visits (52.3%) and inaccurate for one visit, and
- There is no record of 14 monitoring visits (21.5%) in the monitoring tracking system.

Of the 453 questions answered in the 2006 risk assessment, 83 questions (19.6%) were answered incorrectly or not at all. In addition, the possible answers to the risk assessment questions do not provide an accurate assessment of which subrecipients pose the highest risk. For example:

- A subrecipient with one previous monitoring finding currently receives the same ranking as a subrecipient with multiple findings on a previous monitoring report.
- A subrecipient that has never been monitored is currently ranked higher for the question 'time since last on-site visit', but is rewarded by receiving no points for the questions 'results of last on-site visit' and 'status of most recent monitoring report.'
- A subrecipient can be delinquent in providing their audited annual financial report to the Department for multiple months, but if they are in compliance on the day the risk assessment is completed, they are ranked the same as an entity who was in full compliance with the audit requirement throughout the year.

#### Recommendations

Community Services should:

- Revisit the use of the monitoring tracking system for tracking the findings resulting from on-site monitoring visits. This should be done before additional resources are spent in improving or maintaining the current system. If the monitoring tracking system is used, Community Services should develop processes to ensure that data entered into the system is complete and is periodically compared to the data in the monitoring files
- Develop a process or a database that will track the data used in the Department's risk assessment module, and
- Further develop answers to the questions in the risk assessment in order to produce a more accurate risk ranking of the subrecipients.

<i><u>Issue #</u></i>	<i><u>Report Date</u></i> <i><u>Auditors</u></i>	<i><u>Report Name</u></i> <i><u>Audit Scope</u></i>
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**Status:**

- 06/15/09 - Information Systems has made modifications to the monitoring tracking system but additional modifications are needed. The IS division is currently working on projects assessed as higher priority to the Department. The IS division has set the incorporation of the American Recovery and Reinvestment Act contracts and reporting mechanism into the current Community Affairs contract system as a high priority.
- 12/01/08 - The Information Systems Division has made modifications to the Monitoring Tracking System but additional modifications are needed and will be completed by 5/31/09.
- 06/11/08 - The CA Division in conjunction with the IS Division will revisit and update the monitoring tracking system that tracks monitoring findings. A CS staff member, who is not required to travel, will be designated to maintain the monitoring tracking system. The existing monitoring tracking system tracks data used in the Department's Risk Assessment Module. Management will ensure that data is entered in a timely manner.

Prior to the 2008 Risk Assessment, questions and weights were revised to reflect a more accurate risk ranking of the subrecipients. The Risk Assessment will continue to be evaluated and improved.

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<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
47	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/1/2008
<b>Division:</b> Community Affairs			Px	12/01/08 3/31/2009
<b>Section:</b> Community Services - CSBG			Ix	06/15/09

**Issue:** Chapter 4-A  
Community Services Should Review Underlying Data to Ensure That Performance Measures are Correct

Program officers are not required to review the supporting documentation (or even the supporting documentation for a sample of clients) to ensure that the subrecipients are correctly reporting the number of individuals transitioning out of poverty. This number is defined as the number of individuals achieving incomes above 125% of the poverty level.

Four out of the nine LBB performance measures for Community Services use this data in their calculations and of these four, three are key measures for the Department.

The number of individuals transitioning out of poverty is important because it is used as part of both the ROMA and the LBB performance measures, and is used to determine the amount of discretionary funds paid to subrecipients in the form of performance awards. (see Chapter 4-B) The definitions and methods of calculation for this measure do not require the Department to verify the data submitted by the subrecipients; however, the LBB's performance measures guidance requires the Department to have sufficient controls in place to ensure the accuracy of the data. Without the control of testing or verifying at least a sample of the underlying data, it is not possible for the Department to ensure that the data is accurate.

**Recommendations**

- When reviewing a sample of client files during monitoring visits, program officers should re-calculate the reported incomes using the supporting documentation in the client file to confirm that clients who were reported as transitioning out of poverty really did so, and that only allowable income is considered.
- Community Services should develop and enforce a standard methodology for calculating income to ensure consistent and comparable results.

**Status:**

- 06/15/09 - The CSBG monitoring instrument was revised in May 2009 to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients. A new attachment was created for the review of CSBG case management files and to review income documentation for households transitioned out of poverty.
- 12/01/08 - The CSBG monitoring instrument will be revised to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients.
- 06/11/08 - The current process will be reviewed by Management and the Community Services Block Grant monitoring instrument will be revised to clarify the verification of the allowable income of clients that transitioned out of poverty and other CSBG clients.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
48	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 11/13/2008
<b>Division:</b> Community Affairs			Px	12/01/08 5/31/2009
<b>Section:</b> Community Services - CSBG			Px	06/15/09 5/31/2010

**Issue:** Chapter 4-B  
Information Submitted by Subrecipients in Support of Performance Awards Should be Tested for Accuracy

In August of 2007, twenty-eight subrecipients received a total of \$164,000 in performance awards for individuals transitioned out of poverty during the 2006 program year. Analysis of a judgmental sample of 30 families transitioned out of poverty showed that 18 (60%) of the 30 families' files tested did not contain sufficient correct documentation to support the assertion that these families were transitioned out of poverty. Subrecipients are required to submit a list of the families that they transition out of poverty as support for their performance award; however these lists do not contain details such as full names and social security numbers. Community Service's staff verify that the listed incomes are within the poverty level guidelines and that the dates listed support the assertion that the families' income was above 125% of the poverty level for at least 90 days. The analysis of the 30 families' documentation showed errors including:

- Math errors
- Considering partial paychecks at intake and full paychecks in determining that the family was out of poverty,
- Overtime not included when determining the family was in poverty but including overtime in order to determine that the family was out of poverty, and
- Not including a spouse's income to determine the family was in poverty, then including the spouse's income to determine that the family was out of poverty.

In addition, there were three families who were transitioned out of poverty, but the wage earners in these families were the subrecipient's own employees. Although not against the rules, this practice is questionable when used as support for a performance award.

**Recommendations**

If the Department provides monetary awards to subrecipients for transitioning clients out of poverty, Community Services staff should:

- Select a random sample from the list of clients submitted to support the number of clients transitioning out of poverty,
- Request the supporting documentation (income verification) for the selected clients at all points: intake, transitioned out of poverty and 90 days post transition,
- Require subrecipients to provide full names and social security numbers (if available) for each family member transitioned out of poverty and verify that these social security numbers are valid,
- Develop standardized rules that will eliminate any "easy fixes" such as considering a partial paycheck for intake and a full paycheck for out of poverty, or considering overtime for out of poverty calculations, and
- Revise the eligibility criteria in order to prevent subrecipients from receiving an award for their own employees.

**Status:**

- 06/15/09 - Community Affairs has formed an advisory committee of subrecipients to recommend changes to the CSBG performance awards process. The first meeting of the committee was held December 15, 2008. It is anticipated that the committee will continue to meet throughout 2009 and 2010 and provide recommendations regarding the performance awards process.
- 12/01/08 - The Community Affairs Division has formed an advisory committee of subrecipients to recommend changes to the CSBG performance awards process. The first meeting of the committee will be 12/15/08. It is anticipated that the committee will complete the project by 3/31/09. Staff will make recommendations to the Executive Team and/or Governing Board to revise internal procedures and amend TAC rules related to the performance awards process.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
06/11/08 -		To the degree that Performance Awards are utilized, and that transitioning people out of poverty is the measurement used to grant performance awards, staff will recommend that the Texas Administrative Code be revised to include a standard methodology for calculating income to ensure consistent and comparable results. Prior to conferring CSBG performance awards, the Department will select a random sample of client files to verify the accuracy of the data used for granting performance awards. Staff will provide clarification to subrecipients on the criteria that need to be met to report a client as transitioned out of poverty. The Department will require that the subrecipient's executive director and/or program director certify in writing that the clients were transitioned out of poverty as reported. Staff will revise the eligibility criteria for CSBG performance awards to exclude clients who were hired by the subrecipient and consequently transitioned out of poverty.
		Staff will research a reasonable procedure by which subrecipients can verify the validity of social security numbers to the extent they are provided.

49	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	<u>Status</u>	<u>Target Date</u>
			Px 06/11/08	1/1/2009
			Px 12/01/08	5/31/2009
			Px 06/15/09	5/31/2010

**Division:** Community Affairs  
**Section:** Community Services - CSBG

**Issue:** Chapter 4-C  
Performance Awards Should Only Be Given to Subrecipients Who Meet the Eligibility Criteria

In the program year 2006 awards cycle given out in August 2007, there were seven awards totaling \$25,000 given to subrecipients that had unresolved audit findings from their most recent on-site monitoring visits. In addition, performance awards totaling \$20,000 were given to five subrecipients that were delinquent in submitting their audited annual financial report at the time of the award. These subrecipients were ineligible to receive a performance award under the criteria established by the Department. The \$45,000 given out in error represents 27% of the \$164,000 in awards given out during the program year 2006 award cycle.

**Recommendation**  
Community Services staff should ensure that all subrecipients who receive a performance award meet the criteria for receiving an award. In addition, the criteria should be amended to prohibit any subrecipient from receiving an award if they were delinquent in meeting their single audit requirements at any time during the year, not just at the time of the performance awards.

**Status:**

- 06/15/09 - Community Affairs has formed an advisory committee of subrecipients to recommend changes to the CSBG performance awards process. The first meeting of the committee was held December 15, 2008. It is anticipated that the committee will continue to meet throughout 2009 and 2010 and provide recommendations regarding the performance awards process. Community Affairs will coordinate with Portfolio Management and Compliance Division to ensure organizations are not delinquent in their single audit requirements.
- 12/01/08 - The Community Affairs Division has formed an advisory committee of subrecipients to recommend changes to the CSBG performance awards process. The first meeting of the committee will be 12/15/08. It is anticipated that the committee will complete the project by 3/31/09. Staff will make recommendations to the Executive Team and/or Governing Board Staff to revise internal procedures and amend TAC rules related to the performance awards process. Community Affairs will coordinate with Portfolio Management and Compliance Division to ensure organizations are not delinquent in the single audit requirements.
- 06/11/08 - To the extent that CSBG Performance Awards are utilized and that transitioning people out of poverty is the measurement used to grant performance awards, the Department will provide clarification to subrecipients on the criteria which need to be met in order to qualify to receive a CSBG performance award. Further, the CA Director will require submission of the AFR and management letters to CA in addition to PMC and will collaborate with PMC in their review to ensure no awards are made to organizations delinquent in their single audit requirements.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
50	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 1/1/2010

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 5-A  
Only Eligible Administrative Costs Should Be Charged to the Emergency Shelter Grant Program

Currently, all work performed by the ESGP staff is charged to the grant. This means that staff is charging the time they work on developing the Consolidated Plan to the ESGP's administrative funds. However, the U.S. Department of Housing and Urban Development (HUD), which administers the ESGP, states that ineligible administration costs include the preparation of the Consolidated Plan and other application submissions.

The Consolidated Plan serves as the state's application to the federal Government for ESGP funds. The plan states how the Department will pursue the goals of decent housing, a suitable living environment and expanded economic opportunities for all community development and housing programs.

Recommendation

The Department should find an alternate fund to which staff can charge the work performed on the Consolidated Plan.

**Status:**

- 12/01/08 - Staff has changed the process for allocating staff time associated with the HUD Consolidated Plan whereby ESGP funds are not charged for preparation of the Plan.
- 06/11/08 - The Department will utilize an eligible source of funds to develop the Emergency Shelter Grants Program portion of the 5 Year Housing and Urban Development Consolidated Plan, which includes work on the Annual Action Plan and Consolidated Annual Performance Evaluation Report (CAPER). CS staff will allocate time related to the development of the 5 Year HUD Consolidated Plan to an eligible source of funds.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
51	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 5-B  
The Methodology Used for Subrecipient Payments Should Ensure Consistency and Compliance with the Contract

The ESGP contract states that the subrecipient may request advance payment by submitting a properly completed monthly report to the Department. According to the HUD ESGP Program Guide, either cost reimbursement or advance payments can be used, depending on how the funds are handled. The CFR (24 CFR 85.20) states that, "Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees must be followed whenever advance payment procedures are used." Program staff state that the program is set up on a cost reimbursement basis and advance payments are not made. However, a review of one subrecipient indicates that they are making cost projections and receiving advance payments.

**Recommendation**

The Department should review the requirements and benefits of both the advance payment and cost reimbursement methodologies and determine which one to use. The contract and other written guidelines should be revised to ensure consistency with the chosen method.

**Status:**

12/01/08 - The 2008 ESGP contract was revised to only allow a one time advance payment.

06/11/08 - Management will review and ensure that the language in the Emergency Shelter Grants Program (ESGP) contract is consistent with the Housing and Urban Development ESGP Program Guide that allows for either cost reimbursement or an advance method of payment. A set of risk criteria will be established, and the payment method allowed for each subrecipient will be based on the level of risk. Staff will be trained to use the risk criteria to determine the appropriate method of payment for an ESGP subrecipient.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
52	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 12/31/2008
			Px	12/01/08 3/31/2009
			Ix	06/15/09

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 6-A  
The Processes Used to Document and Communicate Monitoring Results Should Be Revised

There are inconsistencies in the manner in which program officers determine which issues are identified as findings and reflected in the final monitoring report and which issues are resolved on-site by the program officers via technical assistance and are not reflected in the report. During a review of the monitoring reports and monitoring instruments of multiple subrecipients, the same issue was reported as a finding in one report, while in another report it was documented as a recommended improvement. Recommended improvements do not require the subrecipient to respond to Community Services on how the issue will be corrected. Also, instances were noted where an issue was documented as a finding on the original monitoring instrument and then changed to a recommended improvement without documenting the reasons for the change.

The program officers who monitor the ESGP subrecipients complete a standard monitoring instrument during on-site monitoring visits. However, the monitoring instrument is not always entirely completed, nor is the monitoring information correctly posted to the monitoring tracking system.

We tested the monitoring files for 26 of the 76 subrecipients in program year 2006 and found that:

- three of 26 the subrecipient files did not contain any monitoring documents for the program year 2006 monitoring visit,
- 12 of the 23 subrecipient files for which documentation of a program year 2006 monitoring visit was available, did not have the monitoring instrument fully completed by the program officer during the monitoring visit,
- 13 of the 26 ESGP monitoring files were not posted to the monitoring tracking system and an additional 6 were not posted correctly, and
- 19 of the 26 monitoring files did not contain a cumulative inventory report, which is required by the ESGP contract and should be submitted to Community Services by October 31st.

The ESGP policies and procedures require that the monitoring reports be sent to the subrecipients within 30 days of the monitoring visit, and that the subrecipients provide written responses to the findings within 30 days from the date of the report. If additional responses are needed, the subrecipients have 15 days to submit their follow-up responses. Follow-up letters requesting additional responses must be sent within 30 days from the date of the original monitoring response, or, if no additional responses are needed, the letter sent to close out the monitoring report must be sent within 30 days of the date of the responses.

- 16 of the 23 subrecipient monitoring files did not contain evidence that the monitoring reports were sent to the subrecipient on a timely basis,
  - six of the 23 subrecipients did not submit their monitoring responses within the required 30 days,
  - three of the 6 subrecipients who were required to submit additional responses did not submit the additional responses within the required 15 days, and
  - 11 of the 23 subrecipient monitoring files tested indicated that the follow-up or closeout letters were not sent within 30 days as required.
- Four of the 23 subrecipient files did not have close out letters in the file, so it is unclear whether these monitoring reports were closed.

**Recommendation**

Community Services should develop processes to ensure that:

- Program officers are consistent in determining what issues are identified as findings and what issues are identified as recommended improvements,
- Monitoring files contain support for monitoring visits,
- Monitoring instruments are properly completed,
- Information entered into the monitoring tracking system is verified against the information in the monitoring files, and
- Correspondence and reports are sent to subrecipients on a timely basis.



<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
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**Status:**

- 06/15/09 - Staff has developed a Monitoring Guide which includes standard language for common monitoring issues. Monitoring Guide was reviewed by Energy Assistance Section, Community Services Section, and Portfolio Management and Compliance Division. Program officers received training May 14, 2009 on the Monitoring Guide. The Texas Administrative Code 10 TAC §5.16 was revised to include the definition of a finding, recommendation and note. Monitoring Guide is being reviewed by Executive Management. Procedures for support documentation have been revised to ensure that monitoring files are complete and that monitoring instruments are properly completed. Monitors are required to verify information entered into the monitoring tracking system coincides with information in the monitoring files. Monitors will be required to send correspondence and reports to subrecipients on a timely basis.
- 12/01/08 - Monitoring staff have developed a draft Monitoring Guide which includes standard language for common monitoring issues. The Program officers received training on the Monitoring Guide and for what is considered a finding, recommended improvement, a note, and standard language for common findings. Staff will finalize by 3/31/09. Additionally, the draft Monitoring Guide will be reviewed by Energy Assistance Section and Portfolio Management and Compliance Division.
- 06/11/08 - 06/11/08 - Management will develop a uniform definition for what constitutes a Finding, a Recommended Improvement and a Note that will be included in a Monitoring Guide Book that outlines standard language for most the commonly identified issues. The Project Manager for Monitoring will provide training to the Program Officers prior to each monitoring cycle to ensure a clear understanding of the Monitoring Guide Book. During the review of draft monitoring reports, the Project Manager will ensure adherence to the Monitoring Guide Book. The CS Project Manager for Monitoring, responsible for ESGP, will provide training to Program Officers to ensure that monitoring files contain adequate support documentation and monitoring instruments are properly completed.

The CA Division in conjunction with the IS Division will revisit and update the monitoring tracking system that tracks monitoring findings. A CS staff member, who is not required to travel, will be designated to maintain the monitoring tracking system.

Management will provide training and oversight to ensure that staff adheres to the existing Monitoring Standard Operating Procedure in regards to timeliness of reports and correspondence, documentation of internal reviews, and communication with subrecipients' governing boards. The existing monitoring tracking system will be updated to generate more useful reports to alert staff about approaching deadlines.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
53	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's		

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 6-B  
Community Services Should Ensure That Subrecipients Comply with Federal Salary Requirements

Px	06/11/08	9/1/2008
Px	12/01/08	2/28/2009
Ix	06/15/09	

The program officers who monitor the ESGP subrecipients do not review the supporting documentation for salaries in order to ensure that subrecipients comply with the Office of Management and Budget's (OMB) Circular A-122, which covers cost principles for nonprofit organizations, and Circular A-87, which covers cost principles for state, local and Indian tribal governments.

Circulars A-122 and A-87 require subrecipients' timesheets to reflect actual time worked. However, the monitoring instrument for ESGP asks, "Do the time sheets reflect actual time worked or a budgeted percentage?" Also, the program officers do not review to ensure that the timesheets are for the total activity of the employee, are maintained at least monthly, are signed by the employee or the authorized supervisor (for the non-profit subrecipients), and that the time sheet is signed by the employee (for state, local and Indian tribal government subrecipients.) Circular A-87 also requires that when an employee is working solely on a single program, the wages are supported by a periodic certification that is prepared at least semi-annually and is signed by the employee or a supervisory official having first hand knowledge of the work performed by the employee.

**Recommendation**

The monitoring instrument should be modified in order to require the program officers to review time sheets to ensure that the time reported is the actual time worked. The program officers should also ensure that the timesheets are for the total activity of each employee, that they are maintained at least monthly, and that they are signed by the correct individuals as required by Circulars A-122 (non-profits) and A-87 (state, local and Indian tribal governments.)

**Status:**

- 06/15/09 - Emergency Shelter Grant Program Monitoring instrument was revised March 9, 2009 to address requirements related to timesheets.
- 12/01/08 - The ESGP Monitoring instrument will be revised to address requirements related to timesheets.
- 06/11/08 - The Emergency Shelter Grants Program (ESGP) monitoring instrument will be revised to expand the questions, and oversight, related to the review of subrecipient timesheets as required by OMB Circulars A-122 and A-87 and as further clarified by the Department's Legal Division.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
54	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 10/1/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 6-C  
The Monitoring Instrument Should Be Revised to Consider All Applicable Requirements

Px	06/11/08	10/1/2008
Px	12/01/08	2/28/2009
Nr	06/12/09	
Ix	06/17/09	

Program officers who conduct on-site monitoring visits use a monitoring instrument to review the subrecipient's compliance with the ESGP contract and with all federal and state laws. However, the monitoring instrument does not contain steps to ensure that the following requirements are reviewed:

- The subrecipient spent all grant amounts within 24 months of the date on which the Department made the grant amounts available,
- Funds are obligated within 30 days and spent within 180 days of the date on which the state made the grant amount available for homeless prevention activities,
- The expenditures are within the contract period,
- No rehabilitation work is performed or funds spent prior to the environmental clearance,
- The subrecipient has supplied copies of certification and inspection by local building officials for rehabilitation projects,
- Subrecipients developed policies and procedures on accepting declarations of income,
- Subrecipients document that clients served by non-homeless prevention activities were homeless prior to residency,
- If the subrecipient received funding for an essential service, they indicated that it was a new or increased level of service provided with local funds during the 12 calendar months immediately before the subrecipient received initial grant amounts,
- The subrecipient is involving homeless individuals and families in providing work or service pertaining to facilities or activities,
- Policies are developed to ensure the confidentiality of records pertaining to any individual provided family violence prevention or treatment services,
- No funds were spent on dwelling units that were not protected by hard-wired or battery operated smoke detectors,
- The subrecipient makes it known that the use of facilities and services are on a nondiscriminatory basis, and
- The subrecipient is providing the services that they state they will provide in their application.

**Recommendation**

Community Services staff should revise the monitoring instrument to include all of the above requirements.

**Status:**

06/17/09 - ESGP Monitoring instrument was revised to address requirements identified in Chapter 6-C of the internal audit report.

06/12/09 -

12/01/08 - The ESGP Monitoring instrument will be revised to address requirements identified in Chapter 6-C of the internal audit report.

06/11/08 - Management will revise the existing Emergency Shelter Grants Program (ESGP) monitoring instrument to include all of the recommendations cited above as interpreted by the Department's Legal Division.

Management will also contact HUD and request monitoring instruments used by other states that HUD considers most effective.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
55	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 9/1/2008

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 6-D  
Subrecipients Should Document the Review of Client Eligibility Prior to Providing Funding for Essential Services

Two of the four categories of ESGP funds, homeless prevention funds and essential services funds are used to assist clients. Most ESGP clients receive homeless prevention services which consist of rent or utilities payments, or other services paid for with ESGP funds to prevent homelessness. Most of the essential services funds are used for subrecipient administration, but some clients receive funds from essential services, which are payments made directly to the client for things like bus tokens, job training or medical and psychological counseling. The subrecipients are not required to retain completed intake forms for clients that receive essential services, and program officers do not review client files to determine if the clients who received these funds were eligible.

Recommendation  
Eligibility should be reviewed, documented and retained for all clients who receive essential services.

**Status:**

06/17/09 - ESGP Monitoring instrument was revised to indicate client eligibility requirements.

06/12/09 -

12/01/08 - The ESGP Monitoring instrument will be revised to affirm the eligibility of clients for essential services.

06/11/08 - Intake forms are currently required for homelessness prevention services provided directly to the clients such as rental subsidies and utility payments. When subrecipients provide essential services that include food, bus tokens and personal hygiene items (such as soap and shampoo), subrecipients maintain a log detailing client names. However, staff will improve on this tool so that it has the ability to affirm eligibility of clients for essential services.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
61	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions	Ix	06/01/09

**Division:** Financial Administration

**Section:** Loan Servicing

**Issue:** Chapter 1-A  
 Condition: The method used to collect and record program income does not distinguish between the source program years.  
 Cause: As payments are deposited to the treasury and posted to the State's Uniform Statewide Accounting System (USAS), the deposit can only be posted to one of three open years - the current appropriation year or on of the two previous appropriation years.  
 Effect: Because of the design of USAS, the Department made a decision to allocate all program income deposits to the oldest open appropriation year. As a result, it is not possible to determine from which program year the loans that generate this program income originated.

**Status:**  
 06/01/09 - A recommendation was not included in the report and at this time audit has determined it would not be cost effective to pursue separation of program year income - HF

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
62	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Division The scope of this audit included the loan document processing and loan servicing functions	Px	05/06/09 7/31/2009
			Ix	06/11/09
			Px	06/12/09 7/30/2009

**Division:** HOME

**Section:** Contract for Deed

**Issue:** Chapter 1-B

Condition: A. In five of twenty-three paid in full (zero balance) homebuyer assistance loans tested (21.7%), the Department did not collect the correct amount from the borrower. For example, we found one loan that was paid off in May 2007. This loan provided for 1/10 of the principal balance to be forgiven in each year of the ten-year term of the loan. The payoff was for the full amount, even though one year of principal should have been forgiven. This resulted in \$1,000 overpayment by the homeowner that has not yet been refunded almost two years later.

B. Contract for deed HUD-I settlement statements are not reviewed in a timely manner. Six of twenty-nine (20.7%) homebuyer assistance files tested did not reflect the accurate principal balance. In six of six files tested (100%), the final closing costs were less than estimated. In four of the six files (66.7%), the reduction to the principal balance of the deferred loan was not posted to the homeowner's account.

Cause: The balances for these loans were not accurately recorded in MITAS, which is the Department's internal accounting system used to track loans. The inaccurate balance information in MITAS resulted in the inaccurate recapture of funds from borrowers who sold their property. The Department is not in compliance with the terms of the note for the down payment assistance program, resulting in an overstatement of the loan balances.

Criteria: The Department of Housing and Urban Development (HUD) requires that program income be used to fulfill draw requests prior to requesting program year funding.

Effect: A. We noted instances where borrowers were due money which had not yet been paid. Payments were not posted on the anniversary date as required by the note. B. Although unused funds are returned to the appropriate HOME program year, the homeowners' loan balances are not reduced by the loan servicing department until instructed by HOME staff, which may take as long as a year.

Recommendation: The Department should:

A. ensure that the information in the MITAS system reflects the actual account balance when processing loan payoffs, ensure that annual payment forgiveness is recorded on the anniversary date of the loan, and refund overpayments promptly

B review the contract for deed HUD-I settlement statements and reduce the loan balance in a timely manner.

**Status:**

- 06/12/09 - Loan Servicing staff will implement procedures to insure that Mitas system reflects the actual account balance when processing loan payoffs, ensure that annual payment forgiveness is recorded on the anniversary date of the loan. And refunds of overpayments are done timely. (David Cervantes - Financial Administration)
- 06/11/09 - In order to ensure review and accurate reconciliation of borrower loan balances in the Department's systems, the HOME Division has amended its Loan Closing Standard Operating Procedure (SOP) to delineate a subprocess for review of the HUD-1 Settlement Statement and updating loan balances, as necessary, in the loan servicing system. In addition to the SOP, the Loan Closing Fule Table of Contents, the Table Funding Checklist for Loan Activities, and Contract for Deed Draw Request Checklist--Form 16.11, indicated different levels of review regarding the Borrower's HUD-1 Settlement Statement. (Jeannie Arellano - HOME)
- 05/06/09 - Management agrees with the recommendations and will in the next 90 days be revising the mechanism for forgiveness in new loans (Lora Myrick) and develop a mechanism for recording forgiveness based on confirmation from the owner of continued homeownership for existing loans (Stephanie D'Couto). Within the next 90 days, management will also ensure that refunds are addressed timely (Stephanie D'Couto) and will put a process in place to review the HUD-I and communicate adjustments timely (Lora Myrick).

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
62	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions	Px	05/06/09 7/31/2009
<b>Division:</b> Financial Administration			Ix	06/11/09
<b>Section:</b> Loan Servicing			Px	06/12/09 7/30/2009

**Issue:**

Chapter 1-B  
Condition: A. In five of twenty-three paid in full (zero balance) homebuyer assistance loans tested (21.7%), the Department did not collect the correct amount from the borrower. For example, we found one loan that was paid off in May 2007. This loan provided for 1/10 of the principal balance to be forgiven in each year of the ten-year term of the loan. The payoff was for the full amount, even though one year of principal should have been forgiven. This resulted in \$1,000 overpayment by the homeowner that has not yet been refunded almost two years later.  
B. Contract for deed HUD-I settlement statements are not reviewed in a timely manner Six of twenty-nine (20.7%) homebuyer assistance files tested did not reflect the accurate principal balance. In six of six files tested (100%), the final closing costs were less than estimated. In four of the six files (66.7%), the reduction to the principal balance of the deferred loan was not posted to the homeowner's account.  
Cause: The balances for these loans were not accurately recorded in MITAS, which is the Department's internal accounting system used to track loans. The inaccurate balance information in MITAS resulted in the inaccurate recapture of funds from borrowers who sold their property. The Department is not in compliance with the terms of the note for the down payment assistance program, resulting in an overstatement of the loan balances.  
Criteria: The Department of Housing and Urban Development (HUD) requires that program income be used to fulfill draw requests prior to requesting program year funding.  
Effect: A. We noted instances where borrowers were due money which had not yet been paid. Payments were not posted on the anniversary date as required by the note. B. Although unused funds are returned to the appropriate HOME program year, the homeowners' loan balances are not reduced by the loan servicing department until instructed by HOME staff, which may take as long as a year.  
Recommendation: The Department should:  
A. ensure that the information in the MITAS system reflects the actual account balance when processing loan payoffs, ensure that annual payment forgiveness is recorded on the anniversary date of the loan, and refund overpayments promptly  
B review the contract for deed HUD-I settlement statements and reduce the loan balance in a timely manner.

**Status:**

- 06/12/09 - Loan Servicing staff will implement procedures to insure that Mitas system reflects the actual account balance when processing loan payoffs, ensure that annual payment forgiveness is recorded on the anniversary date of the loan. And refunds of overpayments are done timely. (David Cervantes - Financial Administration)
- 06/11/09 - In order to ensure review and accurate reconciliation of borrower loan balances in the Department's systems, the HOME Division has amended its Loan Closing Standard Operating Procedure (SOP) to delineate a subprocess for review of the HUD-1 Settlement Statement and updating loan balances, as necessary, in the loan servicing system. In addition to the SOP, the Loan Closing Fule Table of Contents, the Table Funding Checklist for Loan Activities, and Contract for Deed Draw Request Checklist--Form 16.11, indicated different levels of review regarding the Borrower's HUD-1 Settlement Statement. (Jeannie Arellano - HOME)
- 05/06/09 - Management agrees with the recommendations and will in the next 90 days be revising the mechanism for forgiveness in new loans (Lora Myrick) and develop a mechanism for recording forgiveness based on confirmation from the owner of continued homeownership for existing loans (Stephanie D'Couto). Within the next 90 days, management will also ensure that refunds are addressed timely (Stephanie D'Couto) and will put a process in place to review the HUD-I and communicate adjustments timely (Lora Myrick).

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
63	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions	Px	05/06/09 7/31/2009

**Division:** Financial Administration

**Section:** Loan Servicing

**Issue:** Chapter 2

Condition: Once eligibility is determined and construction is complete, no further monitoring of the homeowner or the property is conducted to ensure the property continues to the primary residence of the borrower.

Cause: The Department has not taken reasonable measures to verify that the property continues to be the homeowner's principal residence throughout the period of affordability.

Criteria: HUD home loans require the homeowner to use the property as his/her principal residence for the term of the period of affordability.

Effect: The Department risks being cited by HUD for non-compliance.

Recommendation: The Department should develop a method to help ensure that the principal residence requirement is met for those properties that require it and for which the Department is the first lien holder. Some options for this include:

- consistently collecting property tax and insurance receipts,
- verifying the homeowner's homestead exemption via the property tax receipt or the tax rolls,
- verifying mail service or utility bills,
- community outreach or periodic inspections, or
- asking the homeowner to sign and submit an annual document certifying that the property is their principal residence.

**Status:**

05/06/09 - Management agrees with the recommendations and will in the next 90 days be revising the mechanism for forgiveness in new loans (Lora Myrick) and develop a mechanism for recording forgiveness based on confirmation from the owner of continued homeownership for existing loans (Stephanie D'Couto).



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
64	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions		

**Division:** Financial Administration

**Section:** Loan Servicing

Px 05/09/09 7/31/2009  
Ix 06/12/09

**Issue:** Chapter 3-A  
Condition: A random sample of 61 deposits over a three-year period was tested for compliance with the three-day deposit requirement. The 61 deposits tested included 71 days of HOME loan activity (loan payments and payoffs). Nineteen of these 71 days' deposits (26.8%) were deposited to the treasury after the third business day. These 19 days totaled \$270,180 (30%) of the \$902,613 of funds in the sample. The 19 late deposits range from four to nine days from the date of receipt, with an average of 4.8 days.  
Cause: HOME loan payments are not always deposited within three business days of receipt as required by the government code.

Criteria: Texas Government Code 404.094 "FIJNDS TO BE DEPOSITED IN TREASURY. (a) Fees, fines, penalties, taxes, charges, gifts, grants, donations, and other funds collected or received by a state agency under law shall be deposited in the treasury... A deposit shall be made at the earliest possible time that the treasury can accept those funds, but not later than the third business day after the date of receipt..."

Effect: If deposit of program funds is not done on a timely basis, program income will not be available for immediate distribution and that the State does not lose interest payments on these funds.

Recommendation: The Department should ensure that loan payments are posted and deposited not later than the third business day after receipt.

**Status:**

- 06/12/09 - Management has implemented periodic reviews to Insure that loan payments are posted and deposited no later than the third business day alter receipt.
- 05/09/09 - Within the next 90 days, management will enhance the process to ensure loan payments are posted and deposited no later than the third business day after receipt (Stephanie D'Couto).

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
65	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions	Px	05/06/09
			Ix	06/11/09

**Division:** HOME

**Section:** HOME Production

**Issue:** Chapter 3-B  
Condition: A certificate of completion or other evidence that verified the completion of construction was not included in eight of the 15 files (53.3%) reviewed.  
Cause: Construction loans are forgiven based on a pre-determined date, rather than evidence that the construction is complete.  
Criteria: To ensure loan provisions are satisfied, completion of construction should be documented prior to loan forgiveness.  
Effect: Without some proof of the completion of construction, the Department could forgive a loan on a property before it is finished.  
Recommendation: The Department should:  
• ensure that the term of the unsecured equity loan is sufficient to guarantee completion of construction prior to the loan maturity date, and  
• obtain and include in the loan servicing file the documentation verifying the completion of construction.

**Status:**

- 06/11/09 - To ensure loan provisions are satisfied and completion of construction is documented prior to loan forgiveness, the Division has a series of documents required for each loan file. The Department requires Contract Administrators undertaking construction activities execute a Construction Loan Agreement (CLA), which indicates a construction completion date and requires the Owner to acknowledge that before a final disbursement is made under the agreement, the Owner must provide a signed Affidavit of Completion, Form 11.27 the Department. In addition to the CLA, Division staff verifies construction completion of the housing unit by requiring Department Form 11.03-Final Inspection, which inspects housing conditions for compliance with applicable construction standards, specifications, and codes. This information is reviewed and provided as support documentation prior to the Final Draw Request Checklist--Form 16.26 and release of funds from the Department. Finally, in order to evidence both the construction completion date and loan maturity date, the Department executes a Deed of Trust and Promissory Note with households receiving construction assistance.
- 05/06/09 - Management agrees with the recommendations and will, in the next 90 days be revising the mechanism for forgiveness including documented assurances that the construction has been completed (Lora Myrick)

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
66	5/6/2009 Internal Audit	Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Divi The scope of this audit included the loan document processing and loan servicing functions	Tx	05/06/09 6/15/2009
			Ix	06/03/09

**Division:** HOME

**Section:** HOME Production

**Issue:** Chapter 3-C

Condition: Eight of eight (100%) of the standard operating procedures for the HOME division related to program income have not been finalized and approved. These policies and procedures are still in draft form.

Cause: Operating policies and procedures were not formalized and approved.

Criteria: The Department's policy (1100.01) requires the development and approval of division level (level II) standard operating procedures.

This policy states that "Procedures should be developed for all tasks that require or could benefit from standardization or the imposition of procedures as a control." As rules change and new programs are developed, the existing policies and procedures should be updated to provide guidance to HOME personnel.

Effect: Without formal policies and procedures, functions may not be performed in an effective or efficient manner.

Recommendation: The HOME division should review and update procedures as necessary, and ensure that all procedures are approved and signed by the division director.

**Status:**

06/03/09 - The HOME & HTF Programs Division has finalized all of the Division's Standard Operating Procedures (SOPs), which include those procedures related to program income. These SOPs are available electronically to all staff and lead staff have been identified to maintain and update SOPs, as necessary.

05/06/09 - Management agrees and all eight have now been signed or will be signed by June 15, 2009 (Lora Myrick)

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69	12/20/2006 Internal Audit	Energy Assistance Weatherization Assistance Program Subrecipient Monitoring Consideration of EA Weatherization Assistance program's subrecipient monitoring functions	Px	12/20/06 5/30/2007

**Division:** Community Affairs

**Section:** Energy Assistance

**Issue:** Section 6  
Assess and Satisfy Information Needs

Px	12/20/06	5/30/2007
Px	03/02/07	5/30/2007
Px	04/23/07	5/30/2007
Px	06/26/07	7/30/2007
Dx	08/02/07	11/1/2007
Dx	04/22/08	
Dx	12/01/08	
Dx	06/12/09	

The management information system is adequate to track most of the significant milestones such as the planned monitoring visit date, actual monitoring visit date, monitoring report date, monitoring report response due date and actual receipt date, follow-up letter date, and close-out date (close-out letter). However, data fields have not been created to capture significant milestones relating to the delivery of the monitoring letter to the subrecipient's governing board chair and the subrecipient's response to the monitoring follow-up letter.

A text/memo field called Notes in the Monitoring Tracking System is used to capture the results of monitoring activities such as findings or conditions noted, required corrective actions, concerns and comments; however, the information recorded in the Notes field is unclear, not consistently posted, and, in instances, incomplete.

Findings were not posted to the monitoring tracking system for six of the eight monitoring files tested, monitoring results are not tracked to conclusion (actions taken and final resolution), and multiple areas of concern were noted throughout the monitoring checklists and files that were not posted to the monitoring tracking system.

Adequate information is necessary to ensure timely, efficient delivery of services. Tracking results of subrecipient monitoring activities is important to ensure findings noted are satisfactory resolved. The results of monitoring activities also provides meaningful information management can use to identify and prioritize risks for resources allocation purposes and to identify, plan and provide technical assistance. Significant milestone dates are important to help ensure satisfactory progress is being made toward achieving the goals and objectives of the subrecipient monitoring function.

The Department of Energy (DOE) requires that major findings from subgrantee monitoring visits and financial audits be tracked by the State to final resolution and recommends that the tracking record include, but not necessarily be limited to, findings, recommended corrective actions, deliverables, due dates, responsible parties, actions taken, and final resolution. DOE also requires the State annually summarize and review each subgrantee's audit, program monitoring reports and findings for internal monitoring of State and subgrantee needs, strengths, and weaknesses and that the results of this annual monitoring be considered during annual planning and be available for the DOE Regional Offices to review during their State program monitoring visits.

#### Recommendation

Management should assess its information needs to ensure they are being adequately satisfied. In assessing its information needs, management should minimally:

- determine what information is needed to function and operate on a daily basis,
- evaluate major problems regularly encountered and assess how information can help solve the problems,
- categorize the major decisions program management must make and determine how additional information could help,
- identify various reporting requirements and related information needs,
- evaluate how information can improve the effectiveness of services provided,
- determine what kinds of information could enhance the program's efficiency, and
- assess information needs of others such as executive management and oversight and funding agencies.

Strategies, including computer and non-computer solutions, should be developed for capturing necessary data to operate effectively. Minimally, we recommend the information system be enhanced to capture the results of monitoring activities and track the status of monitoring findings to final resolution.

Regardless of strategies selected, we recommend the processes be formalized with the goal of:

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- recording complete, accurate and timely information, which will require the incorporation of quality control procedures and edits,
- facilitating the monitors performing their day-to-day operating activities and responsibilities,
- facilitating management's review and consideration of current performance against operating goals and objectives, and
- satisfying the reporting requirements of oversight and funding agencies.

**Status:**

- 06/12/09 - The Division of Information Systems is currently working on projects assessed as higher priorities to the Department. The IS Division has set the incorporation of the American Recovery and Reconstruction Act contracts and reporting mechanism into the current Community Affairs Contract System as a high priority.
- 12/01/08 - The Energy Assistance Section and the Information Systems staff have implemented a Monitoring Tracking System on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA staff will analyze this system for possible improvements.
- 04/22/08 - The Energy Assistance Section and the Information Systems Division staff have implemented a tracking system on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA and ISD staff will analyze this system for possible improvements.

Information Systems Division resources are currently allocated to projects assessed as higher priorities to the Department. Because of the focus on the Community Affairs Contract System project, deployment of the CDBG components of the Housing Contract System, and other high priority projects, an upgrade of the EA Monitoring Tracking System has not been presented to the Information System Steering Committee to be established as a new project. EA and ISD will submit an IS Project Request to the Steering in Committee for approval at its next meeting. The IS Project Request form will include estimates in technical and business team hours for development, testing, and deployment

- 08/02/07 - The Energy Assistance Section and the Information Systems staff have a tracking system on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA staff will analyze this system for possible improvements that includes reports and increased narrative field size.
- 06/26/07 - The Energy Assistance Section and the Information Systems staff have implemented a tracking system on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA staff will analyze this system for possible improvements.
- 04/23/07 - 04/23/07 - The Energy Assistance Section and the Information Systems staff have implemented a tracking system on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA staff will analyze this system for possible improvements.
- 03/02/07 - The Energy Assistance Section and the Information Systems staff have implemented a tracking system on the TDHCA intranet. As currently designed, the system captures the pertinent dates, milestone dates, funding amounts, and provides a notes field for narrative text. EA staff will analyze this system for possible improvements.
- 12/20/06 - During the planning of the Contract System being developed by the IS Division, the EA Section identified the daily operational needs of the Section. The Contract System, once complete, will help the Section gather information needed to comprehensively monitor the subrecipients and make effective management decisions. However, Management acknowledges that the Contract System will only provide information for review. The EA Section must provide timely updates, conduct quality control checks, and supplement additional information needs by updating the Intranet monitoring tracking system. The updated monitoring tracking system will assist management by providing information, documenting results, and summarizing desk and field monitoring reviews.

The EA Section will coordinate with IS to update the Intranet monitoring tracking system to incorporate text fields to capture findings and the events that occur up to, and including resolution of, the findings. The updated system will be made available to all EA Program Officers, Project Managers, Section Manager, and to the Division Director. Upon coordination with IS staff, the updated system will be implemented after completion of the 2006 monitoring visits. In the interim, EA is using an Excel monitoring tracking system to track this information.

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71	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08

**Division:** Community Affairs

**Section:** Community Services - CSBG

Px	06/11/08	
Px	12/01/08	2/28/2009
Ix	06/15/09	

**Issue:** Chapter 6-E  
Standard Forms and Processes Should be Developed to Document the Sample of Expenditures and Client Files Reviewed During Monitoring

There are no written procedures for documenting the shelters visited and expenditures reviewed by the program officers during on-site monitoring visits. In addition, the contract specialist performs reviews of monthly expenditures, but does not document the results of these reviews. Finally, there is no written procedure regarding how many client files should be reviewed during an on-site monitoring visit. For example, one program officer may review 12 client files while at another subrecipient, they may only review three client files.

**Recommendation**

Community Services should:

- Develop written procedures and standard forms to document the shelters and expenditures reviewed during monitoring visits,
- Maintain documentation to support the review of monthly performance and expenditure data, and
- Develop written procedures regarding the minimum number of client files that should be reviewed in order to ensure consistency between subrecipient monitoring visits.

**Status:**

- 06/15/09 - ESGP Monitoring Instrument was revised to address identified areas. Additional questions and forms were added to document the review of performance and expenditure data. A minimum of 5% of the client files will be reviewed.
- 12/01/08 - The ESGP Monitoring Instrument and Monitoring SOP will be revised to address identified areas.
- 06/11/08 - Management will expand the Emergency Shelter Grants Program (ESGP) monitoring instrument to document the name and number of shelters visited and to integrate a standard form, including maintaining documentation, for use in reviewing expenditures.

The CS Section will strengthen procedures to document a process for ensuring review of monthly performance and expenditure data.

ESGP Program Officers currently review all client files for the sample months selected.

The Monitoring SOP will be expanded to include a minimum percentage of client files that will be reviewed in order to ensure consistency between subrecipient monitoring visits.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
72	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08

**Division:** Community Affairs

**Section:** Community Services - CSBG

Px	06/11/08	
Px	12/01/08	5/31/2008
Ix	06/15/09	

**Issue:** Chapter 8  
There are Advantages and Disadvantages in Changing the Organizational Structure to Separate the Monitoring and Program Support Functions

The program officers who monitor the subrecipients in both CSBG program and ESGP also provide technical assistance to the subrecipients. Technical assistance is provided when the program officer offers advice or suggestions to help improve the subrecipient's operations. Frequently this technical assistance takes place during on-site monitoring visits. Program officers are assigned a group of subrecipients to monitor and these assignments are rotated every three years. The program officers report to a manager who is directly accountable to the director of the Community Affairs Division. The director of Community Affairs is responsible for not only the monitoring of these programs, but for the performance of the programs, too. This model has several advantages and disadvantages.

The advantages are:

- An ongoing working relationship is developed between the subrecipient and the program officer that allows the program officer to become familiar with the operations and the needs of the subrecipients assigned to them,
- Program officers can identify the subrecipients' training needs and work with the trainer assigned to their program to ensure that the subrecipients get the training they need,
- Program officers can develop subject matter expertise in the CSBG program or ESGP, and
- The director of the Community Affairs Division is responsible for all aspects of the programs in the division and can more easily be held accountable for them.

The disadvantages are:

- There is a risk that managers or program officers could be inclined to identify issues as technical assistance or training needs rather than monitoring findings
- Program officers may develop relationships with subrecipients that could contribute to the risk of favoritism, and increase the potential for fraud, waste or abuse,
- The line between training needs and compliance with the laws and rules governing the administration of the grant funds is not clear,
- In the case of CSBG, technical assistance is not currently an allowable cost for the administration funds that pay the program officers' salaries (see Chapter 1-A),
- The director of the Community Affairs Division may not be willing to bring issues with subrecipients forward to executive management or the Department's governing board because they are responsible for the success of the grant programs, and
- The program officers may not have easy access to information gathered by other divisions within the Department, for example, the Portfolio Management and Compliance (PMC) Division (see Chapter 3-B.)

The Department's PMC Division is responsible for monitoring most of the Department's other programs. Combining the Community Affairs Division's program officers' monitoring function with the PMC Division's would have the following advantages:

- Separating the goals of program support and technical assistance from monitoring,
- Decrease the opportunity for collusion, or other types of fraud, waste and abuse, and
- Decrease the number of monitoring visits by coordinating monitoring visits for multiple programs with each subrecipient.

**Recommendation**

The Department should evaluate the functions and activities of the program officers and other staff of the Community Affairs Division and decide whether to move the monitoring function to another division, or to put into place safeguards to ensure the consistency of monitoring and decrease the potential for collusion or other types of fraud, waste and abuse.

<i><u>Issue #</u></i>	<i><u>Report Date</u></i> <i><u>Auditors</u></i>	<i><u>Report Name</u></i> <i><u>Audit Scope</u></i>
<b><u>Status:</u></b>		
06/15/09 -		Safeguards have been implemented through the revision of TAC rules, the development of a monitoring guide, revisions to the monitoring instruments, and changes to the monitoring processes to ensure the consistency of monitoring and to decrease the potential for collusion, fraud, waste or abuse.
12/01/08 -		Safeguards have been implemented through the revision of the TAC rules. the development of a draft monitoring guide, revisions to the monitoring instruments, and changes to the monitoring processes to ensure the consistency of monitoring and to decrease the potential for collusion, fraud, waste or abuse. The CA Division Director will continue to work with the Executive Team to evaluate the effectiveness of the monitoring function in the Community Affairs Division.
06/11/08 -		Management will evaluate the functions and activities of the program officers and other staff of the Community Affairs Division and decide whether to move the monitoring function to another division, or to put into place additional safeguards to ensure the consistency of monitoring and decrease the potential for collusion or other types of fraud, waste and abuse.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
73	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding 1  
Contracts with Houston and Harris County do not meet Minimum Requirements for Subrecipient Agreements

Condition: Although, TDHCA has agreements in place for housing activities under Supplemental Round 1 that outline scope of work and federal requirements applicable to funded activities, it has not executed comparable agreements for Houston and Harris County under Supplemental Round 2. Instead, contracts for Houston/Harris County include indemnification agreements and do not include any detail on activities funded, scope of work, reporting requirements, or identify applicable federal compliance requirements.

Criteria: Agreements with subrecipients receiving CDBG funds must meet minimum standards outlined in 24 CFR 570.503. This provision of the Entitlement CDBG regulations is made applicable to these supplemental funds by the Federal Register notice of allocations, waivers and alternatives requirements dated February 13,2006 (71 PR 7666). These requirements include at a minimum, the written agreement with the subrecipient shall include provisions concerning the following items:

- (1) Statement of work
- (2) Records and reports
- (3) Program income
- (4) Uniform administrative requirements
- (5) Other program requirements
- (6) Suspension and termination
- (7) Reversion of assets

Corrective Actions:

Within 30 days, amend or supplement existing agreements with Houston and Harris County to cover the minimum requirements outlined in 24 CFR 570.503.

**Status:**

08/29/08 - TDHCA is in the process of replacing the existing agreements with Houston and Harris County with contracts that meet the minimum requirements outlined in 24 CFR 570.503. TDHCA will submit copies of the replacement contracts to HUD once they are fully executed.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
74	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Two: Fiscal controls and accounting procedures for Houston and Harris County Inadequate to Demonstrate Program Compliance

Condition: Although TDHCA has comprehensive monitoring and oversight processes and procedures for housing activities under Supplemental Round 1 to ensure eligibility, allowability and reasonableness of costs, it has not applied comparable controls to funds provided to Houston and Harris County under Supplemental Round 2. Relying on the indemnification clauses in funding agreements with the City of Houston, TDHCA approved drawdowns for Houston and submitted them to HUD for approval without any support material related to the expenses and without any plans to monitor Houston or Harris County activities.

Criteria: Fiscal controls and accounting procedures must ensure funds for these activities are used in compliance with all applicable statutory and regulatory provisions as required by 24 CFR 570.489(d). These include controls that ensure that records "(i) Be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) Ensure that funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) Ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments."

Corrective Actions:

Within 30 days, TDHCA must develop and apply procedures for processing payment requests and/or monitoring systems to ensure activities funded under Supplement Round 2 are in compliance with applicable federal requirements.

Technical Assistance was provided on what was required from the state in order to be compliant with 24 CFR 570.489(d).

**Status:**

08/29/08 - TDHCA has developed and applied procedures for processing payment requests. To date, a significant amount of reimbursement requests have been submitted by the City of Houston and Harris County. The Department has reviewed these reimbursement requests to ensure only necessary and reasonable program costs are submitted to HUD for reimbursement. In addition, TDHCA has implemented and conducted on-site monitoring reviews of the City of Houston and Harris County. No significant issues were identified during these monitoring reviews. Monitoring visit objectives included:

- Determining compliance with 24 CFR 570
- Obtaining an understating and documenting program and fiscal controls
- Testing program and fiscal controls
- Testing support documents for expenditures submitted for reimbursement

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
75	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Three: TDHCA is drawing funds in advance of need.

Condition: As stated above, it has been established that without a specific agreement with Treasury to draw funds in advance, the agency is subject to the requirements found in subpart B of 31 CFR 205, which limits advances of federal funds to the minimum amounts needed for actual, immediate cash requirements. As shown in the table below, the review of the agency's administrative cash balances for the period September 1, 2007 through March 31, 2008, noted that the agency was in a positive cash position beyond the three-day standard for four of the seven months. The positive cash position appeared to be a result of drawing funds in advance of need and drawing salaries based on estimates instead of actual time worked.

In discussions with the agency concerning how it requested funds from Treasury, it was explained that the agency would draw one-twelfth of the grant award at the beginning of each month for administrative expenses. No other explanation for drawing in advance of need was provided. HUD's review did not substantiate the statement, as the timing of the draws and the amount drawn fluctuated every month and there did not appear to be any pattern to the draws.

Without further explanation, there does not appear to be justification for TDHCA to be drawing funds in advance of need, especially since the agency may request funds from HUD's line of credit system daily and will generally receive the funds within 48 hours.

With regards to the salaries, it was explained that the agency drew the salaries based on budgeted time and then reconciled the budgeted time to the actual time worked and adjusted the cash balance for any overages noted. It was further explained that the reconciliations were not timely as the employees were often late in submitting the actual time distribution reports. The process used to draw the salaries is permissible since TDHCA is reconciling the budgeted amounts to actual, as required in OMB Circular A-87 and the reconciliations are completed within the timeframe specified in the circular.

Criteria: The CDBG regulations found at 24 CFR 570.489© required the state to be in compliance with the Treasury requirements.

Corrective Action:

TDHCA has agreed to revise its cash management procedures to be in compliance with HUD's three-day standard and is in the process of implementing new procedures. Continued discussions with TDHCA have noted that the agency is going to revise its process for drawing salaries, and that the salary requests will be based on actual time worked instead of budgeted time. Changing the way the salaries are being drawn will assist the agency in obtaining optimal cash management status.

Within 30 days from the date of this letter, the agency is to provide HUD with its revised cash management procedures and a sample of the format it is will use to draw the funds.

**Status:**

08/29/08 - TDHCA agrees to revise its Cash Management/Draw Procedures in accordance with the requirements found in Subpart B of 31 CFR 205 and 24 CFR 570.489(c)(d). TDHCA is attaching its procedures and a sample of the draw funds format (Attachment A).

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
76	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Four: TDHCA was unable to reconcile its expenses to the draw requests.

Condition: HUD's review noted that the agency could not tie the administrative draws to specific administrative expenses. The process currently being used is a process that nets the expenditures to the revenues and then draws the difference. As the agency could not tie its draws to its administrative expenses, HUD has no way of knowing whether the expenses were incurred for actual program needs or whether the supporting documentation presented ties to a specific draw. To assist HUD in obtaining a level of comfort with its procedures, the agency identified all program expenses for the months of September and December 2007, and March 2008. HUD's review of the categories of expenses for the sample months noted that the expenses appeared to be eligible charges under the grant. However, due to time constraints specific invoices were not reviewed for program compliance.

Criteria: The CDBG regulations found at 24 CFR 570.489(d) set forth the fiscal control and accounting standards for the state.

Corrective Action:

As stated above, TDHCA is in the process of implementing new procedures that will bring its cash management system in line with HUD's requirements. The agency has assured HUD that the new procedures will incorporate weekly to bi-weekly draws and the draws will reconcile to actual expenditures in the general ledger.

Within 30 days from the date of this letter, the agency is to provide HUD with a copy of its new draw procedures.

In addition to reviewing TDHCA's administrative draw procedures, we reviewed ORCA's draw procedures as well. The following information was obtained directly from ORCA.

For DRS-I draws:

- Direct non-payroll costs are drawn 2 weeks after the expenses have been paid.
- Direct payroll costs are drawn the day the State Comptroller' Office requires cash to be in their accounts for payroll. It takes two business days for ORCA to receive these funds. These are paid the 1st of the month.
- Indirect costs are drawn on a monthly basis 2 weeks after the month ends (April's indirect is drawn May 15th ).

For DRS-II draws:

- Direct non-payroll costs are drawn every 2-3 months after the expenses have been paid.
- Direct payroll costs are drawn every 2-3 months after the expenses have been paid.
- Indirect costs are included in the direct draw requests that are 2-3 months after the fact.

When questioned about the differences between the draw processes for the two grants, it was explained that very little monies had been expended from the Disaster II B-06-DG-48-0002 grants and that once the expenditures pick up, the procedures would be in line with the procedures noted for the Disaster I B-06-DG-48-0001 grant. Additionally, HUD's review of the categories of administration expenses noted that the expenses appeared to be eligible to be charged to the grant. However, due to time constraints specific invoices were not reviewed for program compliance. Overall, based on the review, ORCA was in compliance with the cash management requirements.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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**Status:**

08/29/08 - TDHCA agrees to revise its Cash Management/Draw Procedures in accordance with the requirements found in Subpart B of 31 CFR 205 and 24 CFR 570.489(c)(d). TDHCA is attaching its procedures and a sample of the draw funds format (Attachment A).

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**Status**      **Target Date**

Px 08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Six: Inadequate Project Descriptions

CRITERIA: An ERR is required for each project subject to 24 CFR 58.38. The ERR is required to include a complete description of the project and all the activities that the recipient has determined to be part of the project.

CONDITION: The review of TDHCA's environmental files found that the tiered disaster programs lacked an adequate project description for the site-specific actions. Although the broad plans (level one tier) provided a general project description, such as "rehabilitation of buildings", the actual description to be accomplished at each address, such as "roof replacement" was omitted on all site specific reviews. For the tiered programs the site-specific project description was not detailed and does not meet the requirements of 24 CFR 58.38(a) (1). A detailed project description is critical because it is necessary for projects to be properly classified and experience the proper level of environmental review.

**CORRECTIVE ACTION:**

Currently, HUD has reviewed the TDHCA Operating Procedures which require complete descriptions for all proposed projects. However, the TDHCA tiering procedures do not require a site-specific activity description. The State procedure for tiering must be amended to include a requirement for the site-specific activity description and review. Please work with HUD to submit your amended, written tiering procedure that will ensure compliance with the requirements of 24 CFR 58.38(a) (1) as soon as possible. The State must then implement the tiering procedure approved by this office.

**Status:**

08/29/08 - TDHCA has worked with HUD to replace the previous tiering procedures with new tiering procedures suggested by HUD which requires more detail on the site-specific activity description. TDHCA began training program recipients on this addition during owner occupied training for disaster assistance in July 2008. Particular emphasis was given to the new sample for tiering as well as the need for a more substantial and detailed site-specific activity description.

In addition, TDHCA worked diligently with SETRPC on the site-specific activity description. SETRPC now provides a more detailed project description that includes, among other things, the square footage of the home, the number of bedrooms, and the number of baths. TDHCA has instructed and is working with the Houston-Galveston Area Council and the Deep East Texas Council of Governments, the other two COGs administering funding, to use the enhanced checklist as a guide to update their own site-specific activity description

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78	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Seven: Support Documentation

CRITERIA: Based on the lack of documentation in the files reviewed, the State has failed to fully comply with the requirements of 24 CFR 58.5 (Related Federal Laws and Authorities).

CONDITION: The inadequate documentation includes:

a. Floodplain Management. All projects that receive federal funds that do not meet the requirements of being exempt under 24 CFR 58.34 or categorically excluded under 24 CFR 58.35(b) must have documentation of compliance with 24 CFR 58.5(b) and the requirements of Executive Order 11988, Floodplain Management. These requirements obligate grantees to determine if projects are located in or impact floodplains. If the project is located in or impacts a floodplain, the prescribed 8-step process must be completed and documentation of the 8-step process compliance is required to be included in the ERR as noted at 24 CFR 55.20.

Both the City of Port Arthur and SETRPC have completed the 8-step process for the demolition of dangerous structures at seven locations and the repair and reconstruction of homes. Both of the early notices (step 2) were published July 15, 2007 and both omitted the total number of acres of floodplain involved, as required by regulation. The identification and evaluation of practicable alternatives (step 3) was incomplete and did not discuss locations outside the floodplain or alternative methods to serve the project objective. Since step 3 was incomplete, the succeeding steps were also unacceptable. (i.e. Step 7 includes a list of the alternatives considered)

Rehabilitation activities completed in the City of Beaumont by SETRPC identified properties that were located in the 100 year floodplain, however it was not documented whether the 8-step process review was necessary or performed.

b. HUD environmental standards. 24 CFR 58.5(i) requires that noise-sensitive projects which are located in high noise areas must conduct a noise analysis and must provide noise attenuation measures, as appropriate under 24 CFR 51, subpart B. The environmental review of Brittany Place, a proposed new multifamily facility, did not include a noise assessment of appropriate rail and highway noise generators, although a railroad is within 3,000 feet and the South Twin City Highway (347) is within 1,000 feet.

The environmental assessment Gulf Breeze II overlooked the presence of aboveground storage tanks, although the pictures of the project site clearly show the tanks. The tanks are located approximately one thousand feet west of the proposed facility. The regulation at 24 CFR 51 subpart C which establishes the safety standards for HUD-assisted projects from specific, stationary, hazardous, above ground operations which store, handle, or process hazardous substances was overlooked. The calculation of an Acceptable Separation Distance (ASD) for potentially hazardous sites is required, barring documentation that the tanks are not (and will never be) operative.

CORRECTIVE ACTION: As part of HUD's environmental review procedures, the TDHCA must certify that it has complied with the requirements of the laws and authorities of 24 CFR 58.5, as applicable, and must consider the criteria, standards, policies and regulations associated with these laws and authorities. TDHCA currently has HUD-reviewed operating procedures that correctly describe the review and documentation process. Those procedures were not followed.

This error appears to be a result of a rush by the agency to serve the public's housing needs after the disaster and excessive workload in a brief time period. Staff clearly understands the regulations and applications. However they are unable to immediately and thoroughly review the volume of necessary environmental documentation within management imposed time frames. This finding can be cleared by the same actions to address Concern #1, which is presented later in this letter.

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**Status:**

08/29/08 - TDHCA certifies that it has complied with the requirements of the laws and authorities of 24 CFR 58.5, as applicable, and considers the criteria, standards, policies and regulations associated with these laws and authorities to the best of its abilities.

TDHCA hired a temporary employee on July 1, 2008 to provide support to staff. The employee is currently being trained on the environmental review process, specifically on providing site-specific environmental clearance. The employee has a background in housing and has past experience with FEMA that has resulted in adeptness at mapping, in particular floodplain and firmette mapping. The employee has proven to be an asset and TDHCA is considering a transition into a permanent position to provide clearances for Supplemental Round 2 housing activities.

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Status      Target Date

Px 08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Eight: Environmental Assessment

CRITERIA: The State, as Responsible Entity (RE), is obligated to prepare an Environmental Assessment (EA) in accordance with 24 CFR 58.4, 58.10, and 58.36 for projects which are neither exempt nor categorically excluded.

CONDITION: In the EAs reviewed for Brittany Place Homes II, the project at Ray Avenue & Hwy 73 and Gulf Breeze I and II, the State did not provide adequate compliance with both NEPA and HUD regulatory requirements to evaluate alternatives to the project, and to recommend modifications to minimize adverse effects of a project. These EAs failed to document the identification, consideration, or evaluation of alternatives or modifications to the projects. In addition to the required "No Action" alternative, EAs must consider other alternatives including scope, location, design and materials.

CORRECTIVE ACTION: TDHCA currently has operating procedures that correctly describe the EA process, including the assessment of alternatives. This error appears to be a result of new personnel, a rush to serve the public in need of housing after the disaster and an excessive workload. In part due to training for the new personnel, staff clearly understands the regulations and applications, but is unable to immediately and thoroughly review the volume of necessary environmental documentation. To clear this Finding, submit all environmental assessments that support future RROFs for multifamily projects. HUD will notify TDHCA when this procedure is no longer needed based on a pattern of acceptable submissions.

**Status:**

08/29/08 - TDHCA prepared and submitted (as subscribed above) by UPS Overnight two multifamily environmental assessments to the Fort Worth HUD office for review on August 19, 2008. The EAs were for Pointe North contract no. 7060006 and Orange/Navy contract no. 7060007. TDHCA has been working with HUD on both projects to address any noted deficiencies.

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80	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Px	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Nine: Dissemination of Public Notice Not Properly Documented

CONDITION: The State's distribution of copies of its public notices to interested parties is required, but was not observed on any of the projects reviewed.

CRITERIA: The Notice of Intent to Request Release of Funds (RROF) and the Notice of Finding of No Significant Impacts, per 24 CFR 58.43 and 24 CFR 58.70 (on a combined Notice), must be distributed to the local news media; individuals and groups known to be interested in its activities; appropriate local, state, and Federal agencies; the Headquarters and the appropriate Regional Office of the Environmental Protection Agency; and to the HUD Area Office. These Notice distribution requirements are in addition to publishing the Notice in a newspaper of general circulation.

CORRECTIVE ACTION: TDHCA currently has operating procedures that correctly describe the dissemination of the public notice process. Future RROFs must attach the dissemination list used so that HUD may verify that the proper public notice dissemination occurred.

**Status:**

08/29/08 - TDHCA requested proof of notification related to the two projects listed in the response to Finding 8 and forwarded these items to HUD Fort Worth with the EA documents on August 19, 2008 for review (Attachment D).

Additionally, TDHCA will require subrecipients provide the dissemination list with all future RROFs to demonstrate compliance and has incorporated this addition as part of the environmental training process.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
81	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 3/31/2009

**Division:** Bond Finance

**Section:**

**Issue:** Chapter 1-A  
The Department Could Improve Its Monitoring of Program Cash Flows and Its Program Master Servicer and Trustee

The Department effectively monitors its cash flows to ensure that actual revenues from mortgage payments are sufficient to meet debt service payments on a timely basis. However, the Department could improve its monitoring of cash flows by:

- More closely monitoring mortgage-backed securities to ensure that the purchase price is based on the total principal of the underlying mortgages contained in the securities.
- Reconciling mortgage payment data received from the Program master servicer and trustee to ensure the Program trustee is accurately accounting for Program funds.

The Department could also improve its monitoring of the Program master servicer by assessing risk and developing a monitoring plan to ensure the master servicer complies with Program requirements.

The Department should document its current procedures for issuing Program bonds. The Department has not documented its procedures for issuing bonds under the Program. Detailed, written policies and procedures are a key management control that helps the Department ensure that desired results are achieved and that current procedures are continued in the event of staff turnover.

**Recommendations**

The Department should improve its monitoring of cash flows by:

- Expanding its mortgage-backed security purchase reconciliation process to include verification of pool purchases by individual mortgage principal amounts.
- Reconciling mortgage payment data and bond redemption schedules received from Countrywide and The Bank of New York Mellon Corporation to ensure that Program bonds are redeemed timely.
- Developing a risk-based compliance monitoring process of its master servicer to ensure all Program requirements are met.
- Document its current policies, procedures, and control processes for issuing Program bonds.

**Status:**

01/21/09 - Bond Finance has developed and implemented Standard Operating Procedures for issuing single family bonds.

11/07/08 - TDHCA plans to conduct a compliance-related audit of loans funded in FY2008 before March 31, 2009. 1,990 Program loans were closed and funded in FY2008 and TDHCA plans to audit a sample of these loans. These sample loans will also be audited to ensure that they, coupled with other related loans, accurately match the purchase price of the underlying mortgage-backed security.

08/18/08 - The Department agrees to implement these recommendations as follows:

The Department intends to reconcile the individual loan pools purchased to the principal amounts of the underlying mortgages to ensure pool purchase prices are accurate. To accomplish this, the Department anticipates contracting with an independent third party provider to perform program monitoring responsibilities.

Person Responsible: Director of Texas Homeownership Division

In April 2008, a process was implemented to compare pool level repayment data provided by Countrywide to the financial data reported by Bank of New York on a monthly basis. To date, no discrepancies have been found. Additionally, effective June 2008, the semi annual Bank of New York supplemental payment schedules were reconciled to actual cash receipts for the previous six month period. The Department will continue these reconciliations semiannually.

Person(s) Responsible: Financial Services Team Leader; Bond Financial Analyst

In order to supplement and enhance the current agreement with Countrywide to perform a tax compliance review on each loan, the Department proposes to develop a risk-based compliance monitoring process of its Master Servicer in conjunction with an independent third party provider.

Person Responsible: Director of Texas Homeownership Division

The Department intends to consolidate documentation on its current policies, procedures, and control processes by preparing a Standard Operating Procedure for issuing bonds. The Department currently maintains detailed bond transcripts, flow charts, calendars, board resolutions, applications and documents indicating compliance with all applicable laws and regulations.

Person Responsible: Bond Financial Analyst

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<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
82	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 9/30/2009

**Division:** Bond Finance

**Section:**

**Issue:** Chapter 1-B  
The Department Should Strengthen Its Policies and Procedures to Minimize Risks Associated with Interest Rate Swaps

Px 08/18/08 9/30/2009  
Px 11/07/08  
Ix 01/21/09

The Department should improve its documented swap polices. The Department's documented policies for swaps address many significant issues related to the risks of swaps. However, the Department could improve its current policies by addressing other swap issues, including:

- Forward-starting swaps—These are swaps with effective dates that are delayed until a specified time after the issuance date of the bonds. Using these swaps creates a risk because the Department is not protected from interest rate increases on its variable rate bonds until the effective date of the swap. The Department's current swap policies do not limit the duration of forward-starting swaps, which could increase the Department's exposure to interest rate fluctuations.
- Fixed notional value swaps and declining notional value swaps—Two of the Program's five current swaps have notional values that decline similarly to that of the corresponding bond principal. The remaining three swaps have a notional value that is fixed for the first 9 to 10 years, at which point the notional value systematically declines. Fixed notional value swaps may place the Department at risk of incurring an incrementally higher interest expense if the related bond principal is paid off early (due to mortgage prepayments or other circumstances) than it may have incurred if the swap had been based on a declining notional value. The Department's policies do not establish parameters for use of fixed and declining notional value swaps.
- Knock-out options—These are swap options that cause the swap to be terminated if interest rates escalate or decline beyond levels specified in the swap. Currently, the Department does not have any swaps that contain these options, and its policies do not address the use of knock-out options, which could expose the Department to higher interest rates if it enters into future swaps with these options.

The Department should improve its monitoring of the fair values of its swaps. The Department does not have an internal process to monitor and validate the fair value of its swaps, which is disclosed in the notes to its financial statements. As a result, it cannot adequately evaluate the accuracy of the swap valuations received from its financial advisors. The accuracy of a swap's fair value becomes significant if the swap is terminated before its expiration date. The Department has not terminated, nor does it anticipate terminating, any of its swaps. The Department has the option to terminate its current swaps at its discretion. The current swaps could also be terminated under certain situations, such as the financial institution participating in the swap files bankruptcy or changes in laws allowing the use of swaps. As of August 31, 2007, the Department's five Program swaps had an estimated fair value of negative \$5.8 million, as reported by its swap advisor. This represents a payment the Department would be required to make if early termination occurs for all five swaps.

The Department should ensure it complies with its recently adopted policy requiring diversification of swaps. Currently, the Department has \$241 million (66 percent) of its swap notional value with one financial institution, Bear Stearns Financial Products, Inc. The Department approved a swap policy in January 2008 that requires the Department to diversify its swaps among financial institutions. Department management stated it intends to follow this policy when entering into future swaps. In March 2008, Bear Stearns Companies Inc. (parent company to Bear Stearns Financial Products, Inc.) experienced financial difficulties and was acquired by JPMorgan Chase & Co., with the help of the federal government. Bear Stearns Financial Products, Inc. had credit ratings of AAA and Aaa from Standard and Poor's and Moody's, respectively, as of April 2008.

#### Recommendations

The Department should:

- Improve its written swap policies to:
  - Address the allowable and unallowable uses of forward-starting swaps by defining the allowable duration and amount of such swaps.
  - Establish parameters for the use of fixed notional value and declining notional value swaps.
  - Establish parameters for the use or prohibition of knock-out options.
  - Develop, document, and maintain a methodology to calculate and monitor the fair values and termination values of interest rate swaps.
  - Implement, as soon as feasible, its recently adopted policy to diversify its interest rate swaps among various financial institutions for future swaps.

**Status:**

01/21/09 - Bond Finance will present amendments to TDHCA's Interest Rate Swap Policy at the February 2009 Board Meeting

11/07/08 - Bond Finance will present amendments to TDHCA's Interest Rate Swap Policy at the January 2009 Board Meeting.

Swap Financial Group, as TDHCA's Interest Rate Swap Advisor and Consultant, provides quarterly market analysis using highly sophisticated financial modeling software. TDHCA maintains calculations and supporting documentation for each analysis.

TDHCA will diversify swap counterparties when negotiating new swap contracts. No additional swap contracts have been negotiated since the audit.

08/18/08 - The Department agrees to implement these recommendations as follows:

The Department intends to reconcile the individual loan pools purchased to the principal amounts of the underlying mortgages to ensure pool purchase prices are accurate. To accomplish this, the Department anticipates contracting with an independent third party provider to perform program monitoring responsibilities.

Person Responsible: Director of Texas Homeownership Division

In April 2008, a process was implemented to compare pool level repayment data provided by Countrywide to the financial data reported by Bank of New York on a monthly basis. To date, no discrepancies have been found. Additionally, effective June 2008, the semi annual Bank of New York supplemental payment schedules were reconciled to actual cash receipts for the previous six month period. The Department will continue these reconciliations semiannually.

Person(s) Responsible: Financial Services Team Leader; Bond Financial Analyst

In order to supplement and enhance the current agreement with Countrywide to perform a tax compliance review on each loan, the Department proposes to develop a risk-based compliance monitoring process of its Master The Department agrees to amend its Interest Rate Swap Policy by:

- Addressing the allowable and unallowable uses of forward-starting swaps by defining the allowable duration and amount of such swaps.
- Establishing general parameters for the use of fixed notional value and declining notional value swaps depending on transaction structure and the appropriateness of either type of swap.
- Establishing general parameters for the use of knock-out options, however under current market conditions it is not the intention of the Department to use knock-out options.

Person Responsible: Director of Bond Finance

The Department agrees to:

- Develop, document, and maintain a methodology to calculate and monitor the fair values and termination values of interest rate swaps. In October 2005, the Department selected an independent third party advisor, Swap Financial Group, as its Interest Rate Swap Advisor & Consultant to primarily be responsible for duties and services necessary or advisable for monitoring and managing risks associated with TDHCA's interest rate swaps. Swap Financial Group will continue to provide quarterly fair values and termination values, however the Department will actively work to document the methodology for each calculation.

Person Responsible: Bond Finance Project Manager

- Diversify swap counterparties as directed by the current swap policy, which was revised in January 2008. To date, no additional swap contracts have been negotiated.

Person Responsible: Director of Bond Finance

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83	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 11/30/2008

**Division:** Financial Administration

**Section:** Financial Services

Px 08/18/08 11/30/2008  
Px 11/06/08 11/30/2008  
Ix 06/12/09

**Issue:** Chapter 2  
The Department Effectively Uses Program Funds as Required by Bond Indentures and Contracts; However, It Should Develop a Process to Track and Allocate Administrative Costs for the Program

Although the Program expenditures recorded by the Department are reasonable and generally necessary, it could improve its monitoring of the use of Program funds. The Department does not have a formalized methodology to distribute indirect administrative costs to the Program. The Department does have a federally approved cost allocation plan that it uses to allocate administrative overhead costs to federal grants and contracts. However, it does not identify and allocate administrative costs to the Department's nonfederal programs. Without an agency-wide cost allocation methodology, the Department cannot ensure that administrative costs are accurately allocated to select programs.

The Department tracks direct Program expenses for the Texas Homeownership Program Division, which is dedicated solely to the operation of the Program; however, the Department does not track Program administrative expenses that are shared with other divisions. Additionally, the Department lacks a documented allocation schedule or formal process to identify and allocate all appropriate Program costs.

The Program's bond indenture allows the Department to be reimbursed for "expenses of carrying out and administering its powers and duties and functions" in connection with the Program. The bond indenture further states that these expenses are to be "properly allocable to the Program." To comply with these requirements, all Program costs should be accurately identified and tracked, including administrative overhead costs. This would allow the Department to determine whether Program funds transferred to the Department for administration costs are insufficient or excessive.

According to the Department's fiscal year 2007 financial statements and accounting records, the Department transferred a total of \$2.12 million from Program funds and Residential Mortgage Revenue Bond Program funds to its general fund to reimburse itself for administration of these two programs.

At auditors' request, the Department prepared its best estimate of fiscal year 2007 administrative costs for both the Program and the Residential Mortgage Revenue Bond Program. Based on this estimate, the Department's total cost to administer these programs for fiscal year 2007 was \$2.17 million. The Department may have undercharged these programs by a total of \$50,000 for administrative overhead costs during fiscal year 2007. This indicates a need to develop a methodology to allocate costs to the Program.

**Recommendations**

The Department should:

- Develop and document a cost allocation methodology that includes appropriate allocations to the Program.
- Ensure that reimbursements of administrative costs from Program funds do not exceed actual costs.

**Status:**

- 06/12/09 - Management has developed and implemented an SOP for allocating operating costs to programs and has began period reviews to determine if any adjustments are necessary
- 11/06/08 - Financial Services is in the process of developing a cost allocation methodology for allocating program funds and procedures for evaluating administrative costs charged to programs.

The Department's cost allocation methodology has been defined and has been incorporated into the agency budget and accounting system. The Financial Services section is in the process of developing standard operating procedures to document the methodology for allocating costs to ensure that the reimbursement of administrative costs does not exceed actual costs.

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08/18/08 -	The Department concurs with the recommendation to develop and document a cost-allocation methodology for allocating program funds and to periodically evaluate administrative Program costs to ensure that the reimbursement of administrative costs does not exceed actual costs.			
84	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 11/30/2008

**Division:** Information Systems

**Section:**

Px 08/18/08 11/30/2008  
Px 11/08/08 11/30/2008  
Ix 01/21/09

**Issue:** Chapter 3-A  
The Department Has Not Configured Its Internal Accounting System to Maintain Audit Trails

Although the Department controls access to the MITAS System through the use of user logins and passwords, it has not enabled the audit trail feature in the MITAS System. The MITAS System is the Department's internal accounting system for the Program; it contains general Program loan information, but it does not contain specific confidential information of Program borrowers. The MITAS System is an accounting software package the Department purchased from the MITAS Group. Audit trails maintain a transaction and logging history for a system. Without audit trails, the Department cannot consistently identify who created a transaction or changed data or when the activity occurred. This weakness may hinder any Department efforts to identify and resolve the source of errors or unauthorized changes to its data.

If unauthorized changes are made, it may limit the Department's ability to identify the source of the change and accurately reconcile Program funds. The Texas Administrative Code requires agencies to maintain appropriate audit trails based on a documented security risk assessment.

**Recommendation**

The Department should perform a risk assessment to determine whether it should enable the audit trail function in the MITAS System and implement the resulting decision.

**Status:**

- 01/21/09 - The department completed the MITAS risk assessment on November 24, 2008, and implemented the resulting audit trail decisions.
- 11/08/08 - The Department is currently performing the Mitas risk assessment and expects to be complete with it and associated audit trail decisions by November 30, 2008. The Department has reconfigured the current server environment to allocate disk space for any required system logging, based on the risk assessment
- 08/18/08 - The Department agrees with the recommendation and will perform a risk assessment to decide whether it should enable the MITAS audit trail function. Because of resource limitations on the server hardware that currently houses MITAS, the Department will also upgrade the hardware to add the disk space required for increased system logging.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
85	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 11/30/2008

**Division:** Information Systems

**Section:**

**Issue:** Chapter 3-C  
The Department Has Not Conducted a Security Risk Assessment Since 2005

Title 1, Texas Administrative Code, Section 202.25 (1 TAC 202.25), recommends that state agencies adopt 24 security policies and other information technology security controls based on a documented security risk assessment. The Department performed an agency-wide risk assessment in 2005, including an assessment of the security over information systems and its controls over high-impact information system processes. The Department reviewed the controls over these high impact information system processes again in 2006. The Department did not document its reasons for not implementing an information security control and eight of the policies recommended in 1 TAC 202.25. Auditors communicated details of these system security weaknesses to Department management. The Department could improve its information technology security by conducting a security risk assessment and addressing any weaknesses it identifies.

Recommendation  
The Department should perform, document, and implement (as appropriate) a security risk assessment.

**Status:**

- 01/23/09 - On January 23, 2009, the Department completed an updated security risk assessment which addresses controls listed in Title 1, Texas Administrative code, Section 202.25. The risk assessment documents existing and recommended information security policies and other controls and established a target date for implementing each recommendation.
- 11/08/08 - The Department is in the process of performing an updated security risk assessment, which addresses controls listed in Title 1, Texas Administrative Code, Section 202.25.
- 08/18/08 - The Department agrees with the recommendation and has created a security policy upgrade plan which includes the step of performing an updated security risk assessment.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
86	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 10/31/2008
<b>Division:</b> Bond Finance			Px	11/07/08 8/31/2009
<b>Section:</b>			Ix	01/21/09

**Issue:** Chapter 4  
The Department Does Not Include Statutorily Required Language in All Program Contracts

The Program's contracts do not contain the statutorily required language granting the State Auditor's Office audit authority and access to records. These contracts include those with bond counsel, The Bank of New York Mellon Corporation, and Countrywide Home Loans, Inc. Contracts that do not contain this statutorily required language may limit the State's ability to provide effective oversight of contract terms, contractors, and the use of state funds. Access to records is an essential element of auditing. Texas Government Code, Section 2262.003, requires that all state agency contracts contain contract terms specifying that:

- The State Auditor may conduct an audit of any entity receiving funds from the State directly or indirectly under the contract.
- An entity subject to audit by the State Auditor must provide the State Auditor with access to any information that the State Auditor considers relevant to the audit.

These contract language requirements were effective as of September 1, 2003.

**Recommendations**

The Department should comply with statutory requirements by:

- Amending all current contracts to include terms granting the State Auditor audit authority and access to records.
- Including in all future contracts terms granting the State Auditor audit authority and access to records.

**Status:**

01/21/09 - Amend existing contracts as they are renewed.

11/07/08 - Existing contracts will be amended when they are renewed and all future contracts will contain the language to allow the State auditors office authority and access to records.

08/18/08 - The Department agrees to comply with statutory requirements relating to program contracts. The Department will review and amend all contracts to include terms granting the State Auditor audit authority and access to records as contracts are renewed. The Department has already incorporated Section 2262.003 of the Texas Government Code in the Request for Proposal for Underwriting Services and Request for Proposal for Master Servicer to be presented to the Board at the September 4, 2008 meeting, which included terms granting the State Auditor audit authority and access to records.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
87	11/25/2008 Internal Audit	Internal Audit Report on the OCI's Bootstrap program Review of the processing and monitoring functions of the Office of Colonia Initiatives' Bootstr		

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 1-A  
The Department Should Ensure Two-Thirds of Bootstrap Funds are Set Aside for Properties Located in Counties Eligible for Financial Assistance

Px 11/25/08  
Px 01/21/09 1/30/2009  
Ix 05/12/09

Since November 2007, \$3,970,755 in Bootstrap loans has been committed and partially spent. Of this amount, \$858,590 has been for properties located in the 41 counties eligible for financial assistance. This does not completely comply with Section 2306.752(d) of the Government Code which states, "(a) at least two-thirds of the dollar amount of loans made under this subchapter in each fiscal year must be made to borrowers whose property is located in a county that is eligible to receive financial assistance under Subchapter K, Chapter 17, Water Code." Of the \$6.5 million in Bootstrap funding for program year 2008, two-thirds, or \$4.3 million, is designated for the counties eligible for financial assistance under the Water Code. Of this two-thirds amount, \$2.4 million has been obligated to and/or spent in counties which are not eligible under the Water Code.

**Recommendations**

The Department should:

- ensure that two-thirds of the available Bootstrap loan funding is set aside for counties eligible for financial assistance under the Water Code, and
- establish a method by which the list of counties eligible for assistance is regularly updated to ensure compliance with the statute.

**Status:**

- 05/12/09 - On 5/12/2009, the OCI division provided SOP for the Texas Bootstrap Loan Program Reservation System with an effective date of 1/30/2009 which describes the Program requirements as recommended.
- 01/21/09 - On October 27, 2008 the Department mailed the attached letter to all NOHPs notifying them of the updated EDAP Determination. OCI staff has spoken with TWDS Attorney Joe Reynolds. Last week Mr. Reynolds stated that he will forward by email updates as they occur. OCI staff will also follow-up on a quarterly basis to ensure it obtains all updates. SOPs will be updated to reflect this process.
- 11/25/08 - The Department will improve its procedures and tracking methods to ensure 1) that two thirds of awards are located in counties eligible to receive financial assistance under Subchapter K, Chapter 17, of the Water Code and 2) that the counties eligible for the two-thirds set-aside are regularly updated.

Management initially relied on faulty information, but has corrected this information and agrees that the current process is appropriate.

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<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
88	11/25/2008 Internal Audit	Internal Audit Report on the OCI's Bootstrap program Review of the processing and monitoring functions of the Office of Colonia Initiatives' Bootstr		

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 1-B  
The Total of All Loans for Bootstrap Homes Should Not Exceed the \$60,000 Limit Set By Statute

Px 11/25/08  
Px 01/21/09 2/15/2009  
Ix 05/12/09

Statute (Section 2306.754 of the Government Code) limits the amount of funding for Bootstrap loans to \$30,000 for the Department's loan and an additional \$30,000 for all other sources of funding. Some non-profit owner-builder housing providers obtain additional funding above the \$60,000 total allowed by statute in the form of other loans, usually forgivable loans (such as loans from the non-profit owner-builder housing provider, the Federal Home Loan Bank or the United States Department of Agriculture.)

Even though these loans are forgivable and in most cases are not expected to be re-paid, according to the Department's legal division, they are loans and not grants if they are secured through a lien on the property. As a result, they should still be considered as part of the \$60,000 limit for the total of all loans. A statistical random sample of 201 of the 426 Bootstrap loans closed from September 2005 to June 2008 found that 84 (42%) of these loans exceeded the \$60,000 limit. In addition, there were 9 loans that exceeded the \$60,000 limit even after disregarding the amounts of the forgivable loans. In some instances, loans are listed as forgivable; however, there is no provision in the note or the warranty deed that states the debt is forgivable. These loans ranged from \$65,000 to \$80,000 each.

Even including the money saved by requiring the families that participate in the Bootstrap Loan Program to help construct their own homes, it is still difficult for a modest home to be built for less than \$60,000 including the costs of the property, the escalating costs of construction materials, and the other associated costs such as inspections, appraisals and closing costs. As a result, maintaining the \$60,000 limit may result in fewer homes built under the Bootstrap Loan Program.

**Recommendations**

The Department should:

- Fully comply with the \$60,000 limit for all loans made under the Bootstrap Loan Program unless the legislature makes a change in statute to either raise the \$60,000 limit, or to specify that forgivable loans are grants, even if they result in a lien on the property, and
- Ensure all additional loans are documented in the loan file, and in those instances where lenders provide a forgivable loan, ensure the provision is also documented.

**Status:**

- 05/12/09 - As of 2/16/2009, the SOP has been updated to restate the Statute requirement that all Bootstrap loans may not exceed \$30,000 from the agency and a total of \$60,000 of loans from all sources.
- 01/21/09 - OCI will continue to follow Program Rules and Statutes to ensure compliance. NOHPs are required to complete Form 3 listing all lien holders, lien positions and lien amounts. In addition OCI now provides the legal department copies of all loan documents associated with the Department's loans prior to funding to ensure compliance. SOPs will be updated to reflect this process. OCI will continue to ensure that copies of all Notes and Deed of Trust are obtained and reviewed prior to funding. In addition the Department's Legal Department will review all loans prior to funding to ensure compliance. SOPs and Program Manual will be updated to reflect this process.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
11/25/08 -		Management received what it determined to be a conservative reading of the statute regarding maximum allowable funding to not allow deferred forgivable loans from its legal counsel. As there is a definition that states that a deferred forgivable loan is considered a grant for purposes of the enabling statute for this program, Management believes that the deferred forgivable loan provides some reasonable interpretation and therefore decided that since the alternative was to stop the program from going forward in most cases, it was a reasonable risk to take under the circumstances.
		Management understands and has fully considered the legal interpretation and the auditor's point of view but feels it is justified in continuing the program allowing for a deferred forgivable loan in addition to \$60,000 loans per transaction based on the statutory definition of a deferred forgivable loan.
		The Department will make sure that processes ensure that all loan files are documented accordingly.

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<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives  
**Section:**

Px 11/25/08 1/31/2009  
Px 01/21/09 2/28/2009  
lx 05/12/09

**Issue:** Chapter 1-C  
Bootstrap Loan Funds and Payments Should Be Tracked and Re-Allocated as Required By Statute

The Government Code (Section 2306.7581(a-b)) requires the Department to establish an owner-builder revolving loan fund for the sole purpose of funding Bootstrap loans. The Department is required to transfer at least \$3 million each fiscal year to the owner-builder revolving loan fund and to deposit money received in repayment of a Bootstrap loan to the fund. Although at least \$3 million has been allocated to the Bootstrap Loan Program as required, the Department does not maintain the funds set aside for the Bootstrap Loan Program in a separate fund, nor are the re-payments made on Bootstrap loans specifically allocated back to the program. In addition, when Bootstrap funds are unspent and deobligated, the funds are moved into the Housing Trust Fund and could potentially be reallocated to another of the Department's programs. In program years 2006/2007, \$3.2 million in Bootstrap funds were de-obligated.

- Recommendations  
The Department should:
- Develop a methodology to track Bootstrap Loan Program funds, loan payments and de-obligated funds, and
  - Ensure that all re-payments made on Bootstrap loans are used to fund the Bootstrap Loan Program.

**Status:**

05/12/09 - As of 3/30/2009, the Program has created the Housing Trust Fund SOP to ensure compliance with statutory funding requirements.

01/21/09 - OCI will monitor on a monthly basis the Housing Trust Fund Report provided by Financial Administration. Financial Administration will create a total of four accounts to track loan repayments and deobligated funds. To track repayment funds they will create two accounts for local funds and general revenue funds and for deobligated funds they will also create two accounts for local funds and general revenue fund

11/25/08 - Management acknowledges the need to track loan repayments and deobligated funds. Management will work with the Financial Administration Division to ensure Bootstrap funds are accounted for separately and that Bootstrap loan payments are recycled by the Program. While not formally handled through a separate account, historically Bootstrap Program loan repayments and deobligations have been channeled back directly into the Bootstrap program.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 2-A  
Bootstrap Loans Sometimes Result in the Department Taking a Subordinate Lien Position

Px 11/25/08  
Px 01/21/09 1/30/2009  
Px 05/13/09 9/30/2009

There is a \$30,000 limit for Bootstrap loans and a \$60,000 limit for the total of all loans on Bootstrap homes. (See Chapter I-B) Most Bootstrap loans have another loan supplementing the Department's loan. These loans are generally made by non-profit owner-builder housing providers, local government entities or private lenders such as banks. Section 2306.754 of the Government Code does not require the Department to place a lien against a home financed under the Bootstrap Loan Program. However, if a lien is placed, the Department must take the primary lien position if the amount of the Department's loan is greater than the amount of the other (leveraged) loan. Also, Texas Administrative Code, Title 10, Part I, Chapter 2, §2.15(3) states that:

"The Department may accept a parity or subordinate lien position if the leveraged loan is greater or equal than the Department's loan. However liens related to other subsidized funds provided in the form of grants and non-amortizing loans, such as deferred payment or forgivable loans, must be subordinated to the Department's loan."

Not all Bootstrap loans are in compliance with this requirement. The Department discovered this recently and began enforcing this requirement for all new loans in November 2007. As a result, some non-profit owner-builder housing providers are now structuring Bootstrap loans so that, for example, the Department's loan is in the amount of \$29,999 with the additional loan in the amount of \$30,000, or the Department's loan is for \$24,899 with the additional loan in the amount of \$24,899.47, giving the Department the second lien position. Another common practice is to combine the leveraged loan with a forgivable loan, so that the Department ends up with the subordinate lien position.

Although the practice of giving the Department a subordinate lien position when it contributes less money to the home technically complies with the rules governing the Bootstrap Loan Program, it results in the Department subordinating its right to any recoverable interest in the home in the event of a foreclosure. A statistical random sample of 201 of the 426 Bootstrap loans closed from September 2005 to June 2008 found that in 106 (53%) of these loans, the Department's lien was subordinate to a loan of equal or lesser value, and in 39 (19%) of these loans, the Department's lien was subordinate to a deferred payment or forgivable loan, which is not permitted under the rules. Many of these loans were initiated before the Department identified this problem and began enforcing the requirements regarding lien position.

**Recommendations**

The Department should:

- Ensure that all future Bootstrap loans comply with the Texas Administrative Code regarding lien position relative to other loans,
- Consider whether the Department is willing to give up first lien position for an amount as low as forty-seven cents, and
- Determine whether amendments should be made to the Texas Administrative Code to further specify the Department's intent regarding lien position.

**Status:**

- 05/13/09 - Program SOP have been updated regarding the Program's Lien Position requirement. After Program Rules have been adopted by the Department's Governing Board and published in the Texas Register the Program Manual will be updated.
- 01/21/09 - OCI will continue to follow Program Rules and Statutes to ensure compliance. NOHPs are required to complete Form 3 listing all lien holders, lien positions and lien amounts. In addition the Department's Legal Department will review all loans prior to funding to ensure compliance. SOPs will be updated to reflect this process. Currently there are no provisions that restrict the amount of lien. OCI will route memo for Executive Director's signature clarifying the Department's current policy regarding lien position and amounts. Program Rules are clear that TDHCA cannot subordinate to a lesser loan.

<i><b>Issue #</b></i>	<i><b>Report Date</b></i> <i><b>Auditors</b></i>	<i><b>Report Name</b></i> <i><b>Audit Scope</b></i>
11/25/08 -		<p>As of November 2007, the Department does not allow a greater lien position to a lender with a lesser amount, while the loan amounts are close to provide the maximum amount of financing available. A large number of administrators with this program have provisions that do not allow any other lien position other than a first lien position and therefore the alternatives are to either not allow the program to proceed or accept a statutorily correct lien positioning that is close in amount.</p> <p>This is an area that has been identified in public comment to be changed statutorily. Management will monitor this issue closely during the legislative session.</p> <p>This practice assists the Department in meeting its Rider 5 requirement of the General Appropriation Act to provide funds to families with incomes of 30% and below.</p> <p>-</p>

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 2-B  
All Bootstrap Loans Should Be Monitored Prior to Closing

Px	11/25/08	11/30/2008
Px	01/21/09	2/28/2009
Ix	05/13/09	

There are three types of loans used in the Bootstrap Loan Program (see text box.) For interim construction and residential construction loans, the program staffs are required to make an on-site visit to inspect the houses at 40%, 80% and 100% of completion. When the non-profit owner-builder housing provider uses purchase money loans to fund their Bootstrap houses, the houses may not ever be seen by the border field officers or by any Department staff. The non-profit owner-builder housing providers are instead required to provide an appraisal and an inspection report from a licensed inspector or a certificate of occupancy if the home is located inside the city limits.

In four of 33 files tested (12%) the appraisal document was missing or was for a different address with a similar floor plan. In some instances, one appraisal is used for several homes on the same street if the homes have the same lot size and floor plan. However, the lot size and floor plan were different in this case. Since the non-profit owner-builder housing provider hires their own appraisers and inspectors, there is an increased risk that fraud could occur if there were collusion between the appraiser, the inspector and the non-profit. Although this is not likely, requiring the Bootstrap Loan Program staff to see and document each house at least once during construction would help protect the Department's interest and reduce the risk of fraud. We did not identify any instances of fraud in our review of the Bootstrap Loan Program.

In reviewing 45 open loan files at the border field offices and testing an additional 14 files for closed loans, it was difficult to determine if the border field officers were monitoring these homes because 48 of these 59 loans (81%) were purchase money loans and there was insufficient evidence of monitoring activities documented in the files. When reviewing the open loan files, it was not always readily apparent when some activity such as a loan approval, a change of address, monitoring visit, or inspection occurred. In addition, we visited a sample of 64 Bootstrap homes in the areas supervised by the three border field offices. We found one property with an old, inhabitable dwelling that was not torn down before the loan closed (prohibited by the program rules), and seven homes where the addresses in the system used to electronically track these loans did not match the location of the actual house.

In some cases, we asked the staff for an explanation of a discrepancy, which then resulted in additional research, or a call to the non-profit to obtain an answer. Documenting events in a log would help ensure that anyone who looked at the file would be able to determine the current status of the loan and easily identify any significant changes to the file.

**Recommendations**

- Each Bootstrap home funded by the Department should be viewed at least once prior to closing by an employee of the Department and the process should be documented in the loan file.
- Each Bootstrap loan file should contain an activity sheet or chronological log that the staff can use to document significant changes to the file.

**Status:**

05/13/09 - The Program has taken action to update the Program SOP to ensure compliance with the audit recommendation.

01/21/09 - The Department will continue to require an improvement survey, a certificate of occupancy and/or a third-party inspection in addition to an appraisal report. In addition the Department will also require the owner-builder applicant to sign an affidavit of occupancy at closing stating that the home being purchased will be their primary residence. Affidavit of Occupancy will be attached to the Appraisal Report. Program Manual and SOPs will be updated to reflect this requirement. History sheets have been supplied to all OCI staff originating Bootstrap Loans. SOPs will be updated to reflect this process.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
11/25/08 -		<p>The Department is required to balance the risk associated with certain practices with the administrative burden and expense of mitigating that risk. The Auditor has noted that “there is an increased risk that fraud could occur if there were collusion between the appraiser, the inspector and the non-profit.” Management will look to a mechanism—either homeowner sign-off for final construction and address, staff physical review and/ or photographic evidence coordinated with an appraisal to demonstrate finished construction and ensure that the address is accurate.</p> <p>Management agrees each Bootstrap Loan File should contain an activity sheet or chronological to document significant changes to the file. Standard Operating Procedures will be revised to include this activity sheet.</p>

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 2-C  
Bootstrap Loans Should More Fully Comply With the Program Rules

Px	11/25/08	11/30/2008
Px	01/21/09	1/30/2009
Ix	05/13/09	

We reviewed a total of 19 open and 14 funded loan files for thirty-four different requirements found in statute, the Department's rules or the Bootstrap Loan Program Manual. We found that in 6 of the 33 files tested (18%) the loans exceeded 95% of the appraised value of the home, or there was not an appraisal in the file with which to determine the loan-to-value ratio. The 95% loan-to-value ratio is a requirement in the Bootstrap Loan Program Manual.

In addition, we noted several instances where loan files indicated that the applicant or homeowner exceeded the debt-to-income ratio allowed by the Texas Administrative Code rules. Allowing applicants to exceed the established debt-to-income ratio increases the risk that they will be unable to make their loan payments and could face foreclosure.

As a result of this observation, we reviewed data in the MITAS system used to electronically track loans and found that:

- Of the 367 loans closed and funded for fiscal years 2006 and 2007, 30 (8.2%) exceeded the 50% debt-to-income ratio allowable at that time.
- Of the 97 loans that were still open as of June 2008, five (5.2%) exceeded the 45% debt-to-income ratio currently allowed.

We found that some of the files in our testing population were also missing other documentation, especially for the open loans. However, once a loan is ready to be closed, it undergoes review by several different divisions of the Department and any missing documents are generally obtained.

Recommendations

- Each Bootstrap file should contain the required information such as appraisals, calculations of loan-to-value ratios, and debt-to-income ratios.
- Program rules should be followed relative to the loan-to-value ratios and debt-to-income ratios.

**Status:**

05/13/09 - The Program has taken action to update the Program SOP to ensure compliance with the audit recommendation.

01/21/09 - The underwriting summary from Mitas will be placed in each loan file to address debt-to-income ratio calculations and loan-to-value ratios. SOPs will be updated to reflect this process. Direct Lending Officer will underwrite Program Loans originated by BFOs and OCI Director and/or Manager will underwrite Program Loans originated by Direct Lending Officer to ensure compliance. SOPs will be updated to reflect this process.

11/25/08 - Management acknowledges inconsistencies in the Mitas System and implemented standard operating procedures in November 2007 to ensure that accurate data is entered into the Mitas System in a uniform manner.

The 95% loan-to-value ratio is a relatively new directive. It was intended to only be applied to loans originated under the 2008 Texas Bootstrap Loan Program Manual.

The Department did not require appraisal reports until Program Year 2006; at that time a 100% loan-to-value ratio was required. Prior to Program Year 2006 it was the nonprofit organizations' responsibility to ensure sufficient equity.

Management will review and revise its Standard Operating Procedures to more thoroughly document the recommendations in regards to the debt-to-income ratios and loan-to-value ratios.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 3  
The Reservation System Has Increased the Use of Bootstrap Funds, But Unspent Funds From Prior Contracts Should be De-obligated

Px 11/25/08 11/30/2008  
Dx 01/21/09  
Nx 05/12/09

Since September 2007, the reservation system used for the Bootstrap Loan Program has resulted in a more efficient process for distributing Bootstrap loan funds to non-profit owner-builder housing providers. During the first nine months that the reservation system has been utilized, 57% of the available funds have been committed or expended, compared to 33% for the same length of time under the old application process.

The reservation process allows the funds to be encumbered, but only when the non-profit has an owner-builder ready to proceed with the program. This is an improvement over the old application process where thousands of dollars were reserved for up to two years by non-profits, even when they did not have owner-builders ready to proceed. In addition, non-profit owner-builder housing providers that were able to complete their approved number of homes had to wait until the next award cycle before applying for more funds. Under the reservation system, these non-profit owner-builder housing providers can continue assisting up to ten applicants at a time without putting their program on hold. As a result, the implementation of the reservation system has dramatically increased the rate of expenditure for program year 2008 funds, compared to the prior year. (See figure 1)

Historically, 25% of all Bootstrap loan funds awarded to non-profit owner-builder housing providers through the application process have been de-obligated due to slow performance or non-compliance. There is currently more than \$500,000 remaining in several contracts from the application process. In March 2008, one non-profit owner-builder housing provider had \$53,000 in 2008 Bootstrap funds reserved in the reservation system while maintaining an unused contract balance of \$561,000. This amount was de-obligated sometime in June or July 2008. Another non-profit owner-builder housing provider had an unused contract balance of \$93,600 as of July 2008, but had already reserved \$190,800 in the reservation system by that same date. This problem should not be an issue in the future when all previous contracts expire, and the remaining balances are finally de-obligated.

**Recommendation**

The remaining unused Bootstrap funds should be de-obligated as soon as the old contracts expire.

**Status:**

- 05/12/09 - Two contracts currently remain open under prior award methods. Both contracts will expire September 30, 2009. OCI will continue to monitor remaining contract.
- 01/21/09 - Three contracts currently remain open under prior award methods. Two contract will be closed within the next 60 days. OCI will continue to monitor remaining contract.
- 11/25/08 - Management agrees and will continue to monitor all balances to ensure funds are expended or de-obligated in a timely manner. The Reservation System allows nonprofit organizations to reserve funds on a first-come first-serve basis. It rewards nonprofit organizations and owner-builders applicants that are ready to proceed.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
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**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 4-A: The Bootstrap Loan Program Appropriately Certifies Non-Profit Owner-builder Housing Providers, but Improvements Should Be Made to More Closely Comply with Statutes

Px	11/25/08	1/31/2009
Px	01/21/09	6/1/2009
Px	05/13/09	9/30/2009

One requirement of the certification process requires the Department to verify the organizations' capacity to administer the Bootstrap Loan Program. To demonstrate this, the organization must provide an unqualified opinion on its financial statements from a Certified Public Accountant (CPA), or a signed, notarized affidavit from the organization's executive director. In addition, the organization must show that they have administered activities similar to those carried out through the Bootstrap Loan Program, or show at least one year of service to the community which they intend to serve. In two of the ten certification files tested (20%), we found neither an unqualified CPA opinion nor a signed, notarized affidavit regarding the organizations' financial statements. In addition, the organizations were newly formed Habitat for Humanity branches that did not demonstrate the required year of service to the community. It appears the affiliation with the national Habitat for Humanity organization was used to determine their capacity; however, this was not documented in the certification files.

The Texas Administrative Code requires that organizations submit a signed, notarized affidavit from the executive director declaring that the organization is structured as required; however, the required structure is never defined in the Code. As a result, organizations are required to submit an affidavit, but there are no requirements to declare anything in that affidavit. The Department's Community Housing Development Organization (CHDO) rules were used to develop the rules governing the certification of non-profit owner-builder housing providers for the Bootstrap Loan Program, and this section was not eliminated when writing the Department's rules.

The Department should:

- Ensure that organizations applying to be certified as a non-profit owner-builder housing provider submit an unqualified opinion by a CPA or a signed, notarized affidavit from the executive director certifying that the organization's accounting records conform to the standards of financial management systems as required.
- Request changes to the Texas Administrative Code to eliminate the organizational structure requirement, and then amend the certification checklist to eliminate the organizational structure and public comment sections.

**Status:**

- 05/13/09 - After Program Rules have been adopted by the Department's Governing Board and published in the Texas Register SOPs and Program Manual will be updated to reflect all changes.
- 01/21/09 - Direct Lending Officer will conduct an initial review of all NOHP Certification Applications submitted and make recommendation to OCI Director and/or Manager. OCI Director and/or Manger will review all NOHP Certification Applications and make final recommendation. SOPs will be updated to reflect this process. Program Rules will be updated.
- 11/25/08 - Management agrees with recommendations and will institute the changes including the amendment to the Texas Administrative Code.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
95	11/25/2008 Internal Audit	Internal Audit Report on the OCI's Bootstrap program Review of the processing and monitoring functions of the Office of Colonia Initiatives' Bootstr	Px	11/30/2008
			Px	2/28/2009
			Px	9/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 4-B: Improvements Are Needed to Better Align the Bootstrap Manual with the Texas Administrative Code Rules and the Loan Origination Agreement

There are three items in the Texas Administrative Code and 13 additional items in the loan origination agreement between the Department and the non-profit owner-builder housing providers that are not covered in the manual.

The following rules in the Texas Administrative Code are not found in the manual:

- Non-profit owner-builder housing providers are prohibited by rule from using Bootstrap loan funds to pay delinquent property taxes or related fees or charges on properties.
- A first year consultation agreement is defined in the rules, but not addressed in the manual.
- A conflict of interest provision is defined in the rules, but is not found in the manual.

In addition, there are 13 additional items included in the loan origination agreement that are not covered in the manual. Five items involve standard contract language including: a prohibition against using program funds for political activities, sectarian activities, and to purchase alcohol, a reminder that the Department is subject to open records requests, and a statement informing the non-profit owner-builder housing providers that they must notify the Department if they become the subject of any legal action involving activities associated with the loan origination agreement.

Other missing items involve the direct administration of the Bootstrap Loan Program. These items include:

- The nine instances by which the Department can involuntarily terminate the agreement with the non-profit owner-builder housing providers,
- Language requiring the non-profit owner-builder housing providers to refund any funds that the Department subsequently determines resulted from an overpayment,
- Performance benchmarks and milestones required of the non-profit owner-builder housing providers,
- Requirements of the non-profit owner-builder housing providers in accounting for the program funds,
- Reporting requirements of the non-profit owner-builder housing providers as it relates to the program,
- Requirements for retention and accessibility of records,
- Certification that the non-profit owner-builder housing providers will not employ undocumented workers, and
- Requirements for the non-profit owner-builder housing providers to modify any reservation of funds submitted for a Bootstrap loan.

The Department should ensure that all requirements of the Bootstrap Loan Program are included in the program manual, and continue to periodically update the manual to include any changes in program requirements.

**Status:**

05/13/09 - OCI will update Program Manual accordingly. Currently Program Rules and Statutes are included in Program Manual. OCI will be presenting draft Program Rules to the Department's Governing Board in June 2009, the rules will also include statutory changes from the 2009 Texas Legislative Session, if any.

After Program Rules have been adopted by the Department's Governing Board and published in the Texas Register the Program Manual will be updated.

01/21/09 - OCI will update Program Manual and add Loan Origination Agreement as an exhibit to the Program Manual. Currently Program Rules and Statutes are included in Program Manual.

11/25/08 - Management agrees. Both Program Statutes (Exhibit 1) and Rules (Exhibit 2) are currently part of the Program Manual that is distributed to the nonprofit organizations participating in the Bootstrap Program.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
96	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 1-A  
Draw Requirements Should Be Established and Met Prior to Approving Payments

Px	12/19/08	1/30/2009
Px	01/21/09	2/28/2009
Px	05/13/09	9/30/2009
Ix	06/09/09	

Draws submitted by counties and reimbursed by the Department are not adequately supported or in compliance with federal cost principles. Counties must comply with the Office of Management and Budget's (OMB) Circular A-87, Cost Principles for State, Local and Indian Tribal Governments and nonprofit self-help centers must comply with OMB Circular A-122, Cost Principles for Nonprofit Organizations. At least one issue was identified in each of the 12 draws tested that should have prevented the Department from reimbursing the expenditures. The process for reviewing the draw requests and supporting documentation is not adequate.

The Department has not developed minimum documentation requirements for counties to use when submitting draw requests. The majority of expenditures reimbursed for rehabilitation, public service, reconstruction, and special needs were supported only by employees' timesheets. There was no documentation of the work performed by the employee during the hours charged to the contract activities. Without knowing what the employee was working on it is difficult to ensure that the expenditures are related to the contract and that they do not exceed the established project budget. In addition, some of these timesheets were changed after the employee signed them.

Draws submitted for reimbursement of rehabilitation expenditures are not supported by work write-ups, income eligibility documentation, proof and length of ownership, documentation of property taxes paid prior to assistance, insurance requirements, home inspections, itemized invoices for material and supplies, or details of the work performed.

The following issues were also identified in the draws we reviewed:

- Draw documentation is not consistently date stamped when received by staff. This makes it difficult to determine if these documents were submitted on time.
- Draw hold policies are not followed. Eight of the 12 draws reviewed did not have an email located in the contract file documenting the reasons for the hold.
- Draws are held up to the 15 day mark, then sent back to the county for resubmission but management is not signing off on these draws as required.
- Draw documentation information is not correctly posted to ORCA's ORACLE system which is used to track information on the self-help center contracts.
- Six of the 12 draws tested did not match the information posted in ORACLE.
- Counties and nonprofits were reimbursed for late fees. According to OMB Circulars A-87 and A-122, "costs are reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under circumstances prevailing at the time the decision was made."
- Reimbursements for travel expenses were not in compliance with the State Comptroller's Office rates.
- Vehicle mileage logs did not support the maintenance charges reimbursed.
- Drinking water charges were reimbursed after the self-help center was connected to the public water system.
- Reimbursements were made for phone calls not related to the program.
- Invoices supporting reimbursements were not within the time period covered by the draw (but were within the contract period.)
- A personnel costs calculation form could not be located for each employee.
- A draw for one county had no supporting documentation at all.

Recommendations

The Department should:

- develop minimum documentation requirements for counties to use when submitting draw requests,
- develop a draw checklist to ensure that all draws are supported by the required documentation,
- include a date stamp on all documents received, and
- verify that all information is correctly posted to ORACLE.

<i>Issue #</i>	<i>Report Date</i> <i>Auditors</i>	<i>Report Name</i> <i>Audit Scope</i>
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**Status:**

06/09/09 - The SOP has been revised and took effect on May 15, 2009.

Draw checklists and program forms were created to document minimum documentation requirements. The checklists and forms were provided to Colonia Self-Help Center Providers on May 19, 2009. The checklists and forms are effective June 1, 2009. The draws forms and other program forms have been placed on the Departments website at [www.tdhca.state.tx.us/oci/centers/forms.jsp](http://www.tdhca.state.tx.us/oci/centers/forms.jsp). SOPs were also revised to ensure all documents received are date stamped and information is posted on ORACLE and the Colonia Self-Help Center T:/ drive.

05/13/09 - After Program Rules have been adopted by the Department's Governing Board and published in the Texas Register the Program Manual will be updated.

01/21/09 - Currently revising SOP and tables into checklists for draw processing. All documents are being date stamped and appropriate information is being posted to the ORACLE database.

In order to help ensure compliance with federal, state and programmatic rules and requirements we would like to define the terms "subrecipient" and "vendor" for the inclusion in the Colonia SHC Program Rules and to outline the types of documentation considered adequate for the reimbursement of expenses incurred by these different entities in carrying out the activities of the program.

12/19/08 - Management agrees that basic draw requirements should be established and met prior to approving payments. Minimum documentation requirements for counties to use when submitting draw requests have been developed. A table describing acceptable back-up documentation may be found in Chapter 2, Section 2.2, Drawdown Procedures, of the 2007 Texas Community Development Block Grant (TxCDBG) Implementation Manual and in Attachment # 1 to the Colonia Self-Help Center (SHC) Program Standard Operating Procedures (SOPs). However these tables will be reviewed, updated and transformed into a checklist for use during the draw processing.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
97	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

Px	12/19/08	1/30/2009
Px	01/21/09	2/28/2009
Ix	06/11/09	

**Issue:** Chapter 1-B  
The Department Should Adhere to Pre-Draw Requirements

The Department's policies and procedures document the pre-draw requirements that should be met prior to reimbursement of the first draw. The pre-draw requirements include: an executed contract, a copy of the county's audit or a certification letter from a certified public accountant, an authorized signatories form, a local resolution and a certification of exemption form. The border field officers are required to ensure that all pre-draw documentation is received prior to approving payment of the first draw.

A contract tracking sheet is used to ensure pre-draw requirements are met. However, the pre-draw section of the contract tracking sheet is not consistently completed by staff. Without documenting that the pre-draw requirements were met, the Department could reimburse a county that has not met the requirements. In a review of the nine contracts for which draws were reimbursed, four (44.4%) did not contain a copy of the required certification of exemption form. 24 CFR 58.34 (b) requires the responsible entity to provide a written notice describing the activities the entity considers to be exempt activities. In addition, 14 draws were reimbursed prior to the receipt of the report of real property acquisition.

**Recommendations**

The Department should:

- ensure that all pre-draw requirements are met prior to reimbursing the first draw, and
- ensure that the contract tracking sheet is completed for each contract.

**Status:**

- 06/11/09 - The draft program rules were presented at the May 2009 board meeting and were published in the Texas Register on June 5, 2009. We anticipate final adoption of the program rules in July 2009. The SOP and required attachments were revised and made effective May 15, 2009. Management (OCI Director) will oversee the adherence of all Rules, SOPs and checklists.
- 01/21/09 - Currently revising SOP and updating contract tracking sheet. Also creating compliance checklist to ensure quality controls are built into the normal and recurring operating activities. This will ensure consistency by comparing the written standard operating procedures required to what actions are actually being performed by the OCI staff. This will allow for reviews of other's work and to reduce the risk of error or inappropriate actions. SOP is also being updated to reflect the OCI Director's quarterly review of all contract tracking sheets.
- Finalizing review of SOPs and contract tracking sheet for completeness and accuracy.
- 12/19/08 - Management agrees with the recommendation and will revise Section 12 of the SOPs, Monitoring and Oversight, to emphasize management oversight of adherence to SOPs and checklists.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
98	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 5/31/2009
<b>Division:</b> Office of Colonia Initiatives			Px	01/21/09 5/31/2009
<b>Section:</b>			Px	06/11/09 7/30/2009

**Issue:** Chapter 1-C  
Administrative Threshold Requirements Should Be Met

The border field officers are required to review the reimbursements paid to counties to ensure compliance with the administrative thresholds detailed in the Community Development Block Grant Implementation Manual (CDBG Manual). The administrative thresholds set limits on the use of administrative funds in proportion to the use of other funds. For example, the first administrative threshold allows up to 50% of administrative funds to be drawn prior to the start of construction, and the second allows an additional 40% to be drawn after the start of construction but before submission of the close out documents. Three of the nine contracts we reviewed (33.3%) exceeded the first or second threshold requirement. Several of the other contracts reviewed had an extremely high rate of administrative expenditures reimbursed compared to low public service and rehabilitation expenditure rates. The border field officers should not reimburse administrative expenditures incurred by the counties if they will exceed the administrative thresholds.

The administration thresholds used by the Department were developed by ORCA to fit their Community Development Block Grant (CDBG) Program, which consists primarily of large infrastructure projects. The Department's self-help center construction projects are primarily individual homes and public service projects. Using the administrative thresholds set by the ORCA means that 90% of the administrative funds can be reimbursed to the county after the start of construction on only one home.

**Recommendation**

The Department should develop its own administration thresholds that reflect a reasonable expenditure of funds for the Self-Help Center Program.

**Status:**

- 06/11/09 - Draft Program Rules were presented to the Department's Board on May 21, 2009. Administrative thresholds were created and included in the draft rules see section 3.7. Final adoption of the program rules are anticipated in July 2009.
- 01/21/09 - Currently revising Colonia Self-Help Center Program Rules. Administrative thresholds have been developed and will be included in program rules. Draft program rules will be presented to the TDHCA Board of Directors at the March 2009 board meeting.
- 12/19/08 - Management agrees with the recommendation and will develop and incorporate in the Colonia SHC Program Rules administrative thresholds that are both tailored to the program and more complex than the thresholds currently enforced through the TxCDBG Implementation Manual.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
99	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009
<b>Division:</b> Office of Colonia Initiatives			Dx	01/21/09 2/28/2009
<b>Section:</b>			Ix	06/11/09

**Issue:** Chapter 2  
The Department Should Comply with the Requirements of the Davis-Bacon Act

The U.S. Department of Housing and Urban Development (HUD) has confirmed that the Davis-Bacon Act applies to self-help center contracts. The Davis-Bacon Act of 1931 requires the payment of not less than the prevailing wage to workers performing construction work financed in whole or part with assistance received under the Housing and Community Development Act of 1974. This act states that CDBG funded contracts for the rehabilitation of residential property consisting of not less than eight units must comply with the Davis-Bacon Act.

The self-help center contracts are not currently in compliance with the Davis-Bacon Act. Five of the ten contracts reviewed do not contain the required prevailing wage language in the special conditions section of the contract. However, for the five contracts that did contain the required language, documentation of the prevailing wage rate could not be located in the contract files. In addition, the Department's self-help center contracts do not require the county to ensure that the nonprofit administrators of the self-help centers comply with the Act. When a contractor is required to comply with the Davis-Bacon Act, they must pay their employees on a weekly basis. In the 12 draws reviewed, there was no documentation to support that the contractors paid their employees weekly.

Due to miscommunication regarding the applicability of the Davis-Bacon Act, the Department has not required the counties to submit some of the required close-out forms prior to closing the contract. The forms that should have been submitted are the Final Wage Compliance Report (Form A), Certificate of Construction Completion (Form A709) and a Start of Construction Notice (Form A706). According to the CDBG Manual, a start of construction notice and a certificate of construction completion are required for each house rehabilitated or reconstructed under the program.

**Recommendations**

The Department should:

- ensure that the requirement for compliance with the Davis-Bacon Act is included in all future contracts,
- maintain documentation in the contract files to support compliance with the Davis-Bacon Act, and
- require counties to submit the required close out forms prior to contract close out.

**Status:**

06/11/09 - Tracking sheet revised to track Davis-Bacon. All new contracts contain the Davis-Bacon provisions. Staff has been trained on the Davis-Bacon trigger of 8 homes or more under a single construction contract. Reviewed existing contracts to determine if Davis Bacon was triggered.

01/21/09 - In the Colonia SHC Program, housing rehabilitation may be performed in different ways, but the Performance Statements of the respective contracts always identify the manner of the rehabilitation; rehabilitations may be 100% self-help construction, a mixture of self-help construction and contract labor, conducted in coordination with construction skills training courses or contracted out entirely to construction contractors. The OCI is currently routing internally through the legal and executive offices a draft letter to HUD requesting a written response as to whether or not Davis-Bacon applies to single family, owner-occupied structures rehabilitated in whole or part through CDBG funding.

Currently routing letter for approval. Draft letter has been in route since December 2008.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
12/19/08 -	The Department has three previous determinations from the US Department of Housing and Urban Development (HUD) on the applicability of Davis-Bacon. These earlier determinations reflect that Davis-Bacon is not triggered for an individual residential structure involving less than 8 families. Staff is seeking further written clarification from HUD on the applicability of Davis-Bacon on multiple single family buildings and the Self Help Program design and will, if necessary, modify all existing contracts and add Davis-Bacon compliance as a Special Condition to all contracts to lend the appropriate leverage to require compliance. Currently, only contracts which contain construction work on public property, such as the construction of a self-help center or the portion of house-to-line water and/or wastewater connections that require access lines on public easements require documentation of compliance with Davis-Bacon. Counties are currently required to submit all required close-out documentation prior to contract close-out or the contract will not be closed and proof of Davis-Bacon compliance will be added if needed.	

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
100	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 3/30/2009
			Px	01/21/09 3/30/2009
			Ix	06/11/09

**Division:** Office of Colonia Initiatives  
**Section:**

**Issue:** Chapter 3-A  
Only Authorized Staff Should Approve Environmental Clearances

The Department has not designated the certifying officer for the Self-Help Center Program's environmental clearances. Certifying officers for the Department are determined by the Department's executive director and approved by HUD prior to their authorization to approve environmental clearances. Three individuals at the Department have been approved by HUD to sign off on environmental clearances submitted by subrecipients of the Department's other programs. At least one of nine contract files reviewed had an environmental clearance that was approved by an individual who was not authorized to approve the clearance.

In addition, the Department does not retain the environmental clearance documentation submitted by the counties once the clearance has been approved. OCI's policy is to return all documents to the counties once the Department has approved the clearance. However, since the Department is acting on behalf of HUD when certifying the clearance, copies of the documentation used to approve the clearance should be retained by the Department to support these decisions.

- Recommendations  
The Department should:
- designate a certifying officer for the Self-Help Program's environmental clearances to ensure that only approved staff signs off on environmental clearances, and
  - retain copies of all environmental clearances after approval.

**Status:**

06/11/09 -	The SOP and Quarterly Reports have been revised. Environmental reviews will be conducted by the Department's environmental officer in the newly created Program Services Department.
	The SOP took effect on May 15, 2009. The Cameron, Webb and Hidalgo Counties' environmental reviews were conducted by the Department's environmental officer.
01/21/09 -	SOP and contract tracking sheets are being revised
12/19/08 -	Management agrees with the recommendation to designate a certifying officer to perform the review of environmental assessments for Colonia SHC contracts. Management will revise Section 8, Environmental Determination, of the Colonia SHC SOPs to allow for a Department wide SOP to address all environmental issues for all federally-sourced funds administered by the Department in order to ensure uniformity of policy and procedure.
	Management also agrees with the recommendation to maintain environmental assessments in the contract file instead of returning all or parts of the assessments to the respective Responsible Entities. The filing procedure, including the recording of site-specific information (if deemed necessary by the Environmental Specialist) will be detailed in the revision of Section 8 of the SOP.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
101	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 3/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

Px	12/19/08	3/30/2009
Px	01/21/09	3/30/2009
Ix	06/12/09	

**Issue:** Chapter 3-B  
Environmental Clearances Should Be Completed and Documented Prior to Starting Construction and Paying Draws

The Department is required to review and approve the counties' environmental clearances prior to reimbursing expenditures incurred for construction or rehabilitation of a home. In the draws we reviewed, the Department reimbursed counties for costs incurred prior to completion of the environmental clearance. In addition, draws were approved for homes where an environmental clearance was never completed.

The contract tracking sheet used by the Department is not sufficient to determine if the environmental clearance was approved prior to draws being reimbursed because the sheet only has one box to check if the clearance was approved. The document does not allow the border field officer to indicate if site-specific reviews are needed for the contract or to indicate which units have been cleared. In addition, once the environmental clearance is approved, it is not consistently posted to the environmental screen in ORACLE, which is the automated system used jointly by ORCA and the Department to track information on the self-help center contracts. The environmental clearance approval is often only found in the contract file in Austin. The border field staff reviews the environmental screen in ORACLE and the contract tracking sheet to determine if the environmental clearance was approved prior to approving a draw for payment.

In one instance, the Department discovered that a county was conducting work without correctly completing an environmental clearance. The Department contacted HUD to determine how to correct the issue. An environmental finding letter was sent to the county detailing the required corrective actions to be completed prior to the reimbursing the costs under the contract. However, the Department reimbursed expenditures after the environmental clearance was obtained but before all the corrective actions detailed in the letter were completed.

**Recommendations**

The Department should:

- ensure that all environmental clearances are received and documented prior to the start of construction or before expenses are incurred,
- verify that all required corrective actions were taken prior to the payment of draws,
- revise the contract tracking sheet to include information on site-specific clearances, and
- ensure that the environmental clearance information is posted to ORACLE and the contract tracking sheet correctly and on a timely basis.

**Status:**

06/12/09 - SOP and quarterly report were revised to track environmental and site specific clearances.

The SOP took effect on May 15, 2009. All environmental clearances are being conducted by Program Services/HOME Division.

01/21/09 - SOP and contract tracking sheets are being revised

12/19/08 - Management acknowledges the importance of ensuring that all environmental requirements are satisfied prior to releasing funds; however, it should be noted that there are several CDBG eligible activities utilized in Colonia SHC contracts that may be environmentally cleared on an area served basis or classified as exempt or categorically excluded and can be reimbursed prior to the clearance date of a full environmental assessment and/or prior to approval of site-specific clearances.

Management agrees that the Contract Tracking Sheet should be revised to include the contract-specific requirements for site-specific environmental assessments and that environmental clearance information should be posted to ORACLE, noted correctly on the contract tracking sheet and done so on a timely basis. A Department wide SOP for the environmental review process will be developed which will include language to clarify a contract's requirements or lack thereof for site-specific clearances. Furthermore, Section 8, Environmental Determination, of the Colonia SHC SOPs and the ORACLE SOP will be revised to ensure that all information regarding environmental clearances are accounted for and documented.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
102	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009
			Px	01/21/09 2/28/2009
			Ix	06/12/09

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 4-A  
The Department Should Ensure That Counties Comply with the Special Conditions Outlined in the Contracts

The contracts between the Department and the counties for the Self-Help Center Program identify the special conditions that are required before the Department will release funds. There are standard conditions required in every contract, as well as special conditions that were added to the contracts that received fiscal year 2007 funds. The Department is not in compliance with the special conditions related to public service policies, rehabilitation guidelines, model subdivision rules, documentation of contractors' registration with the Texas Residential Construction Commission, and flood insurance approval.

All of the 21 draw requests we reviewed reimbursed counties for their expenditures even when the counties did not meet the required special conditions:

- \$ 203,291 was reimbursed prior to the Department receiving documentation that the counties had approved and were enforcing the model subdivision rules.
- \$ 21,930 for public service was reimbursed without approved public service policies, and
- \$ 24,368 for rehabilitation was reimbursed without approved rehabilitation assistance guidelines.

It was impossible to determine if all of the contractors that were required to register with Texas Residential Construction Commission were actually registered because the homes that were constructed or rehabilitated were not added or updated in ORACLE to include the total budget for each unit. In addition, the required special condition for flood insurance was not located in any of the nine contracts reviewed. Finally, the special conditions were not documented in ORACLE.

Recommendations

The Department should:

- ensure that all required special conditions are included in the contracts and enforced prior to reimbursing counties for their expenses, and
- update the ORACLE system to include the special conditions and the total project budget for each home constructed or rehabilitated.

**Status:**

06/12/09 - The draft program rules will require the proposal to contain all special condition requirements, except executed contract with the Department and environmental clearances. The SOP, tracking sheet and quarterly report were revised to track all required special conditions and total project costs for each home constructed or rehabilitated.

The SOP took effect on May 15, 2009. Final program rules will be presented to the Board on July 30th for final adoption.

01/21/09 - SOP and contract tracking sheets are being revised

12/19/08 - Management agrees that all required Special Conditions should be included in the contracts and enforced prior to reimbursing counties for expenditures as applicable to the conditions detailed in the individual Special Conditions. Management will revise Section 12, Monitoring and Oversight, of the Colonia SHC SOPs to emphasize management oversight of compliance with all SOPs and will develop reports and checklists to assist in the process.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
103	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 5/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 4-B  
The Department Should Ensure That All Required Amendments and Modifications Are Complete

If a change to the original contract with a county is required during the contract period, the change is normally handled by a contract modification or a contract amendment. Contract modifications are required for minor changes that do not significantly alter the number of beneficiaries, location, types of activities, scope of work or budget line item totals. Modifications are also used to change the performance statement or the contract budget. According to the CDBG Manual, contract modifications are changes in quantities or beneficiaries of less than 15%. In all three of the modifications we reviewed, there were changes of more than 15% to the quantities or beneficiaries, which requires a contract amendment, not a modification.

The CDBG Manual also states that any changes to private property require a full amendment. Two of the three performances statement modifications we reviewed (66.7%) contained changes to private property but were approved by the Department as a contract modification.

Amendments are required when the changes significantly alter the scope of the work or the activities can not be completed within the contract period. Amendments are developed to change the performance statement, contract budget or extend the period of the original contract. According to the CDBG Manual, extensions of the contract period must be submitted at least 30 days prior to the expiration date of the contract. Two of the four contracts with an approved extension (50%) were not requested at least 30 days prior to the expiration date.

The CDBG Manual details the documentation that is required for a contract amendment. Each amendment requires the submission of a letter, along with the supporting documents. For a performance statement amendment, the letter requires the county to describe the proposed changes, and the reason(s) for the changes. For budget amendments, the letter requires the county to describe the reason(s) for the transfer of funds and the impact of the changes on the original scope. Amendments that extend the contract period require a letter to detail the extenuating circumstances which led to the need for the extension. However, the required information is not consistently included in the letters. Three of six amendments did not have all of the required information in the associated letters.

A performance statement amendment requires a project map that shows the location of the original and amended project activities, original and amended target areas, and the geographic area covered in the original environmental assessment. None of the three performance statement amendments we reviewed contained the required project map. In addition, a contract management form is required for all amendments and modifications. Five of the nine amendments and modifications we reviewed did not contain the contract management form.

**Recommendations**

The Department should:

- comply with the requirements for contract amendments and modifications, and
- ensure that all requests for amendments or modifications contain the required documentation.

**Status:**

- 06/12/09 - The draft program rules were presented to the Department's Board on May 25, 2009 and published in the Texas Register on June 5, 2009 for public comments. The SOP and the Contrat Management Form were revised to comply with the requirements for contract amendments and modifications. The SOP took effect May 15, 2009.
- 01/21/09 - Program rules are currently being revised and checklists are currently being developed.
- 12/19/08 - Management understands and appreciates the concerns of the audit in this area of the program and welcomes the more formalized amendment procedure to document and justify contractual change as opposed to that of a modification. Management will revise its program rules and develop checklists to ensure that contract changes include all required documentation.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
104	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 4-C  
All Contract Close-Out Reports Should Comply with the Reporting Requirements

Px 12/19/08 1/30/2009  
Px 01/21/09 2/28/2009  
Ix 06/12/09

The counties are required to submit close-out reports immediately upon completion of all construction activities identified in the contract or no later than 60 days following the contract termination date, whichever comes first. We reviewed five contracts that were closed-out between June 2007 and June 2008. The close-out reports are not consistently date stamped by staff. This makes it difficult to determine if the reports were submitted on time. However, we determined that none of the five close-out reports were received within 60 days of the contract termination date by reviewing the close-out report or the information posted to the ORACLE system. The following issues were also noted in our review of the close-out process:

- According to the Department's standard operating procedures, "the border field officers are required to review the close-out documentation to ensure all applicable questions on the close-out documentation are answered completely and to identify any potential problems in the closure of the contract." However, there is not a standard review sheet to ensure that the review is performed consistently between the three border field offices.
- Two of the three close-out reports did not match the total beneficiaries documented in the contract.
- One of the three close-out reports did not match the total quantities documented in the contract. The close-out report was received by OCI staff in August 2007, but these problems were not identified until ORCA completed a monitoring visit in March 2008.
- The CDBG Manual requires the counties to document the costs of the fair housing activity performed. No documentation was located in any of the three close-out reports that indicated the costs of these activities.
- During the close-out process, staff is required to update the ORACLE system with the dates the individual reports are received and to enter information from the reports in the performance screen used for the HUD performance measure reporting requirements. There was no information posted to the system for any of the five contracts we reviewed.
- The contractor and professional service providers are not posted to ORACLE. Without the contractors or the providers posted to the system it makes it difficult to determine if the border field officers are reviewing to ensure all the contractors that met the minority business enterprise requirements are documented in the minority business enterprise close-out report.

**Recommendations**

The Department should:

- date stamp all close-out reports and ensure that the required reports are received within the 60 day limit,
- develop a standard review sheet to ensure consistency in the review of close-out documentation,
- ensure that all required close-out documents are received, and
- verify that all close-out, contractor and provider information is posted to ORACLE.

<i><u>Issue #</u></i>	<i><u>Report Date</u></i> <i><u>Auditors</u></i>	<i><u>Report Name</u></i> <i><u>Audit Scope</u></i>
<b><u>Status:</u></b>		
06/12/09 -	The Standard Operating Procedures (SOP) were revised to date stamp all documents received including close-out reports and to ensure reports are received on time. Close-Out Report checklist was also created and attached to SOP. The checklist requires certain information to be posted to ORACLE.	
	The SOP took effect on May 15, 2009 which includes the Colonia Self-Help Center Contract Closeout Checklist to uniformly review all contracts.	
01/21/09 -	SOPs and checklists are being revised.	
12/19/08 -	Management agrees with the recommendations. A standard review sheet for close-out documents and a checklist for close-out review procedures will be created. The measures will be included as attachments to Section 15, Colonia SHC Contract Close-out Procedure, and will be utilized starting with the next submission of close-out documents.	

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
105	12/19/2008 Internal Audit	Internal Audit Report on the OCI's Self-Help Center program Review of the draw processing and desk review procedures performed by the border field sta	Px	12/19/08 1/30/2009
			Px	01/21/09 2/28/2009
			Ix	06/12/09

**Division:** Office of Colonia Initiatives

**Section:**

**Issue:** Chapter 5  
The Department Should Ensure That Counties Comply with All Reporting Requirements

Counties are required to submit quarterly progress reports to the Department by the 20th day of the month following the end of each quarter. The border field officers review the reports to ensure they are received on time, completed correctly and that the information in the report is accurate. However, there is no standard review document used to ensure that all requirements are met by the counties and that the review is consistent between border field offices.

According to the CDBG Manual, contracts are out of compliance for late or incomplete quarterly progress reports and remain out of compliance until all issues are satisfactorily resolved. The quarterly reports are not consistently date stamped to document when they are received. Quarterly reports are often resubmitted multiple times, making it difficult to ensure that draws are not reimbursed if the contracts are out of compliance for late or incomplete quarterly reports.

The Department added a special condition to the contracts for two counties requiring them to submit monthly progress reports to document the progress made towards meeting the contract performance statement by the end of the contract period. However, we could not locate any monthly reports for either of the contracts.

The border field officer is required to review the contract to ensure the counties are complying with the expenditure thresholds established by the Texas Administrative Code (10 TAC §3.14). The code requires that 6-month, 18-month, 30-month, 42-month and 50-month milestones are met. We reviewed eight contracts that were required to meet the expenditure thresholds. Four of the eight contracts reviewed (50%) did not meet the expenditure thresholds. In addition, the Department is not keeping track of the progress of each of the contracts to determine if the expenditure thresholds are met. If the threshold requirements are not met, there is a risk that the contracts would not be fulfilled, and the Department could end up de-obligating self-help center funds.

The Department's standard operating procedures state that a letter should be sent to a county if the border field officer determines that the county is not on track to meet the next applicable milestone, or if the county has not met its current milestones. When a border field officer determines that a county has not met a milestone, an email should be sent to OCI management to inform them of the violation. The border field officers and management then determine what actions to take. Pre-milestone and milestones letters are not consistently sent to the counties or documented on the contract tracking sheet. In all four contracts that did not meet thresholds, there was no documentation that indicated management was informed of the violation.

**Recommendations**

The Department should:

- develop a standard review sheet to ensure quarterly report requirements and expenditure thresholds are met,
- track the progress of each of the contracts to determine if the expenditure thresholds are met,
- enforce the special condition requiring monthly progress reports, and
- ensure that pre-milestone and milestone letters are sent to the counties and documented on the contract tracking sheet as required.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
<b>Status:</b>		
06/12/09 -	The Standard Operating Procedures (SOP) were revised and Quarterly Report Evaluation checklist was created to evaluate quarterly reports. Contract Tracking Sheet was also revised to ensure proper tracking of milestones and special conditions.	
	The SOP took effect on May 15, 2009 which includes the quarterly report evaluation checklist and revised contract tracking sheet.	
01/21/09 -	Currently revising SOP and updating contract tracking sheet. Also creating compliance checklist to ensure quality controls are built into the normal and recurring operating activities. This will ensure consistency by comparing the written standard operating procedures required to what actions are actually being performed by the OCI staff. This will allow for reviews of other's work and to reduce the risk of error or inappropriate actions. SOP is also being updated to reflect the OCI Director's quarterly review of all contract tracking sheets.	
12/19/08 -	The Department agrees with the recommendation to develop a report to allow management to verify the status of each contract with regards to quarterly reporting requirements, expenditure thresholds, pre-milestone and threshold/milestone letters. A contract tracking sheet has already been developed to track submission of quarterly reports, quarterly review letters (if necessary), thresholds, and pre-milestone letters – this tracking sheet will be revised to ensure that it is as comprehensive as it needs to be. Management will also revise Section 12 of the SOPs, Monitoring and Oversight, to emphasize management oversight of adherence to SOPs and checklists by all staff. Management agrees with the need to provide oversight to ensure that monthly reporting requirements are met for the duration of a suspension. Management will develop and implement a tracking system to ensure timely receipt of monthly reports.	

106	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	<u>Status</u>	<u>Target Date</u>
			Px	06/11/08 11/30/2008
			Ix	12/01/08

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 7-A  
Community Services Should Require All Certifications Listed in Federal Law

Community Services requires applicants for ESGP funding to certify to certain provisions that are required by federal law. The certification that is currently used requires the subrecipient to certify that all laws and regulations are followed. However, Title 42, Chapter 119, Subchapter 1, Part B, Section 11375 of the U.S. Code specifically states that a certification is required for the following items:

- any renovation carried out with ESGP assistance shall be sufficient to ensure that the building involved is safe and sanitary, and
- the renovation will assist homeless individuals in obtaining:

(A) appropriate supportive services, including permanent housing, medical and mental health treatment, counseling, supervision, and other services essential for achieving independent living; and

(B) other Federal, state, local, and private assistance available for such individuals.

Recommendation

The certification signed by the applicants should be revised to include the required statements.

**Status:**

12/01/08 - The 2009 ESGP NOFA included all required certifications. Board approved 11/13/08.

06/11/08 - The application for Emergency Shelter Grants Program funds will be expanded to include all required certifications as referenced above.



<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
107	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 11/30/2008
<b>Division:</b> Community Affairs			Ix	12/01/08
<b>Section:</b> Community Services - CSBG				

**Issue:** Chapter 7-B  
An Exception to the Documentation Required for Eligibility Should be Included on the Application

For applicants who have not received ESGP funds in the past, there is an exception in the Texas Administrative Code for requiring the documentation of participation of homeless individuals on the applicant's governing board. This exception is not considered on the application eligibility review sheet, which could cause an eligible applicant to be disqualified. The Texas Administrative Code states that applicants who have not previously received ESGP funds from the Department are exempt from this requirement, but must comply with the requirement prior to execution of a contract with the Department.

Recommendation  
The application eligibility review sheet should be revised to include this exception.

**Status:**

- 12/01/08 - The prescreening instrument was updated to include the exception and will be utilized during the 2009 application review.
- 06/11/08 - The pre-screening Emergency Shelter Grants Program application form will be revised to include this exception.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
108	6/11/2008 Internal Audit	Audit of the Community Services Block Grant and Emergency Shelter Block Grants Review of the draw processing and monitoring functions of the Community Affairs Division's	Px	06/11/08 11/30/2008
			Ix	12/01/08

**Division:** Community Affairs

**Section:** Community Services - CSBG

**Issue:** Chapter 7-C  
Requirements in the ESGP Application Should be Revised

In comparing the ESGP application to the Texas Administrative Code, there are areas where the application and the Texas Administrative Code do not match:

- The application states that the non-profit collaborative applicants are required to submit a ruling documenting their status as a 501(c) tax-exempt entity. The ruling should be on IRS letterhead, legible and signed by the IRS District Director. However, the Texas Administrative Code Section 5.204 (a)(2) states only that the Department prefers the eligibility documentation to be submitted in this way but also provides other options for documenting eligibility.
- The instruction section of the application, (Attachment G – Match) is missing requirements from the Texas Administrative Code Section 5.204(d)(2), which requires the applicant to submit a letter from the realtor or appraiser for the value of a donated building if documenting a donated building as part of their match. Or the applicant can submit the title, annual salary, percentage of time dedicated to ESGP activities, source of funds and the dollar amount for employee positions used as a match.
- In the application packet, applicants who are applying for the special initiative for homelessness prevention funds are required to answer the questions detailed under that section instead of developing a project narrative. However, the Texas Administrative Code does not exclude applicants who are submitting a special initiative application from the requirement to provide a narrative along with the application.
- In the collaborative application section, it states that, "a lead organization that provides only administrative support and not direct client services is excluded from the requirement of submitting attachments B, C and D", however this exception is not in the Texas Administrative Code.

Recommendation

Revise the application to comply with the Texas Administrative Code.

**Status:**

- 12/01/08 - 2009 ESGP NOFA was revised and approved by the Board 11/13/08. In response to the first bullet in 7-C, the revised TAC rule for ESGP was streamlined per Legal's instructions and the proposed rule 5.307(a)(2) states applicants must submit documentation as a 501(c) tax-exempt entity. The understanding with Legal was that the NOFA would provide any additional detail on what documentation may be submitted. Page 13 of the 2009 ESGP NOFA specifies what may be submitted. Regarding the second bullet, again the proposed ESGP TAC rule, 5.307(c)(2) was streamlined and now only identifies match sources which can be utilized. Page 14 of the 2009 ESGP NOFA specifies what documentation should be submitted. Regarding the third bullet, the 2009 ESGP NOFA no longer includes applying for a special initiative project. Regarding bullet four, the exception which was in the 2008 ESGP Application is not in the 2009 ESGP NOFA. Proposed rules were approved by Board November 2008 and will be codified January 2009.
- 06/11/08 - Management will revise the Emergency Shelter Grants Program application to comply with the Texas Administrative Code.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
109	8/1/2008 HUD	HUD's Monitoring Report on CDBG Disaster Funds Management Review of the Department's CDBG Supplemental Disaster Funds.	Ix	08/29/08

**Division:** Disaster Recovery

**Section:** CDBG

**Issue:** Finding Five: Incorrect Project Classification

**CONDITION:** The review of TDHCA's environmental files revealed that the Environmental Review Record for SETRPC included reconstruction activities that had been classified as Categorically Excluded under 24 CPR 58.35(a)(4) (An Individual Action). This classification is only appropriate when a project developing five or more housing units on scattered sites includes units that are no closer than 2,000 feet. Programs may not use the classification of Categorical Exclusion when they do not comply with this condition. TDHCA staff discovered the error that more than 5 units are within 2000 feet of each other prior to the monitoring visit.

**CRITERIA:** The regulations at 24 CPR 58.35(a) (4) allow for certain projects for individual actions to be classified as Categorically Excluded from NEPA review, thus allowing for a relatively simpler environmental review than for more complex projects. Unfortunately, the State has used this classification for a project that does not meet the qualifying conditions. This error in classification has allowed the project to proceed without the proper depth of environmental review required by the regulations. Currently, HUD has reviewed the TDHCA Operating Procedures that correctly describe the classification process. Because of the tiered nature of this project, the relative vague project design, and the perceived urgency to provide needed resources to affected individuals, these procedures were not followed. This error appears to be compounded by the intense workload imposed in a condensed time period. Staff clearly understands the regulations and applications, but was unable to immediately and thoroughly review

**CORRECTIVE ACTION:** Because there are many more housing reconstructions yet to be funded, TDHCA must prepare a tiered Environmental Assessment for the balance of this project, including a revised public notice and Request for Release of Funds (RROF). Please work with HUD to submit these documents as soon as possible.

**Status:**

08/29/08 - Although the Finding was specific to SETRPC, TDHCA explored the need for an Environmental Assessment in all three Councils of Government (COG) administering funding under Supplemental Round 1 and after plotting the addresses of all assisted households determined that only the South East Texas Regional Planning Commission (SETRPC) was in violation of 24 CFR 58.35(a)(4). The Department has provided technical assistance to SETRPC through on-site visits and conference calls, and reviewed documents throughout the process. TDHCA has received and reviewed an Environmental Assessment performed by SETRPC and has accepted it as complete, allowing SETRPC to publish a Finding of No Significant Impact and a Notice to Request a Release of Funds. The first comment period of 15 days has elapsed and a Request for Release Of Funds, Notice, and Affidavit was overnighted to HUD Headquarters on August 4, 2008. The release of funds occurred August 25, 2008 (Attachment B).

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>	<u>Status</u>	<u>Target Date</u>
110	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s	Px	08/18/08 11/30/2008
<b>Division:</b> Information Systems			Tx	11/08/08 11/30/2008
<b>Section:</b>			Ix	01/21/09

**Issue:** Chapter 3-B  
The Department Lacks Detailed, Written Password Policies and Procedures

The Department uses adequate password parameters to ensure the use of "strong" passwords. However, the Department could improve its overall password controls by updating its documented information technology policies to reflect its current password criteria and other detailed password procedures. In addition, the Department uses shared passwords to access certain restricted information in the MITAS System and does not consistently enforce its policy requiring shared MITAS System passwords to be changed at least every six months.

The Department's information technology policies could be improved by including detailed password criteria and procedures. Although the Department's current use of information technology password parameters ensures the use of "strong" passwords (see text box), it has not documented these parameters and other password procedures in its written policies and procedures. Written, detailed policies and procedures are an important tool in ensuring consistency in the event of staff turnover and other operational changes.

A detailed written policy should include:

- A prohibition against the use of recently used passwords.
- The Department's criteria for the minimum age of passwords before they can be changed, as well as the minimum password length and complexity.
- A maximum password age, requiring all passwords to be changed on a regular basis.

The Department uses shared passwords to access certain protected screens in the MITAS System. Access to these screens permits the user to create, edit, or delete certain loan information contained in the MITAS System. Several Department supervisory employees have access to these passwords and grant access to other personnel on an as-needed basis. Because of the use of shared passwords, the Department cannot identify the users who access the screens and alter the data. Furthermore, the Department's policies do not address who should be granted access to these password protected screens or the assignment of passwords. Implementing a role-based access system would more effectively protect the MITAS System. A role-based access system restricts access to users based on their job functions, with permissions assigned to specific roles.

The Department does not consistently enforce its policies that require passwords to be changed periodically. The shared passwords discussed above have not been changed in nearly one year, at a minimum. Three of the passwords have not been changed in more than 15 months. Department policy requires shared MITAS System passwords to be changed every six months. Older passwords are more likely to be ascertained by unauthorized individuals. An agency should require users to change their passwords as often as necessary for its environment.

Recommendations

The Department should:

- Update its written policies to document current password parameters and procedures.
- Establish role-based access to the MITAS System and eliminate the use of shared passwords.
- Ensure that users comply with its policy requiring shared MITAS System passwords to be changed at least every six months if the Department continues the use of shared passwords.

<u>Issue #</u>	<u>Report Date</u> <u>Auditors</u>	<u>Report Name</u> <u>Audit Scope</u>
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**Status:**

- 01/21/09 - On November 24, 2008, the Department updated TDHCA Standard operating Procedure 2264.31, "Mitas Security" with a policy requiring that the limited number of system users with access to password-protected functions and fields within screens performed associated password changes only at their workstations for tracking purposes.
- 11/08/08 - Regarding password parameters, the Department has updated TDHCA Standard Operating Procedure (SOP) 1264.01, "User Accounts and Network Access," with written policies to document password parameters and procedures.  
The Department has consulted with the MITAS vendor regarding password-protected functions and fields within screens, and the vendor has confirmed that these password-protected features cannot be removed. Because of this, the Department will establish a policy requiring that the limited number of system users with access to these passwords perform changes only at their workstations for tracking purposes.
- 08/18/08 - The Department agrees to implement the recommendations by:
  - Updating TDHCA Standard Operating Procedure (SOP) 1264.01, "User Accounts and Network Access," with additional policies to state the password parameters that are already systematically enforced for network accounts through Windows domain settings.
  - Eliminating the use of shared passwords in MITAS and establishing rolebased access to the system screens that currently require a shared password, which will also eliminate the need for the policy requiring shared MITAS passwords to be changed every six months.

111	8/18/2008 State Auditor's O	Audit of the Single Family Mortgage Revenue Bond Program at TDHCA Review of the Department's processes of managing Program bond payments, interest rate s
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<u>Status</u>	<u>Target Date</u>
Px	08/18/08
Ix	11/08/08

**Division:** Information Systems

**Section:**

**Issue:** Chapter 3-D  
The Department Does Not Conduct Tests of Its Disaster Recovery Plan in a Timely Manner

The Department conducted a test of its disaster recovery plan in June 2008. Prior to that time, the Department had not conducted a complete test since January 2006. Title 1, Texas Administrative Code, Section 202.24, and Department policy requires an annual test of the disaster recovery plan. A disaster recovery plan outlines steps staff should take to secure or recover information when a natural disaster or other business disruption prevents normal operations. Conducting timely tests of its disaster recovery plan can help the Department decrease its risk of losing data in the event of a disaster and ensure that the Department's mission-critical functions can be resumed as quickly as possible.

**Recommendation**

The Department should conduct a test of its disaster recovery plan at least annually and when major changes are made to the plan.

**Status:**

- 11/08/08 - The Department will conduct complete tests of its disaster recovery plan on an annual basis and when major changes are made to the plan
- 08/18/08 - The Department agrees with the recommendation and will conduct complete tests of its disaster recovery plan on an annual basis and when major changes are made to the plan. The Department notes that although a complete test of its disaster recovery plan was not completed in fiscal year 2007, it carried out disaster recovery testing activities such as restoring databases and files from backup tapes and evaluating backup scripts and schedules. Additionally, the Department's Disaster Recovery Team engaged in planning activities for the June 2008 test at intervals throughout fiscal year 2008.

**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Presentation and discussion of recent internal audit reports.

**Required Action**

None, information item only.

**Background**

**An Audit of Loan Servicing and Recycling of Program Income in the HOME Division**

The audit found that since September 2005, the HOME division has recycled \$12 million in program income. These program income funds were used to provide housing assistance to additional low-income Texans. Since the Department began tracking program income in 1993, \$28.8 million has been recycled. However, the accuracy of the Department's records needs improvement. In five of 23 (21.7%) zero balance homebuyer assistance loans, the Department did not collect the correct amount from the borrower when the property was sold and three borrowers were due money that had not been paid. In addition, six of six (100%) contract for deed files had closing costs that were less than originally estimated. Although unused funds are returned to the appropriate HOME program year, it may take as long as a year to reduce the homeowner's loan balance.

Generally, when documentation was available, the loan files reviewed complied with applicable laws, regulations and contract provisions. The Department has sufficient processes in place to ensure that the period of affordability is met for loans which require a period of affordability under the Department of Housing and Urban Development's (HUD) rules.

**Report on the Internal Audit Division's Quality Assurance and Improvement Program**

The Institute of Internal Auditors' International Professional Practices Framework (Standards), updated in January 2009, require that the director of internal audit develop and maintain a quality assurance and improvement program that includes both internal and external assessments of the internal audit division. The objective of the internal and external assessments is to evaluate the internal audit activity's conformance with the definition of internal auditing, the Standards and the code of ethics. The newly revised Standards require that the results of these periodic assessments are communicated to the board at least annually.

The internal audit division at the Department maintains an ongoing quality assurance program and performs ongoing monitoring as required. In addition, the internal audit division recently completed a self-assessment. The scope of this self-assessment included the audit projects with reports released between December 2007 and December 2008.

Based on the review of the audit working papers and the discussions with internal audit staff during this self-assessment, the internal audit division fully complies with the definition of internal auditing, the Standards, and the code of ethics. This opinion, which is the highest possible rating, means that policies, procedures and practices are in place to implement the Standards and that the requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function were met.

### **Recommendation**

No action is required.



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

[www.tdhea.state.tx.us](http://www.tdhea.state.tx.us)

Rick Perry  
GOVERNOR

Michael Gerber  
EXECUTIVE DIRECTOR

May 6, 2009

**BOARD MEMBERS**  
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Juan S. Muñoz, Ph.D.

To: The Governing Board and Audit Committee Members of the Texas Department of Housing and Community Affairs

Re: Internal Audit Report on Loan Servicing and Recycling of Program Income in the HOME Division

The internal audit division has completed its audit of the HOME division. This audit was performed to determine if the Department maintained accurate records for HOME division loans, recaptured the correct amount of HOME funds when properties were sold prior to the end of the affordability period, and recycled the program income from these loans.

The audit found that since September 2005, the HOME division has recycled \$12 million in program income. These program income funds were used to provide housing assistance to additional low-income Texans. Since the Department began tracking program income in 1993, \$28.8 million has been recycled. However, the accuracy of the Department's records needs improvement. In five of 23 (21.7%) zero balance homebuyer assistance loans, the Department did not collect the correct amount from the borrower when the property was sold and three borrowers were due money that had not been paid. In addition, six of six (100%) contract for deed files had closing costs that were less than originally estimated. Although unused funds are returned to the appropriate HOME program year, it may take as long as a year to reduce the homeowner's loan balance.

Generally, when documentation was available, the loan files reviewed complied with applicable laws, regulations and contract provisions. The Department has sufficient processes in place to ensure that the period of affordability is met for loans which require a period of affordability under the Department of Housing and Urban Development's (HUD) rules.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sandra Q. Donoho".

Sandra Q. Donoho, MPA, CIA, CISA, CFE, CICA  
Director of Internal Audit

Encl. (1)

cc: Michael Gerber, Executive Director  
Tom Gouris, Deputy Executive Director for Housing Programs  
Bill Dally, Chief of Agency Administration  
Jeannie Arellano, Director of the HOME Program  
David Cervantes, Director of Financial Administration



## **Executive Summary**

Since September 2005, the HOME division has recycled \$12 million in program income from principal and interest payments, and interest on program income and matching funds for both single-family and multi-family properties. These program income funds were used to provide housing assistance to additional low-income Texans. Since the Department began tracking program income in 1993, \$28.8 million has been recycled. We were unable to easily determine the exact fiscal years in which the loans were made that generated this program income due to the design of the State's Uniform Statewide Accounting System, which only allows deposits to be posted to the current appropriation year or to the two prior appropriation years. It may be possible to track the sources of program income using a more complex method, but the resulting information may not be useful enough to justify the extra time and expense of this process.

The accuracy of the Department's records needs improvement. In five of 23 (21.7%) of the zero balance homebuyer assistance loans tested, the Department did not collect the correct amount from the borrower when the property was sold. There were three instances where borrowers were due money that had not yet been paid. In addition, six of six (100%) of the contract for deed files tested had closing costs that were less than estimated. Although unused funds are returned to the appropriate HOME program year, the homeowners' loan balances are not reduced by the loan servicing department until instructed by HOME staff, which may take as long as a year.

Generally, when documentation was available, the loan files reviewed complied with applicable laws, regulations and contract provisions. The Department has sufficient processes in place to ensure that the period of affordability is met for loans which require a period of affordability under the Department of Housing and Urban Development's (HUD) rules.

### **Other Key Points**

- HOME loan payments are not always deposited within three days of receipt as required by the government code. In a random sample of 61 deposits covering a three-year period, 26.8% were deposited after the third business day.
- Construction loans are forgiven based on a pre-determined date, rather than when the construction is complete. Eight of 15 files (53.3%) we tested did not contain a certificate of completion issued prior to loan forgiveness.
- The Department does not have a process for ensuring that homeowners in the owner occupied housing assistance and the contract for deed programs continue to meet the principal residence requirement throughout the life of their loan.
- Eight of eight (100%) of the HOME division's policies and procedures are still in draft form several years after they were written.

*An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division*

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**Summary of Recommendations**

- The Department should ensure that the account balances are correct before payoffs occur and after closing statements are reviewed, and that overpayments are refunded promptly.
- The Department should ensure that loan payments are posted and deposited no later than the third business day after receipt.
- The Department should ensure that the term of the unsecured equity loan is sufficient to guarantee completion of construction prior to the loan maturity date, and obtain and include in the loan servicing file the documentation verifying the completion of construction.
- The Department should develop a method to help ensure that the principal residence requirement is met for those properties that require it and for which the Department is the first lien holder.
- The HOME policies should be finalized and approved as required by the Department's policy for division-level standard operating procedures.

**Summary of Management Responses**

Management generally agrees with the audit findings and has developed a schedule to implement the recommendations.

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## **Detailed Results**

### **Chapter 1**

## **Program Income from the HOME Division is Recycled, but the Accuracy of the Department's Loan Servicing Records Needs Improvement**

Since September 2005, approximately \$12 million in program income from HOME funds was recycled to provide housing assistance to additional low-income Texans. (see Table 1). The Department of Housing and Urban Development (HUD) requires that program income be used to fulfill draw requests prior to requesting program year funding. Since the Department began tracking program income in 1993, \$28.8 million has been recorded as program income and recycled. We were unable to easily determine the exact fiscal years from which the loans that generated program income originated because of the design of the State's Uniform Statewide Accounting System (USAS), which only allows deposits to be posted to the current appropriation year or to the two prior appropriation years.

### **Program Income**

Program income in the HOME division is the result of principal and interest payments from multifamily rental housing developed with HOME funds, payments of principal and interest from single family loans made with HOME funds, and interest earned on program income and matching funds. When these funds are received, they are entered into the Housing Contract System and tracked as program income.

In five of 23 paid in full (zero balance) homebuyer assistance loans tested (21.7%), the Department did not collect the correct amount from the borrower when the property was sold. Three instances were identified where borrowers were due money which had not yet been paid. In addition, contract for deed HUD-1 settlement statements were not reviewed in a timely manner. As a result, although unused funds are returned to the appropriate HOME program year, the homeowners' loan balances are not reduced by the loan servicing department until instructed by HOME staff, which may take as long as a year.

### **Chapter 1-A**

## **The Design of the Uniform Statewide Accounting System Prevents the Use of this System to Track Program Income by Year**

The method used to collect and record program income does not distinguish between the source program years. It is possible to identify the amount of program income that was collected and recycled, but it is not possible to readily identify the specific program year from which the program income was collected. The Department receives loan payments daily, and the source of these payments includes multiple program years. As payments are deposited to the treasury and posted to the State's Uniform Statewide Accounting System (USAS), the deposit can only be posted to one of three open years - the current appropriation year or one of the two previous appropriation years (USAS is the accounting system of record for the State of Texas, and is administered by the Comptroller of Public Accounts). Because of the design of USAS, the Department made a decision to allocate all program income deposits to the oldest open appropriation year.

*An Internal Audit Report on*

***Loan Servicing and Recycling of Program Income in the HOME Division***

As a result, it is not possible to determine from which program year the loans that generate this program income originated. For example, program income collected for the current fiscal year (September 2008 through August 2009) is posted as fiscal year 2007 program income. It may be possible to track the sources of program income using another more complex method, but the resulting information may not be useful enough to justify the associated time and expense. The table below summarizes the available data regarding program income.

Program Income Receipts and Draws for Program Income Years 2004 - 2007 (to date)					
Year	2004	2005	2006	2007	Total
Received	\$2,872,525	\$3,747,134	\$3,786,917	\$1,528,165	\$11,934,741
Drawn	\$2,903,163	\$3,747,134	\$3,786,917	\$1,512,842	\$11,950,056

Source: Data from the U.S. Department of Housing and Urban Development's Integrated Disbursement and Information System. This data is unaudited, however, we performed various comparisons and determined that this data is generally accurate.

Note: Since program income is recorded in the earliest available year in USAS, program income for fiscal year 2009 (through February 27, 2009) is recorded in program income year 2007 above.

Table 1

Chapter 1-B

**Loan Servicing Records Should Accurately Reflect the Principal Loan Balance**

In five of twenty-three paid in full (zero balance) homebuyer assistance loans tested (21.7%), the Department did not collect the correct amount from the borrower. This is because the balances for these loans were not accurately recorded in MITAS, which is the Department's internal accounting system used to track loans. The inaccurate balance information in MITAS resulted in the inaccurate recapture of funds from borrowers who sold their property. We noted instances where borrowers were due money which had not yet been paid. For example, we found one loan that was paid off in May 2007. This loan provided for 1/10 of the principal balance to be forgiven in each year of the ten-year term of the loan. The payoff was for the full amount, even though one year of principal should have been forgiven. This resulted in \$1,000 overpayment by the homeowner that has not yet been refunded almost two years later.

Six of twenty-nine (20.7%) homebuyer assistance files tested did not reflect the accurate principal balance. This is because payments were not posted on the anniversary date as required by the note. This means that the Department is not in compliance with the terms of the note for the down payment assistance program, resulting in an overstatement of the loan balances.

***An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division***

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In addition, contract for deed HUD-1 settlement statements are not reviewed in a timely manner. In six of six files tested (100%), the final closing costs were less than estimated. In four of the six files (66.7%), the reduction to the principal balance of the deferred loan was not posted to the homeowner's account. Although unused funds are returned to the appropriate HOME program year, the homeowners' loan balances are not reduced by the loan servicing department until instructed by HOME staff, which may take as long as a year.

**Recommendations**

The Department should:

- ensure that the information in the MITAS system reflects the actual account balance when processing loan payoffs,
- ensure that annual payment forgiveness is recorded on the anniversary date of the loan,
- refund overpayments promptly, and
- review the contract for deed HUD-1 settlement statements and reduce the loan balance in a timely manner.

**Management Response**

Management agrees with the recommendations and will in the next 90 days be revising the mechanism for forgiveness in new loans (Lora Myrick) and develop a mechanism for recording forgiveness based on confirmation from the owner of continued homeownership for existing loans (Stephanie D'Couto). Within the next 90 days, management will also ensure that refunds are addressed timely (Stephanie D'Couto) and will put a process in place to review the HUD-1 and communicate adjustments timely (Lora Myrick).

**Chapter 2**

**The Department Ensures Compliance with the Period of Affordability, and Other Laws, Rules and Contract Provisions, but Additional Procedures are Needed to Verify Principal Residency Requirements**

Generally, when documentation was available, the loan files reviewed complied with applicable laws, regulations and contract provisions. Testing of loan files identified only one instance of non-compliance with 24 CFR §92.252(e) and §92.254(a)(4), which relate to the period of affordability. Only one of the owner occupied housing assistance files reviewed did not satisfy HUD's minimum period of affordability.

The federal regulations (24 CFR § 92.252(e)) state that the affordability requirements apply without regard to the term of any loan or mortgage or the transfer of ownership. As a result, the payments are not tied to the affordability period. This means that a homeowner can pay off their loan or their loan can be forgiven before the period of affordability ends.

Loans which involve the acquisition of real property or the reconstruction of real property without acquisition require a period of affordability. The Department has provisions to impose the period of affordability when the loan is initiated. The loan documentation, including the note, allows for resale or recapture of funds in the event that the homeowner does not keep the property throughout the period of affordability. In addition, other legal documents also convey these requirements to the borrower.

In the owner occupied housing assistance program (there is no HUD affordability period for these loans), and in the contract for deed program (HUD requires an affordability period for these loans) that include a deferred forgivable loan, the Department is required to ensure that the property is maintained as the homeowner's principal place of residence throughout the life of the loan. The Department does not have a process for verifying that this requirement is met after the loan documents are signed. This is especially important for properties in which the Department is the first lien holder. Principal residency is not a HUD requirement for owner occupied housing assistance loans, however, since the Department's governing board has chosen to include this requirement

**The Period of Affordability  
for HOME Loans**

The HOME Program imposes an affordability period on acquisition projects assisted with HOME funds in order to ensure the HOME investments yield affordable housing over the long term. The period of affordability is the minimum time for which the property is required to be used as affordable housing. The homeowner is required to maintain the property as their principal place of residence throughout the affordability period.

For homebuyer projects, the length of the affordability period is based on the amount of HOME funds invested in the property. For rental projects, the length of the affordability is based both on the amount of HOME funds invested in the property as well as the nature of the activity funded. The HOME-assisted units must meet the affordability requirements for not less than the applicable period.

Period of affordability requirements must be imposed by deed restrictions, covenants running with the land, or other mechanisms approved by HUD. The affordability restrictions may terminate upon foreclosure or transfer in lieu of foreclosure.

***An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division***

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in the Department's rules (10 TAC 53.31 ((l),(m),(n))), the Department is obligated to ensure the principal residency requirements are enforced.

Eligibility is established when the borrower's loan is approved. The compliance and asset oversight division's monitors inspect single-family properties during construction and verify eligibility documents during the acquisition period. However, once the construction is complete, no further monitoring of the homeowner or the property is conducted to ensure the property continues to be the primary residence of the borrower (multi-family properties are monitored throughout the life of the loan).

Because no funds are collected for deferred forgivable loans and no further monitoring for affordability is required, the Department has not taken reasonable measures to verify that the property continues to be the homeowner's principal residence as required by the Texas Administrative Code. The purpose of verifying principal residency is so that the homeowner can be accurately credited under the deferral provisions of their loan. In addition, because HUD requires compliance not only with federal rules but with state rules even if they are more restrictive than the federal rules, the Department risks being cited by HUD for non-compliance.

### **Recommendations**

The Department should develop a method to help ensure that the principal residence requirement is met for those properties that require it and for which the Department is the first lien holder. Some options for this include:

- consistently collecting property tax and insurance receipts,
- verifying the homeowner's homestead exemption via the property tax receipt or the tax rolls,
- verifying mail service or utility bills,
- community outreach or periodic inspections, or
- asking the homeowner to sign and submit an annual document certifying that the property is their principal residence.

### **Management Response**

Management agrees with the recommendations and will in the next 90 days be revising the mechanism for forgiveness in new loans (Lora Myrick) and develop a mechanism for recording forgiveness based on confirmation from the owner of continued homeownership for existing loans (Stephanie D'Couto).



**Chapter 3**

**Improvements are Needed to Ensure that Loan Requirements are Met and that Policies and Procedures are Finalized**

HOME loan payments are not always deposited within three business days of receipt as required by the government code. Nineteen of 71 days of deposits (26.8%) were deposited to the treasury after the third business day. These 71 days' deposits totaled \$902,613 and the 19 days in error represented \$270,180 (30%) of these funds. Not depositing funds to the state treasury on a timely basis results in funds not being available to recycle, as well as lost interest to the State.

Construction loans are forgiven based on a pre-determined date, rather than evidence that the construction is complete. Eight of 15 files (53.3%) we tested did not contain a certificate of completion issued prior to loan forgiveness.

Finally, eight of the eight (100 %) policies and procedures for the HOME division are still in draft form several years after they were written. These policies should be finalized and approved as required by the Department's policy for division-level standard operating procedures.

Chapter 3-A

**Loan Payments Should Be Deposited on a Timely Basis**

HOME loan payments are not always deposited within three business days of receipt as required by the government code (see text box). A random sample of 61 deposits over a three-year period was tested for compliance with the three-day deposit requirement. The 61 deposits tested included

71 days of HOME loan activity (loan payments and payoffs). Nineteen of these 71 days' deposits (26.8%) were deposited to the treasury after the third business day. These 19 days totaled \$270,180 (30%) of the \$902,613 of funds in the sample. The 19 late deposits range from four to nine days from the date of receipt, with an average of 4.8 days. Timely deposit of program funds ensures that program income will be available for immediate distribution and that the State does not lose interest payments on these funds.

**Texas Government Code  
404.094**

"FUNDS TO BE DEPOSITED IN  
TREASURY.

(a) Fees, fines, penalties, taxes, charges, gifts, grants, donations, and other funds collected or received by a state agency under law shall be deposited in the treasury... A deposit shall be made at the earliest possible time that the treasury can accept those funds, but not later than the third business day after the date of receipt...."

**Recommendation**

The Department should ensure that loan payments are posted and deposited not later than the third business day after receipt.

*An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division*

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**Management Response**

Within the next 90 days, management will enhance the process to ensure loan payments are posted and deposited no later than the third business day after receipt (Stephanie D’Couto).

Chapter 3-B

**Completion of Construction Should Be Documented Prior to Loan Forgiveness**

The unsecured equity loan portion of owner occupied housing and contract for deed loans have a date-certain maturity date, at which point the loan is forgiven. The term of the note is set according to the estimated date of the completion of construction. A certificate of completion or other evidence that verified the completion of construction was not included in eight of the 15 files (53.3%) reviewed. Without some proof of the completion of construction, the Department could forgive a loan on a property before it is finished.

**Recommendations**

The Department should:

- ensure that the term of the unsecured equity loan is sufficient to guarantee completion of construction prior to the loan maturity date, and
- obtain and include in the loan servicing file the documentation verifying the completion of construction.

**Management Response**

Management agrees with the recommendations and will, in the next 90 days be revising the mechanism for forgiveness including documented assurances that the construction has been completed (Lora Myrick)

Chapter 3-C

**The HOME Division's Standard Operating Procedures Should Be Finalized and Approved**

Eight of eight (100%) of the standard operating procedures for the HOME division related to program income have not been finalized and approved. These policies and procedures are still in draft form. For example, draft policies and procedures for program income and refund processes were dated August 2007 and December 2006, but have not yet been approved and signed by the director of the HOME division. As rules change and new programs are developed, the existing policies and procedures should be updated to provide guidance to HOME personnel.

***An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division***

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The Department's policy (1100.01) requires the development and approval of division level (level II) standard operating procedures. This policy states that "Procedures should be developed for all tasks that require or could benefit from standardization or the imposition of procedures as a control."

**Recommendation**

The HOME division should review and update procedures as necessary, and ensure that all procedures are approved and signed by the division director.

**Management Response**

Management agrees and all eight have now been signed or will be signed by June 15, 2009 (Lora Myrick)

***An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division***

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**Appendix A**

**Objectives, Scope and Methodology**

**Objectives**

To review program income in the HOME division to determine:

- if loan servicing results in the maximum affordability period,
- if loans are completed in compliance with relevant laws, regulations, and policies, and
- the amount of program income that has been recycled over the past three years.

**Scope**

The scope of this audit included the loan document processing and loan servicing functions of the HOME division loans for program years 2006, 2007 and 2008. This audit focused on verifying that the Department maintained accurate records over the period of the loans, recaptured the correct amount of HOME funds when properties were sold prior to the end of the affordability period, and recycled the program income from these loans.

We were unable to determine the amount of program income earned for loans initiated in specific years due to limitations in the Comptroller of Public Accounts' Uniform State Accounting System (USAS). USAS only remains open for three appropriation years - the current year and the two prior years. This means that any program income from loans older than three years can not be recorded in the appropriate year. Consequently, all program income is recorded in the oldest open appropriation year.

**Methodology**

The methodology consisted of gaining an understanding of the HOME division's programs and the processes for servicing and monitoring loans. We compared state laws, rules and guidance to loan servicing processes and the HOME division and the financial administration division's loan servicing policies. We tested processes, policies and procedures to ensure compliance with state and federal laws and the Department's rules and regulations. We gained an understanding of the processes by conducting staff interviews and reviewing laws, regulations and policies and procedures, as well as reviewing loan administration practices, financial reports, and loan files.

Specifically, we reviewed the following documents:

- 2008 Texas Consolidated One-Year Action Plan
- 2009 Texas Consolidated One-Year Action Plan
- HUD's HOME Investment Partnership Agreements for 2006-2008
- Loan servicing policies and procedures
- HOME division draft policies and procedures
- Financial administration division's policies and procedures

We used the following documents as criteria:

- Texas Government Code, Title 10, Subtitle G, Chapter 2306, Sub-chapter F, §2306.111 - Housing Funds

***An Internal Audit Report on  
Loan Servicing and Recycling of Program Income in the HOME Division***

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- 24 Code of Federal Regulations, Part 92, Home Investments Partnership Program
- United States Code Title 42, §§12701-12840 HOME Investment Partnerships Program.
- Texas Administrative Code, Title 10 Part 1, Chapter 53.1 – 53.86 (2008 HOME Rules) and previous versions known as 2006 and 2007 Home Rules.
- Texas Administrative Code, Title 10, Part 1, Subchapter A, Rule 1.19 – Deobligated Funds

**Type of Audit**

This audit was a performance audit of the Department's controls over the loan document processing and loan servicing functions for HOME division loans, as well as a review of policies and procedures designed to provide reasonable assurance of compliance with significant laws, regulations and program rules.

**Follow-up on Prior Audit Issues**

We did not identify any prior audit issues related to the objectives of this audit that required follow-up work.

**Report Distribution**

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is being distributed to the:

- Department's Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

**Project Information**

Audit fieldwork was conducted from November 2008 through March 2009. The audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing.

The following staff performed this audit:

Harriet Fortson, MAcy, CGAP, Audit Project Manager  
Mary Beth (Betsy) Schwing, CPA, CFE

**Appreciation to Staff**

We would like to extend our appreciation to executive management, the HOME division, and the financial administration division for their cooperation and assistance during the course of the audit.



## TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

[www.tdbca.state.tx.us](http://www.tdbca.state.tx.us)

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GOVERNOR

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May 28, 2009

To: The Governing Board of the Texas Department of Housing and Community Affairs

Re: Report on the Internal Audit Division's Quality Assurance and Improvement Program

The Institute of Internal Auditors' *International Professional Practices Framework* (Standards), updated in January 2009, require that the director of internal audit develop and maintain a quality assurance and improvement program that includes both internal and external assessments of the internal audit division. The objective of the internal and external assessments is to evaluate the internal audit activity's conformance with the definition of internal auditing, the Standards and the code of ethics.

Internal assessments must include ongoing monitoring of performance of the internal audit activity as well as periodic reviews performed through self-assessment. The newly revised Standards require that the results of these periodic assessments are communicated to the board at least annually.

The internal audit division at the Department maintains an ongoing quality assurance program and performs ongoing monitoring as required. In addition, the internal audit division recently completed a self-assessment. The scope of this self-assessment included the audit projects with reports released between December 2007 and December 2008. The methodology consisted of performing a comprehensive review of the audit working papers for the projects released from December 2007 through December 2008, and included observations and discussions with internal audit staff. The self-assessment was conducted by a senior project manager new to both the Department and the internal audit division who did not participate in the audits under review.

Based on the review of the audit working papers and the discussions with internal audit staff during this self-assessment, the internal audit division fully complies with the definition of internal auditing, the Standards, and the code of ethics. This opinion, which is the highest possible rating, means that policies, procedures and practices are in place to implement the Standards and that the requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function were met.

The Texas Department of Housing and Community Affairs – Internal Audit Division

Report # 09-1032

May 2009

Two opportunities for self-improvement were noted:

- Although all of the audits are carefully planned and all planning working papers and audit programs are reviewed by the director of internal audit prior to the start of fieldwork, the audit program does not clearly document the timing of this approval process. As a result, a step will be added to the standard audit program to ensure that the approval is clearly documented prior to the start of fieldwork.
- The audit division encourages feedback from all stakeholders and actively solicits feedback from the audited divisions via a customer survey. Although the surveys are provided to the audited division for every audit performed and feedback is sincerely encouraged, the survey response rate is only 25%. Obtaining more client feedback would allow the internal audit division to continue to enhance its performance. As a result, the internal audit division has begun using an automated third-party survey and will send out the surveys on an annual basis instead of at the end of each project so that the anonymity of the respondents is increased.

To satisfy the Standards, the quality assurance and improvement program must also include external assessments. An external peer review must be performed once every three years. The next external peer review for the Department's internal audit division is scheduled for the fall of 2009.

If you have any questions regarding our quality assurance process or the recently completed self-assessment, please let me know.

Sincerely,

Sandra Q. Donoho, MPA, CISA, CIA, CICA, CFE  
Director of Internal Audit

cc: Michael Gerber, Executive Director  
Tim Irvine, Chief of Staff

**Internal Audit Division**  
**BOARD ACTION REQUEST**  
**July 15, 2009**

**Action Items**

Presentation and discussion of recent external audit reports.

**Required Action**

None, information item only.

**Background**

**HUD Affordable Housing and Financial Monitoring and Technical Assistance Visit – HOME Program (April 2009)**

From FY 1992 through FY 2008 the Department has received HOME allocations totaling \$639.4 million, of which it has committed \$510.5 million, or 89.2%. The Department has disbursed \$479.1 million, or 74.7 percent, which HUD deems to be unacceptable. In order to improve overall commitment and disbursement rates, HUD believes the Department should work with its various recipients, subrecipients, CHDOs and other recipients, as well as increasing the recapture of funds from poor or non-performing recipients.

The Department is not accounting for recaptured funds separately from its program income. Recaptured funds must be deposited in the participating jurisdiction's HOME Investment Trust Fund local account. Instead, recaptured funds are being accounted for as program income. The Department is required to provide detailed spreadsheets for the period January 1, 2005 to current that clearly distinguish the amount the state received as recaptured funds from the amount the state received as program income.

Despite significant improvement to the state's data entry problems, the project completion data needs improvement. The state allows a maximum 120 day time frame for entering completion data, and there are currently 10 projects significantly exceeding that limit. The Department should repay \$483,115 drawn to cover project costs for one of these projects, or request a reduction to its 2005 grant.

Review of the multifamily portfolio report indicated there are numerous projects that are out of compliance with the HOME Program requirements. Some of the deficiencies/violations could result in the state being requested to repay the full amount of the HOME funds invested if the projects cannot be brought into compliance within a reasonable period of time. HUD listed 24 projects totaling \$14.5 million that are out of compliance



and at risk of requiring repayment, but these are not all of the projects that are out of compliance.

Questioned and unsupported costs in the amount of \$152,494.67, as well as other discrepancies, were noted. The state must either reimburse the ineligible and unsupported costs, or provide support documentation for the costs that can be supported and reimburse the unsupported costs.

Statewide Single Audit Report for the Year Ended August 31, 2008 (April 2009)

The opinion audit of the State's basic financial statements conducted by the SAO and KPMG (also known as the Statewide Audit) included a review of internal controls. The federal compliance portion of this audit covered the Low Income Home Energy Assistance Program (LIHEAP). This audit had no findings for the Department.

**Recommendation**

No action is required.



APR 17 2009

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
Fort Worth Regional Office, Region VI  
Office of Community Planning and Development  
801 Cherry Street, Unit #45, Ste. 2500  
Fort Worth, TX 76102  
Phone (817) 978-5933 - Fax (817) 978-5559  
[www.hud.gov](http://www.hud.gov)

Mr. Michael Gerber  
Executive Director  
Texas Department of Housing and  
Community Affairs  
PO Box 13941  
Austin, TX 78711-3941

RECEIVED  
APR 21 2009  
EXECUTIVE DIRECTOR

Dear Mr. Gerber:

SUBJECT: Affordable Housing and Financial Monitoring and Technical  
Assistance Visit - HOME Program State of Texas - M-08-MC480100

This letter provides the results of HUD's on-site monitoring of the state's affordable housing programs by Melodee Humbert, Senior Affordable Housing Specialist, and Brenda Jennings, Senior Financial Analyst, on March 2-6, 2009. Stephen Eberlein, Program Manager accompanied Ms. Humbert and Ms. Jennings and completed on-site physical inspections at several selected multifamily rental projects. Due to schedule and workload priorities, Mr. Eberlein returned to the Fort Worth Office on March 4, after completing an inspection of the Milam Creek Senior Village project in Milam, Texas. An exit conference was held with you and your staff on March 6, 2009.

Besides yourself, state staff attending the exit conference were: Timothy Irvine, Deputy Executive Director; Bill Dally, Deputy Executive Director of Administration; Tom Gouris, Deputy Executive Director for Programs; David Cervantes, Director of Financial Administration; Cameron Dorsey, Acting HOME and Housing Trust Funds Program Manager; Harriet Fortson, Project Manager, Internal Audit; Patricia Murphy, Director of Portfolio Management and Compliance; Lora Myrick; Performance Manager; Wendy Quackenbush, Compliance Manager; and Esther Ku, Manager, Accounting.

On-site reviews were conducted at several projects. The following state staff accompanied Ms. Humbert and Mr. Eberlein during these reviews: Wendy Quackenbush, and Michael Garrett, Manager of Physical Inspections, Portfolio Management and Compliance.

State recipients and staff contacted during this visit were:

**Skyline Terrace, 1212 W. Ben White, Austin - (CHDO)** – Acquisition and Rehabilitation Single-Room Occupancy (SRO) Project. Sandra Lumley, Property

Management Director; Abby Yarber, Assistant Property Manager, and Tracy Moczygemga, Compliance Analyst.

**Spring Terrace, 7101 N. I-35, Austin – CHDO** – Acquisition and Rehabilitation Single Room Occupancy (SRO) Project. Sandra Lumley, Property Management Director; Abby Yarber, Assistant Property Manager, and Tracy Moczygemga, Compliance Analyst.

**Picadilly Estates – 500 Grand Avenue Parkway, Pflugerville.** New Construction, 1-2 Bedroom Project. Janice McAlister, Community Manager, and Laurie Blackmore, Director of Compliance.

**Cypress Creek at River Bend, 120 River Bend Drive, Georgetown.** New Construction, 1-4 Bedroom Project. Amy Lucas, Community Manager, and Alma Guillen, Compliance Director.

**Milam Creek Senior Village, 1330 E Milam, Luling.** New Construction, 1-2 Bedroom project. Michael Harms, Executive Director, Center for Housing and Economic Opportunities Corp.

The results of the review are described in the enclosed monitoring report. The results were discussed in detail with state staff and with staff of each state recipient during the monitoring process. The following items are enclosed with this letter.

- Attachment I. This report contains six findings and five concerns covering the state's administration of its HOME-funded affordable housing programs and financial management. Several recommendations by HUD were also presented to staff. Although the state is not required to respond to concerns, it may provide a response if it wishes. However, given the circumstances relative to some of the concerns, please provide a written response where requested.

A copy of the on-site inspections reports was left with staff. Overall, the quality of the completed work was acceptable. For projects that are completed within the City of Austin, it is easier for state staff to go on-site should problems arise in the area of construction. However, for other projects that are completed throughout the state, HUD is concerned relative to the lack of ongoing daily construction monitoring and oversight in these communities. As previously discussed with staff, the state should include a component in its application process that specifically requires all applicants for funding under the state's Notice of Funding Availability (NOFA) to include the action(s) the applicants will implement to assure that adequate local monitoring and oversight will be completed on an ongoing, daily basis during the term of each contract. See Concern No. 8.

Based on our monitoring and interviews with staff, HUD concluded that the state has the continuing capacity to implement and deliver its affordable housing and rehabilitation programs at current levels and to manage its financial responsibilities. While this report contains monitoring findings and concerns, the state staff is commended for the actions it has taken to

address previously cited deficiencies and to take steps to implement changes that will help assure that these issues do not recur. The state has significantly improved the quality of its monitoring and has implemented a process to complete the required annual monitorings of its subrecipients and CHDOs. The results of these reviews are being transmitted in writing to the state's recipients, and staff is following-up to correct the findings (federal and state) cited. Technical assistance was provided to assist state staff in completing more comprehensive reviews and developing more detailed monitoring reports, and additional recommendations are included in this report.

Please submit a written response to the findings and the specified concerns within 30 days of the date of this letter. If the state needs additional time to complete its response for any item, it may request an extension for the applicable finding.

It is the intent of this office to continue to work with the state by providing any needed technical assistance and guidance. If you have any questions or concerns, please contact Ms. Humbert at 817/978-5960 or Ms. Jennings at 817/978-5941.

Sincerely,



*for* Katie S. Worsham  
Director

Enclosures

cc:

Jeannie Arellano

Lora Myrick

## MONITORING REPORT – FISCAL YEAR 2009

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS  
(TDHCA)

## HOME INVESTMENT PARTNERSHIPS PROGRAM

All of the following findings, concerns and recommendations were discussed with staff during monitoring and at an exit meeting held on March 6, 2009.

Except as provided in this report, specific details as to file deficiencies, recommendations, comments, etc., relative to (1) individual file reviews, and (2) reviews of contracts and agreements executed between the state and program recipients are not included in this transmission. These issues have been discussed with the state's staff and management. HUD staff is available to discuss these issues in more detail and provide more information at the state's request.

**I. OVERALL HOME ACCOMPLISHMENTS/PERFORMANCE****A. Overall Commitments/Disbursements**

The March 17, 2009, HOME Status of Funds Report (PR27) shows that from FY 1992 through FY 2008, the state has received HOME allocations totaling \$639,441,344. Of that amount, it has committed \$510,527,543 or 89.2 percent of its total HOME commitment requirement of \$572,637,164 to individual activities. The report does not yet reflect the state's FY 2009 HOME Program allocation.

In the area of overall cumulative disbursements, the Status of Funds (PR27) report indicates that of the total amount of funds committed in IDIS, the state has disbursed only \$479,127,540 or 74.7 percent of its total authorization. The state's overall performance in this area is unacceptable. Impacting the state's disbursement rate is the large amount of CHDO funds that are undisbursed.

Cumulative Disbursements

<u>FY</u>	<u>Amount Authorized</u>	<u>Total Disbursed</u>	<u>% Disbursed</u>	<u>Grant Balance</u>
1992	\$ 32,472,000	\$ 32,472,000.00	100.0	\$ -0-
1993	\$ 23,338,000	\$ 23,339,260.80	99.5	\$ 108,739.20
1994	\$ 30,065,000	\$ 29,556,039.74	98.3	\$ 508,960.26
1995	\$ 33,303,000	\$ 33,303,000.00	100.0	\$ -0-
1996	\$ 33,001,000	\$ 33,001,000.00	100.0	\$ -0-
1997	\$ 32,699,000	\$ 32,169,098.79	98.3	\$ 529,901.21
1998	\$ 34,987,000	\$ 34,406,266.78	98.3	\$ 580,733.22
1999	\$ 37,060,000	\$ 36,626,067.43	98.8	\$ 433,932.57
2000	\$ 39,770,585	\$ 38,420,143.52	96.6	\$ 1,350,441.48

Cumulative Disbursements - Continued

<u>FY</u>	<u>Amount Authorized</u>	<u>Total Disbursed</u>	<u>% Disbursed</u>	<u>Grant Balance</u>
2001	\$ 41,517,415	\$ 38,016,639.69	91.5	\$ 3,500,775.31
2002	\$ 39,160,000	\$ 34,396,514.81	87.8	\$ 4,763,485.19
2003	\$ 45,094,671	\$ 39,321,822.10	87.1	\$ 5,772,848.90
2004	\$ 49,513,150	\$ 35,543,088.08	71.7	\$ 13,970,061.92
2005	\$ 44,687,663	\$ 26,545,688.27	59.4	\$ 18,141,974.73
2006	\$ 41,308,832	\$ 7,504,125.20	18.1	\$ 33,804,706.80
2007	\$ 41,420,803	\$ 4,616,784.76	11.1	\$ 36,804,018.24
2008	\$ 40,043,225	\$ -0-	0.0	\$ 40,043,225.00
<b>Total</b>	<b>\$639,441,344</b>	<b>\$479,127,539.97</b>	<b>74.9</b>	<b>\$160,313,804.03</b>

The state needs to work with its state recipients, subrecipients, CHDOs and/or other entities (OE) to improve its commitment and disbursement rates. The state is also reminded that the recapture of funds from poor or non-performing recipients could also have an impact on its overall commitment and disbursement rates.

Administrative Funds

Under the HOME Program, the state may use up to 10 percent of each FY's HOME allocation for administrative costs. In this category, the state provides each state-recipient funded up to four (4) percent of the total amount of the HOME award for administration; the state retains the remaining six percent (6) for its administrative costs.

Through FY 2004, the state has disbursed 100 percent of its 10 percent administrative line item. The balance of the remaining undisbursed funds is as follows.

<u>FY</u>	<u>Amt Authorized</u>	<u>Amt Auth From PI</u>	<u>Amt Reserved</u>	<u>% Auth Reserved</u>	<u>Balance To Reserve</u>	<u>Total Disbursed</u>	<u>% Reserved Disbursed</u>	<u>Available to Disburse</u>
2005	\$ 4,334,330.70	\$374,713.36	\$ 4,334,330.70	92.0	\$374,713.36	\$3,741,744.12	86.3	\$ 592,586.58
2006	\$ 4,063,641.90	\$378,691.71	\$ 4,063,641.90	91.4	\$378,691.71	\$ -0-	-0-	\$ 4,063,641.90
2007	\$ 4,074,694.20	\$174,766.17	\$ 4,074,694.00	95.8	\$174,766.37	\$ -0-	-0-	\$ 4,074,694.00
2008	\$ 3,977,658.80	\$ -0-	\$ 3,977,658.80	100	\$ -0-	\$ -0-	-0-	\$ 3,977,658.80
<b>Totals</b>	<b>\$16,450,325.60</b>	<b>\$928,171.24</b>	<b>\$16,450,325.40</b>		<b>\$928,171.44</b>	<b>\$3,741,744.12</b>		<b>\$12,708,581.28</b>

Since the administrative funds are shared with its state-recipients, a total of \$9,870,195 (6% of \$16,450,326) is available for the state's administration of the HOME Program. Based on this report, except for FY 2000, the state has not utilized any of the additional program income (PI) funds that would have been eligible for administration and project costs. Since none of the administrative funds for FYs 2006 through 2007 have been disbursed, some of these funds (Amt Auth from PI column) may still be available to the state for its HOME administrative costs **provided** it has not committed some or all of those funds to individual project activities in IDIS.

In any event, the state needs to review the status of its administrative draws to assure that these old funds (FYs 2005-2007) are disbursed in a timely manner.

### Reservations to State Recipients and Sub-Recipients (SU)

**CONCERN NO. 1:** The PR27 Report indicates that from FYs 1993 through 2008, the state has numerous open contracts with **state recipients and/or sub-recipients (SUs)**. Some undisbursed funds remain available from allocations dating to 1993.

**DISCUSSION:** Included as a subset of the Total Authorization, Total Commitment and Total Disbursement amounts, are reservations and disbursements to individual state recipients and sub-recipients (SUs). See the chart below. HUD has not attempted to identify these recipients individually in this report.

FY	Amount Reserved to Other Entities (OE)	% Req Rsvd	Amount Committed	% Rsvd Cmtd	Balance to Commit	Total Disbursed	% Disb	Available to Disburse
1992	\$ 8,021,651.18	19.8	\$ 8,021,651.18	100.0	\$ -0-	\$ 8,021,651.18	100.0	\$ -0-
1993	\$ 16,723,833.01	41.7	\$ 16,723,833.01	100.0	\$ -0-	\$ 16,615,093.81	99.3	\$ 108,739.20
1994	\$ 21,209,695.75	41.3	\$ 21,209,695.75	100.0	\$ -0-	\$ 20,700,735.49	97.6	\$ 508,960.26
1995	\$ 24,260,474.20	42.1	\$ 24,260,474.20	100.0	\$ -0-	\$ 24,260,474.20	100.0	\$ -0-
1996	\$ 24,466,016.20	42.5	\$ 24,466,016.20	100.0	\$ -0-	\$ 24,466,016.20	100.0	\$ -0-
1997	\$ 22,180,744.71	40.4	\$ 21,860,328.04	98.5	\$ 320,416.67	\$ 21,652,527.50	97.6	\$ 528,217.21
1998	\$ 25,104,671.00	41.7	\$ 24,730,167.14	98.5	\$ 374,503.86	\$ 24,607,282.18	98.0	\$ 497,388.82
1999	\$ 27,526,917.16	42.6	\$ 27,526,917.16	100.0	\$ -0-	\$ 27,101,242.52	98.4	\$ 425,674.64
2000	\$ 28,033,853.53	41.3	\$ 27,968,127.27	99.7	\$ 65,726.26	\$ 27,213,404.05	97.0	\$ 820,449.48
2001	\$ 26,814,424.18	39.2	\$ 25,479,312.47	95.0	\$ 1,335,111.71	\$ 23,973,623.76	89.4	\$ 2,840,800.42
2002	\$ 28,384,351.72	41.4	\$ 26,287,458.59	92.5	\$ 2,106,893.13	\$ 25,007,368.90	88.0	\$ 3,386,982.82
2003	\$ 32,180,938.94	40.7	\$ 31,459,444.68	97.7	\$ 721,494.26	\$ 30,513,710.68	94.8	\$ 1,667,228.26
2004	\$ 36,375,067.00	41.5	\$ 28,280,102.17	77.7	\$ 8,094,964.83	\$ 24,609,801.36	67.6	\$11,765,265.64
2005	\$ 39,609,550.08	46.7	\$ 33,923,567.76	85.6	\$ 5,685,982.32	\$ 22,627,197.85	57.1	\$16,982,352.23
2006	\$ 32,058,256.88	40.8	\$ 18,900,025.60	58.9	\$13,158,231.28	\$ 7,517,329.20	23.4	\$24,540,927.68
2007	\$ 6,410,814.00	8.8	\$ 2,208,079.00	34.4	\$ 4,202,735.00	\$ 623,936.00	9.7	\$ 5,786,878.00
2008	\$ -0-	-0-	\$ -0-	-0-	\$ -0-	\$ -0-	-0-	\$ -0-
<b>Total</b>	<b>\$399,371,259.54</b>	<b>36.2</b>	<b>\$363,305,200.22</b>	<b>90.9</b>	<b>\$36,066,059.32</b>	<b>\$329,511,394.88</b>	<b>82.5</b>	<b>\$69,859,864.66</b>

**RECOMMENDED ACTION:** The state needs to follow up and identify those state recipients or SUs that have funds uncommitted and/or undisbursed and take the actions necessary to get projects completed, funds drawn, or cancel the remaining balances and reallocate the funds. It is imperative that these older funds be committed and expended as quickly as possible.

Please provide a written report on the state's review and analysis of these open contracts and the actions the state proposes to take to either get the activities completed and funds disbursed or the remaining balances canceled and the funds reallocated to other state recipients for SUs that will be able to complete their activities in a timely manner.

**B. HOME Expiring Funds Report:**

The state is reminded that HOME funds remaining from the state's FY 2002 grant on September 30, 2009 will be recaptured by the United States Treasury. Unexpended HOME funds from 1992 through 2001 allocations are not subject to these rules. While these earlier funds will not be recaptured, they must be 100 percent expended if the state is to be able to access its FY 2002 balances since draws from the HOME Treasury Account are processed on a first-in-first-out (FIFO) basis. (See HOME FACTS – Vol. 2. No.2. dated February 2009 and previously forwarded to the state)

**C. CHDO Performance:**

**CHDO Set-Aside Funds**

The state is required to reserve, at a minimum, 15 percent of each FY's allocation for Community Housing Development Organizations (CHDOs). The state's cumulative CHDO reservation (CR) requirement for FYs 1992 through 2008 is \$81,978,038. The PR27 report indicates that the state has reserved, cumulatively, \$86,691,667 or 105.7 percent of its required CHDO reservation in IDIS. Of the amount of CR fund reserved, the state's CHDOs have committed a total of \$85,765,171 or 98.9 percent to individual activities in IDIS. Of the funds committed, the state has disbursed \$72,254,336 or 83.37 percent.

**D. State's Designation of Community Housing Development Organizations (CHDOS)**

Review of the state's process for the initial certification and subsequent recertifications of its CHDOs found that the state is in compliance with the initial and recertification processes for designating CHDOs. HUD's review of the composition of the CHDO boards for Foundation Communities, Inc. (Skyline Terrace and Spring Terrace projects) found that the state had properly recertified the CHDO prior to its latest award of CHDO set-aside funds and that the boards were in compliance with the required minimum 1/3 low-income representation.

**E. CHDO Written Agreements**

Review of the CHDO written agreements, project and operating funds, executed between the state and its CHDOs contained all of the required HOME provisions.

**CHDO Operating (CO) Funds Agreements**

Review of the CO expense agreement found that this document contains numerous sections that may not be applicable to the use of CO funds; they are, however, applicable to and are contained in the written agreements when project set-aside funds are awarded. It was recommended that the state, with the concurrence of its Legal Division, review the CO agreements and make a determination as to which of the following items are not applicable to a



CO contract and remove them from future contracts. If an item is not applicable or if the state does not intend to enforce one or more conditions, they should not be included in a contract. All of the items noted below were properly included in the contract/agreement for the project funds, but have no real application when only operating funds are provided.

**Exhibit A:** Item 7, Financial Management; Item 8, Insurance; Item 10, Reporting requirements – a and b; Item 13, Subcontracts; Item 15, Nondiscrimination and Sectarian Activity; Item 17, Litigation and Claims; Item 23, Facilitate Performance of Audit; Item 24, Make Audit Reports Available to the Public.

**Exhibit B:** I, Civil Rights; II, Lead-Based Paint; III, Environmental; and IV, Acquisition and Relocation.

**Exhibit C:** Lobbying

The written agreements for both project funds and CHDO operating (CO) funds executed between the state and its CHDOs contain all of the required HOME provisions.

**Other CHDO Comments**

The state needs to ensure that a copy of all contract amendments are included in each CHDO file. Documents in the file for Skyline Terrace indicated that the deadline date for the expenditure of the funds was February 1, 2008; however, the contract period ran from August 1, 2006 through August 1, 2008. The applicable contract amendment was located and placed in the file.

**CONCERN NO. 2:** The state has a significant amount of CHDO set-aside (CR) funds that remain uncommitted and/or undisbursed.

**DISCUSSION:** Because of Hurricane Katrina, the state received a waiver of the statutory CR set-aside requirement for FYs 2005 and 2006, so those funds could be made available to quickly meet the need for affordable housing in the designated disaster areas. The CR set-aside requirement was reinstated with the state's FY 2007 HOME allocation. The state's CHDO's performance in committing funds to individual activities/projects in IDIS is excellent (98.9%); however, the CHDO's performance relative to the completion of these activities and disbursement of the funds (83.3%) is marginally acceptable. See tables below.

FY	CHDO REQ	AMT RESV TO CHDOS	% RESV	CMTD TO IND ACT	% CMTD	BAL TO CMT	TOTAL DISBURSED	% DISB	AVAIL TO DISBURSE
1992	\$ 4,870,000.00	\$ 6,043,933.05	124.0	\$ 6,043,933.05	100.0	\$ -0-	\$ 6,043,933.05	100.0	\$ -0-
1993	\$ 3,500,700.00	\$ 3,500,700	100.0	\$ 3,500,700.00	100.0	\$ -0-	\$ 3,500,700.00	100.0	\$ -0-
1994	\$ 4,509,750.00	\$ 4,813,395.67	106.7	\$ 4,813,395.67	100.0	\$ -0-	\$ 4,813,395.67	100.0	\$ -0-
1995	\$ 4,995,450.00	\$ 4,995,450.00	100.0	\$ 4,995,450.00	100.0	\$ -0-	\$ 4,995,450.00	100.0	\$ -0-
1996	\$ 4,950,150.00	\$ 4,980,583.00	100.6	\$ 4,980,583.00	100.0	\$ -0-	\$ 4,980,583.00	100.0	\$ -0-
1997	\$ 4,904,850.00	\$ 4,904,850.00	100.0	\$ 4,904,850.00	100.0	\$ -0-	\$ 4,904,850.00	100.0	\$ -0-
1998	\$ 5,248,050.00	\$ 6,383,629.00	126.6	\$ 6,383,629.00	100.0	\$ -0-	\$ 6,383,629.00	100.0	\$ -0-
1999	\$ 5,559,000.00	\$ 5,582,472.00	100.4	\$ 5,582,472.00	100.0	\$ -0-	\$ 5,582,472.00	100.0	\$ -0-
2000	\$ 5,673,450.00	\$ 5,701,762.00	100.4	\$ 5,701,762.00	100.0	\$ -0-	\$ 5,196,557.47	97.1	\$ 505,204.53
2001	\$ 6,227,550.00	\$ 6,227,550.00	100.0	\$ 6,227,549.00	99.9	\$ 1.00	\$ 5,898,762.81	94.7	\$ 328,787.19

FY	CHDO REQ	AMT RESV TO CHDOS	% RESV	CMTD TO IND ACT	% CMTD	BAL TO CMT	TOTAL DISBURSED	% DISB	AVAIL. TO DISBURSE
2002	\$ 5,906,400.00	\$ 5,918,048.28	100.1	\$ 5,269,122.64	89.0	\$648,925.64	\$ 5,451,545.91	92.1	\$ 466,502.37
2003	\$ 6,764,200.65	\$ 6,764,200.65	100.0	\$ 6,755,845.83	99.8	\$ 8,354.82	\$ 4,304,003.32	63.6	\$ 2,460,197.33
2004	\$ 6,789,157.80	\$ 6,789,157.80	100.0	\$ 6,519,943.44	96.0	\$269,214.36	\$ 6,205,605.62	91.4	\$ 583,552.18
2005	\$ WAIVED								
2006	\$ WAIVED								
2007	\$ 6,112,041.30	\$ 6,112,041.30	100.0	\$ 6,112,041.30	100.0	-0-	\$ 3,992,848.76	65.3	\$ 2,119,192.54
2008	\$5,966,488.20	\$ 7,973,893.90	133.6	\$ 7,973,893.90	100.0	-0-	\$ -0-	-0-	\$ 7,973,893.90
<b>TTL</b>	<b>\$81,978,037.95</b>	<b>\$86,691,666.65</b>	<b>105.7</b>	<b>\$85,765,170.83</b>	<b>98.9</b>	<b>\$926,495.82</b>	<b>\$72,254,336.61</b>	<b>83.3</b>	<b>\$14,437,330.04</b>

Overall, the state has a total of \$926,496 of FYs 2001 through 2008 funds that have not yet been committed by its CHDOs to individual activities in IDIS, and a total of \$14,437,330 of FYs 2000 through 2008 funds that have not been disbursed. The state needs to continue working with its CHDOs to get these older funds committed and expended. The state's and its CHDO's performance in the area of its overall commitment rate is acceptable. However, performance in the area of the completion of the CHDO activities and disbursement of the set-aside funds is only marginally acceptable. The state needs to complete a review and assessment of the open contracts with the CDHOs identified in the table below.

### Use of Set-Aside Funds by CHDO

FY	CHDO	FUND TYPE	AMT RSVD	AMT CMTD	BAL TO COMMIT	% CMTD /RSVD	AMT DISB	% DISB /CMTD
2000	Pembroke Ct	CR	\$ 1,267,535.63	\$ 1,267,535.63	\$ -0-	100.0	\$ 1,170,318.83	92.3
	Pharr Hous Devel Corp	CR	\$ 407,987.73	\$ 407,987.73	\$ -0-	100.0	\$ -0-	-0-
2001	Pharr Hous Devel Corp	CR	\$ 112,567.40	\$ 112,567.40	\$ -0-	100.0	\$ -0-	-0-
	Statewide CDC	CR	\$ 683,483.60	\$ 683,482.60	\$ 1.00	99.9	\$ 467,263.81	68.3
2002	CDC of Brownsville	CR	\$ 1,113,175.64	\$ 464,250.00	\$ 648,925.64	41.7	\$ 646,873.27**	139.2
	** How can you disburse more than the amount committed??							
003	Gardn's of Weatherford	CR	\$ 841,788.18	\$ 841,788.18	\$ -0-	100.0	\$ -0-	-0-
	Pharr Hous Devel Corp	CR	\$ 795,487.87	\$ 795,487.87	\$ -0-	100.0	\$ -0-	-0-
	CDC of Brownsville	CR	\$ 738,610.00	\$ 730,255.18	\$ 8,354.82	98.8	\$ 35,126.32	4.8
	Gardens of Decordova	CR	\$ 1,194,376.00	\$ 1,194,376.00	\$ -0-	100.0	\$1,074,938.40	90.0
2004	Afford Caring Hous Inc	CR	\$ 11,750.00	\$ 11,750.00	\$ -0-	100.0	\$ -0-	-0-
	CDC of Brownsville	CR	\$ 269,214.36	\$ -0-	\$ 269,214.36	-0-	\$ -0-	-0-
	Grdn's of Weatherford	CR	\$ 302,587.82	\$ 302,587.82	\$ -0-	100.0	\$ -0-	-0-

FY	CHDO	FUND TYPE	AMT RSVD	AMT CMTD	BAL TO COMMIT	% CMTD /RSVD	AMT DISB	% DISB /CMTD
2005	<i>CO Funds NOT sub-granted to CHDOs</i>	CO	\$ 59,477.41	\$ 59,477.41	\$ -0-	100.0	\$ 12,547.42	21.0
2007	Cntr/Hous&Econ Oppor	CO	\$ 50,000.00	\$ 50,000.00	\$ -0-	100.0	\$ -0-	-0-
	Cntr/Hous&Econ Oppor	CR	\$ 597,685.20	\$ 597,685.20	\$ -0-	100.0	\$ 455,682.20	76.2
	Lifenet Comm Behavior	CR	\$ 3,000,000.00	\$ 3,000,000.00	\$ -0-	100.0	\$2,637,166.56	87.9
	<i>CO Funds NOT sub-granted to CHDOs</i>	CO	\$ 255,602.00	\$ -0-	\$ 255,602.00	-0-	\$ -0-	-0-
	Lexington Ct Apts	CR	\$ 1,614,356.10	\$ 1,614,356.10	\$ -0-	100.0	\$ -0-	-0-
2008	<i>CO Funds Not sub-granted to CHDOs</i>	CO	\$ 248,324.00	\$ -0-	\$ 248,324.00	-0-	\$ -0-	-0-

**RECOMMENDED ACTION:** The state needs to work with its CHDOs to improve their performance in this area. If any of the CHDOs are unable to complete the activities covered by their set-aside allocations in a timely manner, the state should consider canceling the contracts and reallocating the funds to other CHDOs that can utilize the funds in a more timely manner.

#### **F. Statutory Commitment/Disbursement**

**CONCERN NO. 3:** The HOME Deadline Compliance Status Report for the period ending February 28, 2009, provides that the state has not yet met its statutory 24-month commitment deadline for its FY 2007 HOME allocation. The state's deadline for meeting the HOME commitment requirement is May 31, 2009. As of the date of this report, the state has a total commitment shortfall in the amount of \$38,041,835.

**DISCUSSION:** HUD's letter of January 26, 2009, advised the state of its preliminary determination that the state was in danger of not meeting its commitment deadline and that the funds would be subject to recapture as of June 1, 2009. This shortfall appears to be attributable to the amount of uncommitted funds as noted in the above tables and could also be affected by the current award or allocation process as well as the process for recapturing and reallocating previously awarded funds from slow and/or non-performing entities.

**RECOMMENDED ACTION:** It is recommended that the state review its current award process for its HOME funds to include the reallocation of funds from prior awards. Efforts should be taken to improve the timeliness of commitments and the completion of projects.

### **G. American Dream Downpayment Initiative (ADDI) Performance**

The state has received American Dream Downpayment Initiative (ADDI) funds for Fiscal Years (FY) 2003 through 2008, totaling \$7,209,365. As of the February 28, 2009 ADDI Accomplishment Report, the state has committed and expended \$6,409,846 or 88.9 percent of its ADDI allocations through FY 2007 to assist 740 first-time homebuyers. A total of \$799,519 of FY 2007 and 2008 funds remains uncommitted and unexpended. The state's performance in this area is acceptable.

### **H. Compliance with the 90 percent rule**

Section 214 paragraph (1) of the HOME statute and the HOME regulations at §92.216(a)(1) and (2), and (b)(1) and (2), provide that not less than 90 percent of the HOME funds expended for rental assistance or rental projects must be for units that are initially occupied by persons or families with incomes at or below 60 percent of the median family income for the area, adjusted for family size. Based on the HOME Lower Income Benefit Report (PR16), the state **is in compliance** with this statutory requirement as 97.9 percent of the HOME funds expended for rental activities were for units initially occupied by persons or families having incomes at or below 60 percent of median.

This report also provides that a total of 15 units are reported as vacant. These are comprised of 9 rental and 6 homebuyer units. The state needs to identify these units and enter the required completion data into IDIS. The state can access the vacant units report at: <http://www.hud.gov/offices/cpd/affordablehousing/reports/index.cfm>

### **I. Program Income:**

See **FINDING NO. 4** in the financial review section of this report.

### **J. Match:**

Under the HOME Program each PJ must make contributions from non-federal sources to housing that qualifies as affordable housing. The contributions must total not less than 25 percent of the project funds drawn from its HOME Investment Trust Fund drawn during the federal fiscal year.

Since the inception of the HOME Program, the state has received a 50 percent reduction to the statutory 25 percent match liability requirement in accordance with §92.222. HUD reviews the distress criteria for PJs and has determined that the state satisfies one of the three distress criteria under §92.222 (a)(2). Therefore, the state's statutory match liability requirement has been reduced to 12 ½ percent. This review is completed annually and is subject to change.

Review of the source documentation maintained by the state indicated that the match claimed was from eligible sources and the amounts claimed were properly documented. The source documentation files sampled were complete, well documented and supported the state's determinations that the match sources were eligible. The state's staff is commended for their efforts to assure that only match from eligible sources is recorded on the required HOME Match Log.

Match contributions to the state's program have traditionally been generated by state recipients and CHDOs undertaking single family housing activities. From the information obtained during this and previous reviews, the responsibility for match contributions has not historically been shared across all components of the state's HOME program. With the significant investment of HOME funds that is being made into multi-family rental housing production, it would appear that the state may be overlooking an important source of match. The state should consider evaluating how it assigns its match responsibility across its program components as it could increase the amount of available match and expand the use of HOME funds in traditionally underserved areas where local resources for match are scarce.

### **K. Data Entry Into IDIS**

The state has made significant improvement in this area and HUD recognizes the state's efforts to correct its numerous data entry problems. While there are numerous activities where there has been no activity for significant periods of time or data is missing, e.g., the total number of units and the number of HOME units in projects have not been entered, etc., the state has improved the management of its data entry process. Of special note is the improvement in the drawdown of TBRA funds.

There is one area, however, where the state needs improvement which is projects for which final draws (FD) have been made, but the activities have not been closed in IDIS within the maximum 120 day time frame established at §92.502(d) for entering completion data. There are currently 10 projects that have significantly exceeded the 120-day limit and the state needs to immediately enter the completion information for these projects. Additionally, the majority of the projects have no entries for either the 'total number of units in the project' or the 'number of HOME-assisted units' (See table below). For information on other open activities in IDIS, please see the open activities report that is available at: <http://www.hud.gov/offices/cpd/affordablehousing/reports/index.cfm>

IDIS #	Activity	City	TTL # Units	# HOME Units	Amount	Drawn	Date of FD	120 Day Clock
9261	New Const	San Antonio	113	113	\$589,000.00	\$589,000.00	8/17/2000	3,151
13530	New Const	Olton	0	0	\$149,031.67	\$149,031.67	5/2/2002	2,528
29744	New Const	San Antonio	37	37	\$730,000.00	\$730,000.00	10/29/2008	156
28515	TBRA	Rockport	0	1	\$ 1,794.00	\$ 1,794.00	9/23/2008	192
17156	Acq + Rehab	San Diego	1	1	\$ 24,100.00	\$ 24,100.00	11/16/2005	1,234
28528	Acq Only	Round Rock	0	0	\$900,000.00	\$900,000.00	6/16/2008	291
1529	Acq Only	LaPorte**	1	1	\$483,115.00	\$483,115.00	8/17/2000	3,151
530	New Const	Olton	0	3	\$149,031.67	\$149,031.57	5/2/2002	2,528

IDIS #	Activity	City	TTL # Units	# HOME Units	Amount	Drawn	Date of FD	120 Day Clock
21724	New Const	Beaumont	0	0	\$ 10,987.50	\$ 10,987.50	7/24/2006	984
26047	Acq + NC	Gatesville	0	0	\$225,000.00	\$225,000.00	6/7/2007	666

The Laporte project noted above is the 57 unit Flamingo Bay Apartment project funded through the state's CHDO, Lakeside Center, under contract number 538611. The project was never completed and the state indicated it thought HUD had reduced its FY 2005 grant for the full amount of this project, \$517,315 (\$483,115 of project costs plus \$34,200 CHDO operating (CO) funds). We verified with our Headquarters Office that HUD has never processed a grant reduction request for the state for any HOME allocation.

In its response to this letter the state should advise whether it wishes to pursue a grant reduction or provide a direct repayment of the funds.

The state needs to continue to review all of the IDIS reports on a regular basis. If this is done, the state should be able to avoid future findings in this area.

**Please provide a written estimate of the state's timeframe for the completion of the balance of all of the corrections for final draws that exceed 120 days.**

#### **L. Multifamily Portfolio – Prohibited Lease Terms**

**FINDING NO. 1:** The Lease Documents for Russell Adams and Joseph Kirk (Spring Terrace - 7101 N. I-35, Austin) contained prohibited lease provisions.

**STANDARD:** 24 CFR 92.253(b)(2)

**DISCUSSION:** In the State of Texas's Standard Lease Document, Item 13. Removal After We Exercise Lien for Rent provides that "...If your rent is delinquent, our representative may peacefully enter the apartment and remove and/or store all property subject to lien." This lease document is one that is generally used universally throughout the state so this provision could be contained in every lease document.

The regulations provide that a lease may not contain any prohibited provisions as noted in §92.253(b). Under §92.253(b)(2) the lease may not include an agreement by the tenant that the owner may take, hold or sell personal property of household members without notice to the tenant and a court decision on the rights of the parties. The state is reminded that it may not allow the inclusion of prohibited lease provisions in the lease documents executed between the tenants and owners of HOME-assisted rental projects. This applies to all rental projects funded directly by the state or through its CHDOs and/or subrecipients.

For HOME-assisted rental projects, the state requires the use of the State of Texas' standard 'lease addendum' form to negate certain prohibited lease provisions that are contained in the standard lease. In the two cases noted, property management failed to use the lease

addendum. While onsite, state staff instructed the property managers to immediately execute the lease addendum with the tenants in question.

**REQUIRED CORRECTIVE ACTION:** State staff advised the HUD monitor prior to the completion of the monitoring that the addendums for the above tenants had been completed and executed and attached to the current lease documents. The state should advise the property owners of its HOME-assisted rental housing of the requirement to review all of the open lease documents for all rental projects and to have an executed lease addendum in the file of each tenant occupying a HOME-assisted unit if prohibited lease terms are contained in the project's standard leases. Because this deficiency was corrected prior to completion of the monitoring, this finding **is cleared**.

## **II. MONITORING**

In the past, the state provided limited monitoring and oversight of its multifamily rental portfolio on a regular and ongoing basis. Given the recent reorganization of the state's Affordable Housing Division, new managers as well as a significant number of staff have been assigned the responsibility for tracking and monitoring its HOME-assisted rental housing projects. HUD acknowledges the state's efforts in this area including the improvements in the current monitoring processes and procedures implemented under the direction of Patricia Murphy, Director, Portfolio Management and Compliance; Wendy Quackenbush, Manager, Compliance Monitoring; and Lora Myrick, Performance Manager, and their staffs.

During the review, the state provided HUD with a list of all of its open multifamily rental projects. The list, as of March 2, 2009, provided information relative to the date of the state's last monitoring visit, a description of the noncompliance issues at each project, the status of the noncompliance (corrected or uncorrected), and the actions taken or to be taken by the state. See further comments relative to this report under **FINDING NO. 2** below.

The state should continue its efforts to refine its monitoring policies and procedures and continue to provide ongoing technical assistance and training to the property managers, landlords and/or owners of all its HOME-assisted multifamily rental projects.

**FINDING NO. 2:** Review of the multifamily portfolio report indicated there are numerous projects that are out of compliance with the HOME Program requirements.

**STANDARD:** 24 CFR 92.201(b)(3)(ii); §92.203(a)(1); §92.216; §92.251(c); §92.252; §92.253; §92.351; 92.503; 92.504(a), (c)(1),(2)&(3) and (d);

**DISCUSSION:** The above report (copy enclosed) was discussed in detail with Ms. Murphy, Ms. Quackenbush and Ms. Myrick. A significant number of questions were raised during the discussion some of which will require consultation and discussion with our Headquarters Office. HUD acknowledges that the state has taken steps to address prior deficiencies in the

administration of its multifamily rental projects. The state's actions included increasing the number of staff assigned in-house and onsite monitoring duties and responsibilities; increasing technical assistance and training efforts to assure that the individual property managers and/or landlords are kept fully aware of their long-term responsibilities for maintaining these projects in full compliance with all of the HOME Program requirements; reworking the Land Use Requirement Agreements (LURAs) to include all required HOME provisions, etc.

The areas of non-compliance are varied. Some of the types of violations noted by the monitors are: **a)** household income is above the HOME limit at initial occupancy; **b)** failure to properly calculate utility allowances; **c)** failure to maintain the units and the property in full compliance with the state's Texas Minimum Construction Standards (TMCS); **d)** gross rents that exceed the maximum allowable HOME rents; **e)** failure to provide the required annual Affirmative Marketing Plans; **f)** failure to provide tenant income certification and documentation; **g)** failure to execute the required lease provisions; **h)** failure to document tenant's income-eligibility at recertification; **i)** noncompliance with senior age restriction requirements; **j)** failure to execute acceptable lease documents; **k)** failure to respond to the state's requests to correct the cited deficiencies and bring the projects/units back into compliance with the HOME requirements; etc.

The report provides information on the actions taken by the state in its attempts to bring these projects back into compliance, and HUD acknowledges the efforts currently underway. However, some of the deficiencies/violations could have serious consequences resulting in the state being requested to repay the full amount of the HOME funds invested if the projects cannot be brought into compliance within a reasonable period of time. After consultation with the Office of Affordable Housing Programs, the following guidance is being provided. This is not all inclusive and does not address all of the violations noted in the state's records.

- Tenants over-income at initial occupancy. Because all of the state's units are 'floating' units, the projects should: **a)** be required to provide additional units (not initially identified as HOME units) to cover those units that were rented initially to over-income tenants; **and b)** the owner/developer should be required to repay the portion of the HOME investment attributable to the number of units that were out of compliance initially or increase the period of affordability (POA) on the number of units that were out of compliance for the amount of time they were out of compliance. It would appear that requiring repayment of the applicable portion of the HOME subsidy would be the most appropriate since the majority of these projects already have a 20-year POA. Increasing the period only serves to extend the state's responsibility to monitor these projects for an increased period of time.
- Gross Rents Exceed the Rent Limits. Repay the tenant(s) the excess rent and require monthly reporting by the owner. If the practice of charging excess rents has existed over an extended period of time either the period of affordability should be extended or a pro-rata share of the HOME investment should be recovered.
- Failure to submit Affirmative Marketing Plans. The HOME final rule at §92.351(c) requires the state to provide an affirmative marketing plan to its



project owners. The state should require all of its owners who have not been complying to immediately begin aggressive affirmative marketing efforts so that it can diversify HOME project waiting lists even before units become available. Failure to affirmatively market all covered HOME activities could have a significant impact on the state's programs.

- Failure to include required lease provisions. These need to be corrected immediately and the leases amended for the applicable time period. All required provisions should then be contained in all future leases.
- Failure to correctly document income at recertification. The state should increase its efforts to provide technical assistance to the property managers, owners, and/or landlords. If there was inadequate income documentation for tenants being recertified, the income must be re-determined. If the tenant was initially income-eligible but at recertification their income exceeds the HOME limits, the applicable adjustment must be made as to the category of the HOME-assisted unit (high or low) and the tenant's rent must be adjusted in accordance with §92.252)(i)(2).

There were two projects for which repayment was required.

1. **Flamingo Bay Apartments, 200 Garfield, LaPorte, TX.** State contract number 538611. This was a CHDO project (Lakeside Center) that was never completed. See comments under Section I – Data Entry into IDIS.
2. **Harbor Lights, 1010 Magnolia, Freeport, TX.** State contract number 530667. This was a 150 unit CHDO rental project that was never completed. **The state reimbursed HUD a total of \$865,000 on July 28, 2005.** No further action is required for this activity.

Based on the information in the multifamily report, failure to resolve the compliance issues for the following projects in a timely manner could subject the state to the repayment requirements at §92.503(b).

- Alpine Retirement Community – IDIS #2604 - state contract number 538092. The date of the last onsite monitoring by the state was March 27, 2004. The project has not been completed and the affordability period has not yet begun. The property was foreclosed and the state took ownership on March 5, 2009. The state is currently obtaining bids for the completion of the repairs.
- Lincoln Courts Apartments – IDIS #2631 - state contract number 533186. The property has been referred to the state's Asset and Enforcement Committee. An informal conference with the owner was scheduled for November 20, 2008, but noncompliance issues remain outstanding. A penalty of \$11,800 against the property owner has been recommended.
- Port Velasco Apartments – IDIS #2636 - state contract number 532305. An onsite monitoring was conducted on June 23, 2008 with corrective action to be completed by November 26, 2008. There has been no response from the owner. Project has been

referred to the Asset and Enforcement Committee and an informal hearing with the owner was scheduled for March 19, 2009.

- **Mexia Homes** – IDIS #2637 - state contract number 532323. The property was sold through a foreclosure sale to a second private owner who refuses to reinstate the HOME deed restrictions. The project has been referred to the Asset and Enforcement Division for further action.
- **Palisades at Belleville Apartments** - IDIS #2647 – state contract number 535247C. An onsite monitoring was conducted on April 10, 2008. The owner has failed to make the required corrections. The administrative penalty process has been initiated.
- **Carriage Square** – IDIS #2670 - state contract number 536291. The state foreclosed and now owns the property. The property is vacant but the state is maintaining it while looking for a buyer.
- **Colorado City Homes** – IDIS #2676 - state contract number 533303. The owner was notified on August 13, 2008 of the outstanding noncompliance issues but has failed to respond. The project is being referred to the Asset and Enforcement Committee.
- **Colorado City Homes II** – IDIS #2677 - state contract number 534341. Same as above.
- **Southeast Texas Community Development** – IDIS #2680 - state contract number 537606. The owner was notified on August 12, 2008 of the outstanding noncompliance issues but has failed to respond. The project is being referred to the Asset and Enforcement Committee.
- **Ebenezer Senior Housing** – IDIS #2681 - state contract number 532339. The state has begun the process for pursuing administrative penalties.
- **Spur Triplex** – IDIS #2694 - state contract 533300. The owner corrected two of the cited violations but all other noncompliance issues remain uncorrected. Reminder notices were sent on February 28, 2008 and August 12, 2008, but the owner has not responded.
- **Sterling Park Square** – IDIS #2696 - state contract number 532303. Cited violations have not been corrected. The owner was notified on February 25, 2009 but has failed to respond.
- **Tyler Community Homes** – IDIS #2698 – state contract number 532277. While the state provides that the affordability period has expired, all of the noncompliance violations were cited prior to the expiration of the affordability period. All remain uncorrected and the state won't release its lien until all corrections are made.
- **Tyler Community Homes (Path)** – IDIS #2699 - state contract number 533199. The corrective action submitted by owner was insufficient to correct all noncompliance. The owner has not responded to follow-up correspondence.
- **Weldon Blackard Rental** – IDIS #2706 - state contract number 539112. The owner corrected one of the cited violations; all other noncompliance issues remain uncorrected. The project will be referred to the Asset and Enforcement Committee.
- **Colonias Del Valle Project** – IDIS #2710 - state contract number 532325. The owner failed to respond to agency requests for monitoring review and failed to submit the 2005 Annual Owner's Compliance Report. The owner was notified again on November 10, 2008 but has not responded.
- **Railroad Street Rental House** – IDIS #2711 - state contract number 532318. All cited noncompliance issues remain uncorrected. The owner has failed to respond to the

state's follow-up letters. The project will be referred to the Asset and Enforcement Committee.

- **Sunrise Villas Apartments** – IDIS #2723 - state contract number 532410. All cited noncompliance issues remain uncorrected. The proposed corrective actions received from the owner on November 8, 2008 were insufficient to correct the noncompliance. Owner was again notified of outstanding noncompliance issues on February 24, 2009. Project will be referred to the Asset and Enforcement Committee.
- **Thomas Street Apartments** – IDIS #2727 - state contract number 532319. All noncompliance issues remain uncorrected. The owner has not responded to a follow-up letter sent on October 15, 2008.
- **Alamo Plaza Apartments** – IDIS #3200 - state contract number 530687. The owner corrected one of the noncompliance issues cited on September 19, 2008. The state will initiate the administrative penalty process if the balance of the violations are not corrected.
- **St. John Colony Park** – IDIS #4001 - state contract 530200. None of the cited noncompliance issues have been corrected. This project is currently under investigation by the state's General Accounting Office.
- **Villa De Reposo – Encinal** – IDIS #4002 - state contract 530201. Project monitored on June 29, 2007. Documentation submitted on September 27, 2007 was insufficient to clear the cited noncompliance issue. Owner given until 9/11/08 to respond. Issue not resolved as of November 7, 2008. The owner has not responded to the subsequent notifications.
- **Alta Vista Village Retirement Community** – IDIS #4006 - state contract number 531300. Project monitored on November 15, 2007. Cited violation not corrected. One unit still in noncompliance. Owner given until September 12, 2008 to respond. Owner has not responded.
- **Spring Garden Apartments IV – Dallas** – IDIS #4007 - state contract number 531301. State CHDO, Affordable Housing of Parker County. Project monitored on November 14, 2007. As of June 12, 2008, noncompliance still not corrected. State is working with the new Executive Director to correct.
- **Plainview Duplex** – IDIS #4008 - state contract number 532308. Project monitored on July 24, 2007. State notified owner on August 12, 2008 that the cited noncompliance issues are still uncorrected. The owner has failed to respond.

The projects noted above do not include all of the open multifamily projects nor do they represent all projects that have noncompliance issues.

**REQUIRED CORRECTIVE ACTION:** In order to allow the state the opportunity to update and clear projects where corrective actions have been completed, the state must provide a detailed report for all of the properties listed on the enclosed report. The report should be expanded to include the following: Date of funding (commitment date); amount of the HOME-assistance; IDIS project completion date; date of initial and any follow-up onsite monitoring visits; updated description of the remaining noncompliance issues and their current status; and an updated status of state actions. Given the number of open multifamily projects, including those listed above, the state should provide this report on or before June 20, 2009.

HUD will review the state's response and provide, as applicable, a more detailed required corrective action for those projects remaining in noncompliance. The state must then provide a quarterly report beginning on October 10<sup>th</sup> and thereafter, on or before the 10<sup>th</sup> of the month for each subsequent quarter beginning January 10<sup>th</sup>, 2010, until the projects have been brought into compliance. The subsequent reports should also include new projects as they are completed and added to the state's monitoring schedule.

The state is reminded that as a direct recipient of HOME funds it is responsible for ensuring that its HOME-assisted rental projects remain in compliance with the HOME requirements for the entire period of affordability. In the agreements it is required to execute with owners, developers and sponsors of HOME-assisted rental housing under §92.504(c)(3), those entities agree to comply with those requirements as a condition of receiving HOME assistance. Failure to comply with the HOME requirements can be cause for repayment of the funds under §92.503(b).

When issues of noncompliance arise it is the state's responsibility to ensure that corrective actions are completed in a timely manner and that, where appropriate, the affordability period of the property is extended to cover the period of noncompliance. When an owner, developer or sponsor fails to resolve issues of noncompliance in a timely manner, the state should immediately move to enforce the full HOME agreement up to and including the recovery of the full HOME investment. When the principals of a HOME-assisted project are nonresponsive to issues of noncompliance, the most stringent corrective actions need to be taken.

### **Substitution of Projects**

The state has posed the question of substituting alternative projects when reimbursement of the HOME funds or voluntary grant reduction may be required. While HUD would provide consideration to such requests, they must be made on a project-by-project basis. Although there is no standard content requirement for such a request, the following areas should be covered.

- Description of the original project to include funding history, completion date, period of affordability, years operated in compliance with the HOME requirements.
- History of significant compliance issues/actions and steps taken to resolve noncompliance.
- Whether all available corrective and remedial actions have been exhausted.
- Description of substitute project to include number of HOME-assisted units, affordability period, location and project principals.
- Source, terms and conditions of all project funding for the substitute project.
- Actions to be taken to ensure ongoing compliance and long term affordability.

Upon receipt of each request, this office will forward them to the Office of Affordable Housing in HUD Headquarters for review.


**III. FILE REVIEWS AND ONSITE MONITORING**

**M. Review of Rental Project Files and Onsite Inspections**

Onsite file reviews and inspections were conducted at the following projects. Copies of the inspection reports were left with staff during the monitoring. Any deficiencies requiring correction are noted in Section 1 of the Inspection Reports. Deficiencies that were recommended for correction but are not required to be completed are noted under Section II of the Inspection Reports. Onsite inspections of selected individual units were completed by Stephen Eberlein, Program Manager, Fort Worth HUD Office.

**Tenant Files Reviewed**

**1. Spring Terrace – 7101 N 1-35 - Austin**

Name	Unit#	Low HM	High HM	Init Occ	Inc Elig	Annual Recert	Inc Elig	Unit in Comp At Move In or Recertification	Unit in Compl At Onsite Insp
		Y		Y	Y			Y	Not Inspected
		Y				Y	Y	Y	Y
		Y		Y	Y			Y	Not Inspected
		Y		Y	Y			Y	Not Inspected
						Y	Y	Y	Not Inspected
		Y		(3 <sup>rd</sup> Recertification)		Y	Y	Y	Y
									Y
									Y
									Y
									Y

This project was a conversion of a motel complex. There are 128 units of which 27 are HOME-assisted. There were some minor issues noted in a couple of the units during the onsite inspection process. All of the noted corrections were completed by management and their maintenance staff prior to the completion of the monitoring visit and in most instances they were completed before HUD staff left the premises following the completion of the file reviews.

There is, however, one major problem at this project that is applicable to tiles installed in the common areas elevators. According to building maintenance staff, the issue is with the installation of the underlayment and application of the mastic used to secure the tiles. Management advised that it has filed a complaint with the contractor that completed the installation and is working to correct this problem throughout the building. The state needs to continue to follow-up on this item to assure that this problem is resolved. The corrective action may result in the complete removal and replacement of the tiles that were initially installed. The state can assure that this issue does not recur by amending its current specifications to require a more durable product be installed and performing more onsite inspections during the construction process. Since these projects are located within the city of Austin, state staff should



<u>Name</u>	<u>Unit#</u>	<u>Low HM</u>	<u>High HM</u>	<u>Init Occ</u>	<u>Inc Elig</u>	<u>Annual Recert</u>	<u>Inc Elig</u>	<u>Unit in Comp At Move In or Recertification</u>	<u>Unit in Compl At Onsite Insp</u>
								Poor Housekeeping – Damage to unit -- Notified Building Management	N
								Unit Recently Vacated – Ready for Occupancy	Y
									Y

A. In the [REDACTED] there was a discrepancy in the 2007 income. The income certification form noted that her annual income was \$29,008, but the Compliance Report form noted an income of \$29,282. Even at the higher income, the applicant was income-eligible so there was no violation. Care needs to be taken to assure that the correct income totals are consistently used.

B. 1) In the [REDACTED] there was an error made when calculating the FY 2007 rent. Part 5 of the Income Certification form provided: "Gross rent \$781 less utility allowance of \$61 equals net rent of \$720. However; the amount noted for the gross rent was \$702. At item #6 of the lease contract, the amount was changed from \$720 to \$702 – given the above calculation, \$720 (not \$702) appears to be the correct contract rent. There was no justification or explanation as to why the rent amount was reduced.

2) Even though there was an error, as noted above, the tenant was still overcharged for the rent paid in FY 2007. The maximum allowable High HOME rent for a 2BR unit in FY 2007 was \$685 (FMR was also \$685). \$685 less \$61 utility allowance equals a maximum contract rent of \$624 – resulting in an overcharge of either \$35/month or \$17/month depending on whether the contract rent charged was \$720/month or \$702/month, as noted in #1 above. **The state needs to determine the amount the tenant was overcharged and the developer/owner should reimburse the tenant either \$420 or \$204.**

C. The contract rent for FY 2008 was correctly calculated.

This is a newly constructed project. There are 180 units in the project of which 29 are HOME-assisted. Overall, the tenants interviewed reported they were happy living in the project. Management provides a prompt response on repair requests and other tenant issues. Building exterior, grounds and common areas are well kept. The units contain Whirlpool appliances, washer/dryer hookups, and multiple media plug-ins. The project also has pools, basketball courts, a community recreation room and fitness center and a computer learning center.

**4. Picadilly Estates – 500 Grand Avenue Parkway – Pflugerville**

<u>Name</u>	<u>Unit#</u>	<u>Low HM</u>	<u>High HM</u>	<u>Init Occ</u>	<u>Inc Elig</u>	<u>Annual Recert</u>	<u>Inc Elig</u>	<u>Unit in Comp At Move In or Recertification</u>	<u>Unit in Compl At Onsite Insp</u>
		Y		Y	Y			Y	Y
		Y		Y	Y			Y	Y
		Y		Y	Y			Y	Y
		Y		Y	Y			Y	Y
		Y		Y	Y			Y	Y
		Y		Y	Y			Y	Y

A. In the [REDACTED] file, the tenant had completed the Inventory and Condition form noting numerous comments and issues regarding the condition of the unit at move-in. It could not be determined from the file whether all of her issues had been addressed. Discussion with the property manager indicated they had addressed her concerns. However, when completing the onsite inspection of this unit, the tenant stated she was very unhappy

with the unit and was planning to move out. The overall condition of the other units inspected did not support her concerns.

B. In the file for [redacted] management executed a Lease Addendum for a 'Rent Concession' to reduce the amount of rent to be initially paid. However, the concession paragraph in the addendum was incomplete in that it did not indicate the month(s) for which the rent concession was applicable. This could be a problem for management when they try to reinstate the actual rent amount at the end of the concession period. Care needs to be taken to assure that all documents are fully completed and executed and dated by all parties, as applicable.

C. In the files for [redacted] the Inventory and Condition forms were in the files but they were blank and unsigned. These should be completed to document the condition of the unit at move in and a similar form should be completed when a tenant moves out. This provides a basis to assess the condition of the unit at move out as well as justification for any repair and/or cleaning charges that may need to be assessed.

This is a newly constructed project for seniors and is still in the lease-up process. The installation of the splash blocks has not been completed and some of the meter box covers need to be secured at the front of the building. With one exception, the tenants interviewed were happy with their units and with the services provided by management. The major complaint by the tenants was that access to the project off the main highway is difficult and can be dangerous. The project should have been provided with a center median crossover to allow easier access to the property. Currently, if tenants/visitors are approaching the project going east bound on the highway, they have to go past the project and complete a u-turn at an un-signalized/uncontrolled turn around further up the highway and then drive back to the entrance of the project. It was recommended that the developer work with the city on having a center median crossover installed to provide better access to this project.

**5. Milam Creek Senior Village – 1330 E Milam – Luling**

<u>Name</u>	<u>Unit#</u>	<u>Low HM</u>	<u>High HM</u>	<u>Init Occ</u>	<u>Inc Elig</u>	<u>Annual Recert</u>	<u>Inc Elig</u>	<u>Unit in Comp At Move In or Recertification</u>	<u>Unit in Compl At Onsite Insp</u>
[redacted]									Y
[redacted]									Y
[redacted]									Y
[redacted]									Y
[redacted]									Y
[redacted]									Y

Due to time constraints, tenant files for this project were not reviewed. However, an onsite inspection of several units was completed.

This is a newly constructed project containing 22 one and two bedroom units. All of the units are HOME-assisted. There were some minor deficiencies noted during the inspection, but management addressed these prior to the HUD monitor leaving the project.

**RECOMMENDATION:** While overall the files were complete and well documented, it was noted that in many instances in the Picadilly Estates project, the 'Move-In Inventory and Condition' forms were in the files but they were blank, or not fully completed, executed and dated by all parties. This oversight may also be applicable in other tenant files for other projects; however, the above projects were the only ones monitored during this visit. This form should be



completed and properly executed and dated by all parties to document the condition of each unit when a tenant moves in. This should then be followed-up by a similar inspection at the time a tenant vacates a unit. Having a fully completed “Move-In” document will provide a justifiable basis for documenting the condition of the unit when a tenant leaves in the event damages or clean-up assessments will be made.

**RECOMMENDATION:** It was recommended that the state develop and implement a “Critical Inspection Checklist” document. This document would include various tasks and if a task is “checked” it means that the contractor must call for an inspection before proceeding to the next step. For example, if the ‘Installation of Underlayment’ item is checked, the contractor must call for an inspection of the underlayment installation before proceeding with the installation of the floor covering. If the contractor proceeds without obtaining this required inspection, he/she would be required to remove or tear out the floor covering so that the underlayment inspection can be completed and then replace the floor covering. All of this would be at the contractor’s expense. This document would apply not only to projects completed in Austin, but would be applicable to every rehabilitation job completed and it would be the responsibility of each state recipient and/or contract administrator to assure that these inspections are made. A copy of a “Critical Inspection Checklist” document has been provided to state staff under separate cover.

#### **IV. STATE’S MONITORING OF MULTI-FAMILY PROJECTS**

During the review the state provided copies of its monitoring letters/reports and as applicable, follow-up correspondence for the following projects.

- People for Progress Housing Development Corp - Sweetwater  
**Project:** Colorado City Homes II - Sweetwater
- Assist our Communities, Inc. – Nolan County  
**Project:** Colorado City Homes I – Sweetwater
- Pine Meadows Apartments - Prairie View
- Lancaster Apartments LP - Houston
- Panola Seniors Community, LTD - Linden  
**Project:** Panola Seniors Community II
- Denton Affordable Housing Corp, Denton  
**Projects:** Denton Strata and Casie
- Forney Fountainhead, LP – Fort Worth  
**Project:** LaVilla Apartments – Forney
- East Texas Apartments, LTD – Metairie, LA  
**Project:** East Texas Apartments – Garrison, TX
- Timpson Seniors Apartments, LTD – Metairie, LA  
**Project:** Timpson Seniors Apartments, Timpson, TX
- Longview Housing Associates, LP – Clarkton, MO  
**Project:** Longview Commons, Longview, TX
- Brentwood Oaks Apartments, LP – Kerrville  
**Project:** Brentwood Oaks – Fredericksburg

In our review of the state’s monitoring letters and reports, it was noted that the state was not including a regulatory citation when a violation of the HOME regulations occurred. The reports do not delineate between what are federal and what are local requirements.

HUD acknowledges the state's efforts in this area.

**RECOMMENDATIONS:** The following recommendations are provided to assist the state in providing clear and concise monitoring reports to its state recipients, CHDOs, contractors and other entities (OEs).

- The report should be separated into two sections: Section 1 would list the findings and/or concerns applicable to the HOME Program regulation; Section 2 would list the findings and/or concerns that are applicable only to the state's contracts or program requirements.
- The report should cite the section of the federal regulations that was violated; e.g., Finding No. xx: "The lease document contains a prohibited provision." This would be followed by the standard or citation: "24 CFR 92.253(b)(2). Staff would then provide a short discussion of the violation and a 'required corrective action.' Generally, a 'finding' is defined as a violation of statute or regulation. A 'concern' is an area or issue that is defined as a situation or issue that is not currently a violation of a statute or regulation but could become or evolve into a finding if the situation or issue is not addressed. For concerns, there would be no standard citation because a violation does not currently exist and the corrective action would be identified as a 'recommended action.'
- In the attachment to the December 18, 2008 letter to the Denton Affordable Housing Corporation, the state cited the following finding: "Major violation of health, safety and building codes." Under the HOME Program, owners are required to maintain the properties and projects in full compliance with the HOME Program regulations for the full period of affordability. In this instance, the violation would more appropriately be stated as: "The project or property has not been maintained in compliance with all applicable state and local property standards and/or codes." The federal 'standard' violated would be cited as: 24 CFR 92.251(c). The report only cited a state standard in this area, the Texas Administrative Code 10, Chapter 60 Subchapter A, §60.110. In this instance, the state appropriately should have cited both standards, but the violation would be included under the federal section since it is a clear violation of the HOME regulations. The state would then follow-up with its 'discussion' and 'required corrective action' as was done in the report document.

For example, for Unit #401 (could not determine if this unit was in the Denton Strata or Casie project), the state cited the following finding: "Household income above income limit at initial occupancy." However, there was no regulatory citation provided. The correct 'standard' for this finding should have been: 24 CFR 92.203(a)(1) and (d); §92.216 and §92.252(h). If there is a comparable state regulation, it could also have been cited.

If the violation is only a state requirement, the same process would be followed. For example, in the attachment to the December 18, 2008 letter to the Denton Affordable Housing Corporation, the state listed the following as a finding: "Pattern of minor violations of health, safety and building codes." There was no information provided as to what state standard or requirement was violated. Therefore, it could not be determined if

this was actually a 'finding' against the state regulations or requirements, or if it should have been a 'concern.'

**CONCERN NO. 4:** Other than for projects that are being carried out within the City of Austin, whether single family owner-occupied rehabilitation or homebuyer assistance, or single family and/or multi-family rental, it appears there is a lack of direct oversight during the construction process of activities being carried out by state recipients, subrecipients, contractors and CHDOs.

**DISCUSSION:** This issue has been brought to the state's attention on numerous occasions in the past, but it appears no actions have been taken by the state to assure that these projects are adequately monitored during the construction process.

The majority of these projects are carried out by contract administrators and/or consultants that are not located in the communities where the projects are being undertaken. Inspections are completed and documented for most projects generally only when a draw request is made. Since many of these consultants or contract administrators do not have staff that is onsite on a daily basis, the contractors are completing these projects with little to no supervision or oversight by the grantees. This lack of oversight has in the past resulted in poor quality construction, failure to follow specifications, installation of inferior materials and other problems. It has led to direct complaints from clients to this office.

**RECOMMENDED ACTION:** It is recommended that the state require, as part of its application process, that all applicants must include information as to how they will provide for the daily oversight of the construction activities being carried out with the funds provided.

Local recipients, as a condition of funding are directly responsible for the administration of their HOME activities. The use of consultants and contract grant administrators does not relieve them of this responsibility. Local recipients must also be reminded that when they use consultants and contract grant administrators, monitoring of these entities must be conducted. If the services provided by these entities will be paid with HOME funds, they must be competitively procured in accordance with 24 CFR 85.36(b).

## **FINANCIAL MANAGEMENT**

The HOME regulations at 24 CFR 92.505 set forth the applicability of the policies, guidelines, and requirements of 24 CFR Part 85 and OMB Circular A-87, as they relate to the state's program. 24 CFR 85.20(a)(2) requires the state's accounting records to be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes and regulations.

Our previous reviews of the Community Development Block Grant (CDBG) Disaster Recovery and Emergency Shelter Grant (ESG) Programs, noted that the state was previously unable to tie its administrative draws back to its general ledger. The state used a process of netting the expenses to revenue and then drawing the difference. In addition, it was found that the state was generally drawing funds in advance of need. To correct this deficiency, the state implemented a new cash management policy in September 2008.

To ensure that the new cash management policy encompassed the HOME Program, as well as the CDBG Entitlement, CDBG Disaster, and ESG Programs, we sampled 12 administrative draws totaling \$834,903.42, for the period November 13, 2008 through February 17, 2009. Of the \$834,903.42 reviewed, approximately \$629,320 was for payroll. The remaining \$205,583 was for travel, supplies, and other administrative costs.

The review of the payroll entailed tracing the payroll draws through the accounting system. Of the transactions reviewed, differences were noted in two of the payroll entries.

The state offered the following explanations for the noted differences.

- Index 05402 noted a \$59.87 difference due to changes in the benefit replacement pay for two employees.
- Index 00862 noted a \$2,943.57 difference due to the employee passing away.

Our review noted that the draws could be tied back to specific general ledger entries, and the differences found were able to be explained. We commend the state for its improvement in this area.

## **I. CASH MANAGEMENT**

The HOME regulations found at 24 CFR 92.502(c)(2), for participating jurisdictions which are not states, state that HOME funds which are drawn down and not expended for eligible costs within fifteen days of drawdown, must be returned to HUD. Any interest which is earned on these HOME funds after fifteen days, from the initial drawdown, belongs to the U.S. Treasury and must be promptly remitted to the Treasury at least quarterly (except that amounts up to \$100 per year may be retained for administrative expenses). Participating jurisdictions which are States are governed by the Intergovernmental Cooperation Act (31 U.S.C. 6501 et seq.) and 31 CFR part 205.

Treasury Circular 1075 (31 CFR Part 205) provides guidance to states on the required procedures for requesting funds from the Federal Government. Under subpart A of these authorities, the U.S. Department of the Treasury (Treasury) generally negotiates intergovernmental agreements with states that outline covered programs, approved drawdown method(s), and interest liability calculation method. Our discussions with TDHCA noted that while the State of Texas does have an agreement with Treasury, the agreement does not currently include TDHCA or the HOME funds.

Without a specific agreement that specifies otherwise, the HOME funds are subject to the subpart B requirements of 31 CFR 205. This subpart limits advances of federal funds to the minimum amounts needed for actual, immediate cash requirements in carrying out a program or project. Timing and amount of cash advances shall be as close as is administratively feasible to actual cash outlay by the state grantee. Although HUD generally uses a 3-day rule for the disbursement of funds, the HOME Program regulations found at 24 CDR 92.502(c) specify that HOME funds must be disbursed within 15 days of receipt.

To sample the state's compliance with the above regulations, we reviewed 26 general ledger indexes pertaining to the HOME Program from the period September 1, 2008 through March 6, 2009. We chose that specific timeframe since the state's new cash management policy did not go into effect until September 1, 2008.

Of the 26 indexes reviewed, five indexes, other than the indexes pertaining to program income and the escrow accounts, appeared to have maintained cash balances beyond the 15-day requirement. The indexes and days in question are noted below.

<b>Index Number</b>	<b>Days in Positive Cash Position</b>
00772	118 days from September through December and 31 days from February - March
00794	61 days from September through November
00880	87 days from September through December and 30 days from February through March
02402	26 days from September through October and 23 days in November
05415	24 days in September

Additional discussions with TDHCA staff provided the following information and chart.

- TDHCA accountants review daily administrative needs and cash accounts to determine need and then prepare a draw.
- The draw is processed in IDIS and received by the state in two days.
- The State Comptroller's office notifies TDHCA that the funds are available for use. The notification generally occurs within two days.
- Once notification is received by the comptroller's office, TDHCA processes the vouchers for payment.
- Actual liquidation occurs on the third day.

The above process is demonstrated in the chart noted below.

Sample Process for HOME Administration							
						Daily Cash	Cumulative Cash Balance
day1	request						
day2		request					
day3	100		request			100	100
day4	-100	250		request		150	250
day5		-250	100		request	-150	100
day6			-100	1000		900	1000
day7				-1000	125	-875	125
day8					-125	-125	0

We requested that the state demonstrate its process by using the above information to explain the apparent cash on hand in three of the five indexes; Index 00772, 00798, and 00880.

The state's response to our inquiry led to the following finding and concern.

**FINDING NO. 3:** The HOME regulations found at 24 CFR 92.207(a) are very specific that HOME administrative funds may only be used for the administration of HOME activities.

The information provided to us by TDHCA on March 30, 2009, pertaining to HOME index 00880 notes that \$209,380.61 of HOME administration funds were used to offset FEMA Program shortages.

Of the amounts shown as cash on hand, in the below table, \$7,018.87 of the September 2008 cumulative balance and \$202,361.74 of October 2008, cumulative balance was used by TDHCA to offset FEMA Program shortages. The HOME funds appeared to have been drawn on September 19 and October 2, 2009.

Grant Number	Index	AY	Appropriation Number	Effective DATE	Current Document Number	Reference Document	Summary Transaction Amount	Cumulative Cash
000053	00880	2009	13036	20080919	D0891426	00008914	92,052.72	92,052.72
000053	00880	2008	13036	20081002	D0891614	00008916	148,616.68	201,629.35

Upon asking why the state was using the HOME funds to offset the FEMA Program shortages, it was explained that the additional HOME funds created cash flow within a specific

appropriation that is shared with the FEMA Program and that due to delays in the FEMA Program draw process, the HOME funds were occasionally used to support the disaster related activities. It was further explained that as the FEMA Program money was recovered the HOME funds were made whole and liquidated with the liquidation complete by January 2009.

In addition to the HOME funds being used to offset FEMA shortages a copy of the state's chart of accounts for the HOME Program indicates that the HOME administration funds from index 00880, may have also been used to offset Disaster Recovery Initiative (DRI) shortages.

The state was advised on March 30 and 31, 2009 that the use of HOME funds to pay the shortages in other Federal Programs was not an appropriate action and not an acceptable practice.

**Corrective Action:** TDHCA must immediately cease using HOME funds to pay the shortages of another program and provide HUD with assurances that it has done so. Further, it must review its accounting records for the period January 1, 2005 to current and provide HUD with the following information.

- The exact dollar amount of HOME money that was used to offset shortfalls in FEMA, DRI, or any other grant besides HOME.
- The date the funds were drawn from the U. S. Treasury or disbursed from the local HOME account for the shortfalls and the date the funds were returned to the HOME Program for use and the date the funds were disbursed for eligible HOME activities.

In addition, TDHCA must calculate the interest that the U.S Treasury would have earned on the funds from the date the funds were drawn until the date the funds were disbursed for eligible HOME program expenses. The state may either use the Treasury rate in effect at the time the funds were drawn or use the state's bank rate. The methodology used to calculate the interest along with a copy of the wire transfer noting that the interest has been returned to HUD to be returned to Treasury must accompany the state's response.

**CONCERN NO. 5:** In addition to the above, our review noted that while some improvement has been made concerning the state maintaining large amounts of cash on hand, the state's payroll processes could still be streamlined. It appears that it is taking the state two weeks or more to liquidate payroll, and then the payroll is not always liquidated since the state is drawing the funds prior to the actual reconciliation of needed payroll. As noted in the state's example funds requested from HUD were available for disbursement within 3-days. As such, the state is advised that it must bring itself into full compliance with the HOME regulations that specify that all funds must be disbursed for eligible activities within 15-days from receipt.

**Recommended Action:** Ensure that all funds are disbursed within the required 15 days, or establish procedures to reimburse the U. S. Treasury interest earned on all funds that are not reimbursed within the 15 days.

During the monitoring visit, the monitor was asked if HUD would allow for some flexibility in its 3-day rule. The flexibility would allow the state to operate on a more efficient basis. Since the HOME Program allows the greater flexibility beyond HUD's normal 3-day standard for disbursement, we are seeking guidance from HUD Headquarters pertaining to the adoption of the 15-day HOME standard for disbursement of funds in the ESG and CDBG Programs as well. We will respond to this issue in a separate letter upon receiving the guidance from HUD Headquarters.

The state is reminded that interest earned on the funds maintained beyond the 15-day standard must be returned to HUD to be returned to Treasury in compliance with Intergovernmental Cooperation Act (31 U.S.C. 6501 et seq.) and the HOME regulations. The CDBG and ESG regulations contain similar requirements.

## **II. PROGRAM INCOME, RECAPTURED FUNDS AND REPAYMENTS**

The HOME program regulations found at 24 CFR 92.503 discuss the financial and programmatic requirements necessary to properly account for any HOME generated program income, recaptured funds, and returned funds. Additional information may be found in CPD Notice 97-9. A copy of CPD Notice 97-9 was provided to state financial staff following the monitoring visit.

### **Program Income**

The program income review consisted of the following:

- A comparison of the IDIS program income receipts to the state's loan processing system for the periods February 1, 2006 through January 31, 2009,
- A comparison of the IDIS program income receipts and disbursements for the period September 1, 2008 through March 6, 2009, to the state's general ledger,
- A comparison of the state's loan processing system to the state's general ledger,
- A review of source documentation for 12 receipts totaling \$1,573,898.11,
- A review to ensure that the program income was disbursed within the 30-day requirement.

The review noted a \$791 program income receipt in the state's loan processing system without a corresponding IDIS receipt. It was explained that the \$791 was inadvertently returned to HUD to be returned to the line of credit. Upon realizing the mistake, the funds were drawn down from the line of credit and placed in the local program income account.

The HOME regulations found at 24 CFR 92.503(b)(3) allow funds disbursed from the local jurisdiction's HOME trust fund account to be returned to the local account. Although the



state felt it was following the proper procedures by drawing the returned funds and placing the funds in its local account, in this instance the funds should have remained in the state's line of credit.

The funds should have remained in the line of credit until the funds were drawn for eligible HOME related activity costs as funds drawn from the U.S Treasury must be adequately supported. The state is advised that funds inadvertently returned to its line of credit must remain there until drawn for eligible program expenses.

Also, one instance was noted which appeared to be a discrepancy between the information in the state's general ledger and loan processing system. Information pertaining to IDIS receipt number 189049-001 in the amount of \$26,719.30 was found in the state's general ledger but not in the loan processing system. Upon investigation by state staff, the issue was attributed to the way the data was queried in the loan processing system. Documentation was provided that noted the amount was input into the loan processing system.

In addition to the above, the comparison of the general ledger disbursements to the IDIS draws in the PR07 report and the general ledger receipts to the IDIS PR09 report for the period 9/1/08-3/16/09 noted the following.

- One GL disbursement was not in the IDIS PR07 report. The disbursement occurred on 10/14/08 in the amount of \$21,870.32. The current document number is YLR08288 and the reference document number is 90297643.
- Two GL receipts are not in the IDIS PR09 report. The receipt amounts and dates are:
  - 10/16/08 in the amount of \$24,188.96; current document number J0891708, reference document number 00008917.
  - 10/14/08 in the amount of \$21,870.32; current document number J0891716, reference document number 00008917.

In response to the above inquiry, the state provided the following explanation:

- 90297643- A warrant was reissued due to the direct deposit being returned because the account was closed. Original voucher number was 00297322.
- J0891708 was processed to remove D0891684 from default. It is on the IDIS PR09 report. The IDIS voucher number is 0247920.
- J0891716 cleared direct deposit default-voucher 00297322.

Other than the above incidents and inquiries, which were sufficiently explained, the state's system for accounting for the program income appears to be sufficient.

To determine the state's compliance with the HOME program income disbursement requirements found at 24 CFR 92.503(a), we reviewed the state's disbursements for the period September 1, 2008 through February 28, 2009. As noted in the below table, the review found the state to be in compliance with the program income disbursement requirements.

Month	Beginning Cash on Hand	Deposits	Expenditures	Ending Cash on Hand
September	\$587,686.10	\$257,501.43	\$825,798.64	\$19,388.89
October	\$19,388.89	\$261,425.33	\$209,608.78	\$71,205.44
November	\$71,205.44	\$219,707.67	\$262,568.35	\$28,344.76
December	\$28,344.76	\$233,089.46	\$253,017.99	\$8,416.23
January	\$8,416.23	\$252,094.13	\$214,433.06	\$46,077.30
February	\$46,077.30	\$159,494.29	\$205,502.54	\$69.05

### **Recaptured Funds**

Recaptured funds are HOME funds which are recouped by the participating jurisdiction (or subrecipient, State recipient or CHDO) when HOME assisted homeownership housing does not continue to be the principal residence of the assisted homebuyer for the full affordability period required by 24 CFR 92.254(a)(4). The amount of the recapture is determined by the recapture requirements established by the participating jurisdiction in accordance with 24 CFR 92.254(a)(5)(ii).

**FINDING NO. 4:** In accordance with 24 CFR 92.503(c), recaptured funds must be deposited in the participating jurisdiction's HOME Investment Trust Fund local account. 24 CFR Part 85 states that the state must maintain records that permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes and regulations.

Our review noted that the state is not accounting for the recaptured funds separately from its program income. Instead, the recaptured funds are being accounted for as program income.

During the monitoring visit and in separate communication with the state, it was agreed that going forward from March 6, 2009, the state would establish accounting procedures to adequately separate the program income from the recaptured funds in its accounting records. It is to be noted that the state is able to separate the funds in its Loan Processing System, but not in its general ledger. It was also noted that none of the money that was classified as program income was used for program administration.

**Corrective Action:** To clear the finding, the state must provide detailed spreadsheets for the period January 1, 2005 to current that clearly distinguish the amount the state received as recaptured funds from the amount the state received as program income.

## **Repayments**

Repayments are HOME funds which the participating jurisdiction must repay because the funds were invested in a project which was terminated before completion (either voluntarily or involuntarily), or invested in housing which failed to comply with the affordability requirements specified in 24 CFR 92.252 or 92.254. Repayments also include the repayment of project specific CHDO technical assistance, site control and seed money loans pursuant to 24 CFR 92.301, when the participating jurisdiction does not waive loan repayment and the project is terminated before completion.

To sample the state's compliance with the repayment requirement, we reviewed data from the state's general ledger system for the period September 2006 through March 2009 and data from the Contract Processing System for the period February 2006 through January 2009. The data between the two systems was compared for consistency for the period September 2006 through January 2009.

**FINDING NO. 5:** As stated above, the HOME regulations found at 24 CFR 92.505 set forth the applicability of the policies, guidelines, and requirements of 24 CFR Part 85 and OMB Circular A-87, as it relates to the state's program. 24 CFR 85.20(a)(2) requires the state's accounting records to be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes and regulations.

As shown below, the information in the state's contract system did not match the information in the general ledger for the time period reviewed.

- One item in the amount of \$455 was found on the Loan Processing System and not on the General Ledger,
- Fifteen items totaling \$71,878.05 were found on the General Ledger System and not on the Loan Processing System.

To explain the above discrepancies between the two systems, it was explained that although the fifteen items were identified by the HOME department, the 15 items found in the general ledger inadvertently failed to be recorded in the contract management system. With respect to the one item not found on the general ledger, it was explained that \$455 of the \$924 entry for activity 21047 was posted to the general ledger and the remaining amount of \$479 was posted to the loan processing system.

Further inquires noted that there currently is no process for reconciling the two systems. It is our understanding that the state is in the process of developing a report that will allow the information from the contract system to be reconciled to the general ledger.

**Corrective Action:** To close the finding, the state must reconcile the two systems for the period January 1, 2005 to current. In addition, the state must establish a process to reconcile the contract

system to the general ledger on a periodic basis. The process must include the frequency of the reconciliation and the responsible party. The reconciliation and the process must be provided to HUD.

In addition, it was noted that the state was not providing HUD with a copy of the wire transfer pertaining to the funds being returned to its line of credit. The state must implement a procedure that provides a copy of the information pertaining to the returned funds to the Fort Worth Field Office.

### **III. RECIPIENT MANAGEMENT SYSTEMS**

The HOME program regulations found at 24 CFR 92.504 specify that the state is responsible for ensuring that its recipients carry out the HOME funded activities in accordance with all applicable requirements. To sample the state's recipient management systems for financial compliance, the HUD reviewer selected a sample of seven activities totaling \$11,120,478 for review and provided the sample to the state prior to the review. Funds had not been disbursed on two of the seven projects, and are not included in the total cited as reviewed.

**FINDING NO. 6:** The HOME regulations found at 24 CFR 92.508 require that each jurisdiction must establish and maintain sufficient records to enable HUD to determine whether the participating jurisdiction has met the requirements of this part. Questioned and unsupported costs in the amount \$152,494.67 as well as other discrepancies were noted and are discussed below.

- The Sixth Street file was unavailable for review. If the state is unable to locate the file, the \$149,031.67 will be considered unsupported and must be reimbursed to HUD to be returned to the state's line of credit.
- The review of the draws for the Luling Senior Housing activity noted the following:
  - Draw 7 noted \$1,440 in unsupported costs for site work.
  - Draw 5 noted \$1,850 in duplicate payments from Draw 2.
  - Draw 1 noted \$173 of settlement charges that were not included in the preliminary settlement statement.

The \$1,613 must either be supported or reimbursed and the \$1,850 must be reimbursed.

- Stored Material costs in the amount of \$247,537 were noted in the Luling Senior Housing and Highland Lakes draws. The HOME Program specifically disallows stored material costs to be paid for with HOME funds. Discussions with state staff noted that the state has discontinued this practice.
- Two examples were noted of the state using preliminary settlement statements to reimburse the settlement costs but did not receive the final settlement statements. The two

project files in question are Foundation Communities and Luling Senior Housing. TDHCA must request a copy of the final settlement statements and compare the final statements to the preliminary settlement statements and reimburse any unsupported costs.

- The settlement statement in the Spring Terrace file was not signed and dated. TDHCA must require all settlement statements, final, or preliminary, to be signed and dated.
- Draw 5 in the Northwest Residential file noted a \$1,350,000 request and a \$135,000 pay out. Discussions with state staff and a reconciliation of the previous disbursements noted that the \$135,000 was the accurate amount. We suggest that TDHCA either require the recipient to resubmit its request for the correct amount or note the correct amount on the draw request and initial the changes.

**Corrective Action:** Within 30 days from the date of this letter the state must either reimburse the ineligible and unsupported costs or provide support documentation for the costs that can be supported and reimburse the unsupported costs. In addition, the state must report on the results of its comparison of the preliminary settlement statements to the final settlement statements for the Luling and Highland Lakes activities and include any unsupported costs in the reimbursement.

#### **IV. OTHER**

The HUD monitors were pleased to find actual program files with source documentation being maintained in the HOME Program Department. However, it is our understanding that the state is investigating going to a paperless system in this department as well as its other departments.

While we recognize that space is a priority, and that file cabinets are currently occupying space needed for additional staff, we again emphasize that the state must consider its due diligence obligations with respect to requiring adequate documentation prior to reimbursing program expenses.

As suggested in our previous letters, at a minimum, the state should consider requiring its subrecipients, contractors, and subcontractors to email an Adobe PDF file of the support documentation with its expense request.