TEXAS STATE AFFORDABLE HOUSING CORPORATION

AUDIT COMMITTEE MEETING

TSAHC Offices
6701 Shirley Avenue
Austin, Texas 78752

Tuesday,
November 14, 2023
9:30 a.m.

COMMITTEE MEMBERS:

VALERIE V. CARDENAS, Chair
DAVID LONG, Member
MELINDA SMITH, Member
LEMUEL WILLIAMS, Member

I N D E X

P R O C E E D I N G S

MS. CARDENAS: Good morning to everyone, first of all. It is Tuesday, November 14, and it is now 9:32 a.m., and I'd like to call the Texas State Affordable Housing Corporation Audit Committee meeting to order.

In order to make sure we've got quorum, I would like to call roll call.

Lem Williams?

MR. WILLIAMS: Present.

MS. CARDENAS: David Long?

MR. LONG: Present.

MS. CARDENAS: Melinda Smith?

MS. SMITH: Present.

MS. CARDENAS: And Valerie Cardenas, I am present, so we do have a quorum.

Before we move on to any action items, do we have any public comment at this time?

(No response.)

MS. CARDENAS: Seeing that there is none, we'll go into tab item 1, which is the Presentation, discussion and possible approval of the minutes of the Audit Committee that was held on August 23, 2023. I hope everyone has had an opportunity to review them, if there are any changes, corrections.

MR. LONG: This is David Long. One comment, it was August 22.

MS. CARDENAS: Okay.

MR. LONG: Isn't that what it shows on there?

MS. CARDENAS: It's showing August 23.

MR. THORNHILL: But the actual minutes show the 22nd.

MS. CARDENAS: Okay. So, we'll make that notation just to correct the agenda item.

MR. LONG: Sorry. The tab cover shows -- but it's August 22.

And with that, Madam Chair, I'll make a motion to approve the minutes as submitted.

MS. CARDENAS: Okay. I have a motion. Do I have a second?

MS. SMITH: I'll second.

MS. CARDENAS: Okay. Is there any public comment at this time?

(No response.)

MS. CARDENAS: Seeing that there is none, all in favor signify by saying aye.

(A chorus of ayes.)

MS. CARDENAS: Any opposed?

(No response.)

MS. CARDENAS: The minutes are approved.

Now moving on to tab item 2 which is the

Presentation, discussion and possible approval of the annual independent financial audit for the fiscal year ending August 31, 2023.

MR. LAWRENCE: Hello. Nick Lawrence, Controller.

We are required by state statute to have an annual audit. I've got Jimmy Romell, with Maxwell Locke & Ritter, to present the fiscal year 2023 audit.

MR. ROMELL: Thanks, Nick.

Good morning, everyone. Jimmy Romell, with Maxwell Locke & Ritter.

This morning we'll be covering -- there's actually three documents we'll be going over this morning with y'all. The primary document is going to be our audit report for your fiscal year ended August 31, 2023. The second item, there is a required communication letter that we're required to present to the Board at the conclusion of our audit.

And lastly, there is an every other year requirement to report to the Board on the Corporation's compliance with the Public Funds Investment Act. So, we didn't do that last year in fiscal year '22, so that way we're doing it this year for fiscal year '23.

So, we'll go ahead and start off with the audit report first and go through that document. And obviously, as I'm going through, if you have any questions for me, I'll be happy to answer those.

So, we are going to be issuing an unmodified or clean opinion, which is the highest level of assurance we can provide as your external auditor. The financial statements of the report begin on page 11.

There is something that's a little different this year than we had last year. If you recall, last year there were a few essentially called sub-entities that were created but had no operations. So, we disclosed those in the financials but because they had no operations or no balance as of the end of the fiscal year, they were disclosed but actually had no impact on the financial statements.

This year two of those entities actually received a contribution from TSAHC in the form of a capital contribution. And so, due to that and due to the nature of those entities and their relation with the Corporation, they're considered what's known as a blended component unit. And what that means is they actually are combined in the financial results included in the audit report, but then further in the audit report in the notes there is a disclosure that shows their individual results as of the end of the year. So, as we're going through the audit report this year I'll kind of point out some of the new language and new information that was in there.

But really, all the balances that consisted as of the end of fiscal year '23 was just cash. They just received cash from the Corporation. But, if you look at the statement of financial position, there's not a distinction between TSAHC.

And then, these two entities, as I mentioned, because they're considered to be blended, they are just rolled up -- think of it like a consolidation. They're just rolled into the financial results of TSAHC, but there is a disclosure later on in the report that shows their individual results for the year. I just wanted to point that out because that is new for fiscal year '23.

So, starting on page 11, that's going to be your statement of net position as of August 31, 2023. Overall, total assets were about $440.7 million; that's an increase of about $112.8 million from fiscal year '22. Primarily the increase was due to increased activity with your single family second lien note program, so the notes receivable balances went up from fiscal year '22.

And then, in addition, you issued Series 2023A bonds during fiscal year '23, so those amounts are considered to be restricted investments and those are now part of your asset balance as of the end of the year. So, those are the two primary reasons for the increase in total assets during fiscal year '23.

And then, total liabilities as of the end of fiscal year 2023 were about $85.1 million. That's an increase of about $61.1 million for fiscal year '22, and that reason for that increase is primarily due to the issuance of the bonds, bringing on new bonds tables. So, that's the primary reason it increased compared to fiscal year '22.

And then, overall net position was about $355.2 million, and of that amount, $346.3- is considered unrestricted, meaning available for general operations of the Corporation. That's an increase of about $51.6 million overall from last year, and then the unrestricted piece increased about $54.3 million from fiscal year '22.

On page 13 is going to be your statement of revenues, expenses and changes in net position. Overall, revenues of about $86.5 million, that's a decrease of around $21.1- from fiscal year '22. And that's primarily due to a decrease in your single family income revenue amounts, primarily due to lower loan volume, because as you know, mortgage rates are still trending up. So, that's the reason why the overall revenue for that program was a little bit less than the prior year.

And then, total expenses for the year were about $34.9 million. That's an increase of about $25.6

million from fiscal year '22. And the primary reason for the increase, if you recall, the second lien program is a three-year forgivable note, so at the inception of those notes the revenue is recognized immediately. And then, at the end of that three-year term, if all the criteria is met for forgiveness, then the loan is forgiven and you're recording the amortization expense for that note receivable.

So, this is the first year where you've had significant amount of notes that have met the forgiveness criteria and have been amortized off of your balance sheet. So, there was about $23 million, roughly, of loan forgiveness related to the second lien program during fiscal year '23, so that's why that amortization expense line item increased significantly.

So, on a go-forward basis, obviously you're going to have more of those things. I mean, you'll have the revenue coming on as well, but you'll definitely see the amortization expense essentially every year now, whereas in the past that really wasn't the case.

So, just wanted to point that out because it is a timing issue, so that's why the last few years that revenue number and the overall change in your net position really was much higher. Because the criteria to meet the forgiveness is what triggers the expense recognition, so that's why there's a little bit of delay when the revenue is recognized versus when the expense is recognized. And that's the primary reason for that increase in expenses during fiscal year '23.

MR. WILLIAMS: So, do we recognize the revenue for the initial three years, or do we amortize that year after year?

MR. ROMELL: No. So, for instance, if you had a $20 million note receivable, that $20 million in revenue is recognized immediately.

MR. WILLIAMS: Okay.

MR. ROMELL: And then, at the end of the three years, that's when the $20 million of expense for the forgiveness. And there's a lot of things that it doesn't always line up that way, but this type of agreement, that's just the way from -- a recognition criteria is what triggers the revenue being up front and the expense being based on when the forgiveness actually happens.

On pages 14 and 15 are going to be the statement of cash flows for fiscal year '23. I just want to point out that overall operating cash flows as positive by about $5.1 million in fiscal year '23.

And then beginning on page 16 are going to be the notes to the financial statements. So, as I mentioned at the beginning, starting at the bottom of page 16 and continuing on to the top portion of page 17, this lists out those component units that I discussed earlier. There's actually more than the two that actually had activity here in fiscal year '23, so we included them all.

And for the ones that did not have any actual activity during fiscal year '23, we actually just noted that from the statement standpoint to note that there was no activity. But on a go-forward basis, as those entities start having either capital contributions or start generating either revenue or expenses, then once again, those are all considered as of now to be blended within the Corporation's financial results. So, those will not be separately presented on the financial statements, but just require disclosure in the notes to say what each individual entity's essentially operations were for that fiscal year.

MR. WILLIAMS: Will, it will be listed as net assets or recognized revenue?

MR. ROMELL: So, any activity they have will be reflected on financials. So, at the end of this year, because, once again, there was only cash - so, the other thing, too, is because they're blended, the way it's recorded - so, TSAHC, obviously when they made a contribution, they recorded cash going out and then essentially an investment in these entities. And the other entity on the other side recorded the cash coming in and then a capital contribution.

But, because they're blended, that investment and revenue between the two entities essentially gets eliminated because they're considered to essentially be one entity for financial reporting purposes.

MR. WILLIAMS: Okay.

MR. ROMELL: So, that's why on the actual face of the financial statements, you only see the cash. The cash is still there; it's transferred in from one entity to another entity. But, the disclosure that's required will show the individual results of those sub-entities to give a better idea of what's actually transacting between TSAHC and those component units.

MR. WILLIAMS: Gotcha. Okay, okay.

MR. ROMELL: But, every year as part of our analysis, if there's any kind of change via the by-laws or the interaction between TSAHC and those entities, there is a potential that instead of being blended as in being combined, they would be considered what's called a discreetly presented component unit. If that happens, then you actually show the results of those entities separately on the face versus shown on just a disclosure.

Every year as part of the audit process we do review that analysis to determine do they still meet the criteria to be, A, a component unit at all, and then, B, are they blended or are they considered discreetly presented to determine the presentation that is shown on the actual final audit report.

And then, moving forward in the notes, let's skip ahead to page 22. If you recall, last year there was a new accounting standard that was implemented related to leasing transactions. And the impact for the Corporation's financials, because there were entities where the Corporation is the lessor, it resulted in an essentially a lease receivable for the future payments and then a deferred revenue for the future payments that were being reported. So that was implemented last year; that's still in play for fiscal year '23.

The new standard for fiscal year '23, which is about halfway down on page 22, relates to subscription-based IT arrangements. Now, essentially what that is, it's very similar to leases except it relates to software. So, if you go out and you had a software service being provided by a vendor and you enter into a long term agreement, then essentially you do the same type of analysis to determine do I need to record a -- in this case you would record a liability for what you will be paying on that over time and then a corresponding right-of-use asset because you don't physically own the software.

It's not yours, but you do have the right to use it. So, once again, it's very similar to leases except of being a tangible, like equipment or a building, it's specifically related to software.

And so, this was implemented during fiscal year '23. We did work with the management of TSAHC to determine which agreements were potentially impacted by this standard and the overall impact, and it was determined that they were not overly significant. So, that's why even though it's been implemented, there actually isn't any change to the financial statements as a result of the implementation.

But, just like with every standard, on a go-forward basis if it has anything to do with any new agreements that are entered into, it will need to be reviewed to determine if ultimately there needs to be a right-of-use asset and a corresponding liability for those future payments related to any kind of subscription-based software arrangements.

MS. CARDENAS: And what would constitute like really significant, just as an example?

MR. ROMELL: It varies. So, obviously, everything that we're doing there is a materiality component as far as what's reported. Kind of a high level look at it is if it's going to mislead a user of the financial statements, then regardless of the dollar amount, then that's considered to be material.

So, there's a quantitative and a qualitative component. So, every year it can change, but usually we tend to review from an impact, because ultimately, if you'd be reporting a right-of-use asset and a liability, the net impact on your net position is very minimal. So, it's really just seeing from a total impact on total assets, from an impact on total liabilities, is there a significant basically way of looking at it that would once again cause the average user of this financial statement document to be misled.

There's not a, it's got to be 10 percent of this, it's got to be 5 percent of that. There's a qualitative component to once again make sure that there's not anything that needs to be reported that you know it's not from a dollar perspective significant, still would ultimately be misleading to the user of the financial statements.

So, moving forward, pages 22 through 28, just go through the Corporation's cash and investment balances. So, the only thing I just want to point out, as I mentioned at the beginning, every year we do review for compliance with the Public Funds Investment Act. Every year we're not required to have an additional reporting document like we are this year, but we just want to point out that we did review as part of our audit compliance with the Public Funds Investment Act and noted no instances of non-compliance based on our review. I just wanted to point that out.

And then moving further along in the report, notes 10 and 11, which are on pages 33 and 34, those will just show the outstanding notes payable as well as the outstanding bonds payable at the end of fiscal year '23. So notes payable was about $2.1 million that was outstanding, with about $751,000 in principal due at the end of fiscal year '24.

And then as I mentioned earlier, with the issuance of the 2023A bonds during fiscal year '23, your outstanding bond indebtedness is now about $76.2 million, which only $375,000 in principal is due in fiscal year '24. But if you look on page 35 at the top, that will show the overall amortization schedule for principal and interest of those outstanding bonds for the next five years individually and then in five-year increments after that.

So then, moving forward, as I mentioned with the component units, there is a required disclosure to show a condensed statement of net position, statement of changes in revenues and expenses, as well as a statement of cash flows. So, on page 37 and 38, which is note 20, you'll see the two entities that received capital contributions. So, TSAHC Park on 14th at about $5.6 million of cash in net position and corresponding capital contribution reflected here. And then TSAHC Juniper Creek, LLC, at $10,000 of a capital contribution, which is minimum cash during fiscal year '23.

So, obviously, on a go-forward basis this disclosure will be much more involved, as well as have more entities as those entities start getting funded and as you start working on the projects that they were set up for.

Then lastly, on page 39, note 22, this just shows the overall net working capital of TSAHC as of the end of fiscal year '23. So, that amount was about $164 million -- actually it's $143.9 -- that's the one that changed, sorry -- $143.9 million of net working capital as of the end of fiscal year '23.

And so, then, after that you'll see, starting where the header says Federal and State Awards, every year our audit is performed under Government Auditing Standards and then also the last several years --

MS. JOHNSON-ROSE: What page are we looking at?

MR. ROMELL: What page? So, it's after page 40 is where the Federal and State Awards section is.

MS. JOHNSON-ROSE: Gotcha, okay.

MR. ROMELL: Unfortunately, some of these pages don't have page numbers at the bottom.

So, this first report in that section is our report for our audit performed under the Government Auditing Standards, and just wanted to note that we noted no instances of non-compliance under the Government Auditing Standards and also noted no material weaknesses in internal controls over financial reporting as part of the audit this year.

The next report after that is going to be our report on our single audit for both the state and federal programs that were tested during fiscal year '23. We are issuing unmodified or clean opinions on compliance for both the federal program and state program that were tested, which we'll cover the actual programs here in a little bit.

And then, we also had no material weaknesses in internal control over compliance for both of those programs. For the federal program we did have one instance of reportable non-compliance that we'll discuss here in a little bit, related to the timing of disbursements when it comes to receiving money that's come back in for repayments on the amount initially loaned.

So, we'll discuss that here shortly.

But, initially, if you want to turn again to page 46, this will show the schedule of expenditures of federal and state awards for fiscal year '23. So, you'll see for your federal program, it's still the CMF program which we tested the last several years. And then, for the state program it's the Affordable Housing Partnership program, which we did test last year as well. So, you'll see overall the total expenditures.

And, just as a reminder, the $3.5 million related to the CMF program, it's a revolving loan program. So that's not $3.5 million every year that's being received by TSAHC. You received the initial amount and then that amount that was paid back is actually loaned back out, but we are required to report the initial balance -- it's considered to be a loan program so it's required that you report it at the initial principal amount that was received as part of that program. So, really, the only current year true expenditures were just the administrative costs of about $32,000.

So, then moving along, beginning on page 48 is going to be your schedule of findings and questioned costs. That just gives a very good summary document of everything covered in regards to the opinions on the financial statements, were there any kind of material weaknesses or significant deficiencies in internal controls.

At the bottom -- because I know this question always comes up -- from a low risk auditee perspective, on the federal side TSAHC is considered to be a low risk auditee because they've had federal single audits for the two years prior to fiscal year '23 and have also had no significant findings in relation to those audits. On the state side, the reason why it still says no is last year for fiscal year '22 was the first year a state single audit was required. So, because there weren't two years' worth of single audits, that's why for this information TSAHC is not required to be a low risk auditee because there hasn't been two years' worth of audits.

So, on a go-forward basis, if there's a state single audit required next year because we've done one now in fiscal year '22 and fiscal year '23, that will move from no to yes. And really the overall impact is not significant because all that really triggers is if you're not considered a low-risk auditee, instead of only having to cover 20 percent of eligible expenditures, that moves up to 40. And so, you only have one state program so it doesn't really have an overall impact. But, I always want to point that out because that's a question we get a lot is what's the distinction between a low risk and non low risk auditee.

So, on page 49, as I mentioned earlier, there was one compliance finding that we had in relation to the federal CMF program. So, when money is loaned out and that principal is repaid back to the Corporation, there is a reinvestment requirement that whenever you receive the payment back, whatever fiscal year that falls in, you have 12 months to essentially commit those funds for reinvestment.

So, for this scenario that we found, there was a repayment of about $2.8 million from an initial amount that was disbursed that occurred during fiscal year '22. So due to that, the requirement to commit those $2.8 million of funds had to be done as of the end of fiscal year '23. And so, based on our testing, there was about $700,000, roughly, of funds that had not been committed for a project that's eligible under this plan.

Now, the Corporation did reach out to the granting agency in March 2023 to ask for an extension, which was denied, unfortunately. So, due to that -- and obviously, you can't use the money just for anything, you have to identify a specific project. So, the Corporation was attempting to do that and they've been in communication with the granting agency to make them aware that they're still looking to commit those funds even though as of 8/31 they hadn't committed the full $2.8 million.

But unfortunately, for our requirements it is pretty much a cutoff as of August 31. If that amount is not committed, then we have to show it as a compliance finding. So, that's what this information on page 49 going into page 50 kind of goes through the requirements and the criteria that this finding falls under.

And then, any time you have a compliance finding, there is what's called a schedule of corrective action plan that has to be prepared by management of the entity to basically say this is what we're doing to address the finding, and so that is on page 51. So, it reports the planned corrective action, who is responsible, and essentially the estimated completion date to resolve the finding.

And so, on top of this, any time you have a finding, the subsequent year we're required to essentially provide a follow-up in our report to state the status of the prior audit finding. So, once this gets resolved during fiscal year '24, next year we'll still have to include a document that says this is what was done, essentially the issue is closed, and then be done.

So, any time you have a finding -- I just want to point that out -- it actually stays in the report for two years, the initial report, the one that actually had the underlying compliance finding, and then the subsequent year is just a follow up to provide a status update on where that finding is, whether it be closed, or in some instances it actually is still pending.

MR. WILLIAMS: So, the fiscal year I'm looking at here, so would it be August to August?

MR. ROMELL: Yes.

MR. WILLIAMS: Okay. And then, the 700K has to be committed before August of '25?

MR. ROMELL: Well, so, initially, it needed to be committed by August of '23.

MR. WILLIAMS: Okay, that's right, you said '23.

MR. ROMELL: The repayment by the entity was received in fiscal year '22, so you have the entire subsequent fiscal year to commit those funds for reinvestment.

MR. WILLIAMS: Gotcha.

MR. ROMELL: I know everyone's in contact with CMF to get those funds committed as quickly as possible.

MS. CARDENAS: So, you noted it's a compliance finding. I know as the organization we put an estimated completion date of March 26. But, I guess since it's a compliance finding, and obviously I know they're going to do their best to deploy those funds, is there a time frame, whether it's not March, whether it's July, as long as it doesn't go over another year?

MR. ROMELL: Right. So, essentially, next year when we perform the fiscal year '24 audit, if it were still outstanding, then we would have to basically say this was a finding from last year. It's still a finding because it still hasn't been resolved.

So, the estimated completion -- the key word being "estimated" -- it's management's best guess as far as when they think they'll be able to be in compliance. Now, obviously you can be in earlier as well, but the main thing is by audit cycle next year, if it's been resolved, then once again the communication to the Board will be a summary of this is what the finding was and it's been completed and it's essentially closed.

MS. JOHNSON-ROSE: Is there any jeopardy of losing the funds if they aren't committed?

MR. ROMELL: No, not that we're aware of. Because once committed -- we reviewed correspondence between management and CMF, and CMF is aware that they are still working on it. That's a very good question because sometimes, depending on the nature of a finding, you could be at risk of losing funding of having to repay. But, in this scenario that's not the case.

It's merely a timing of making sure those funds get committed for an eligible project under the terms of the grant agreement.

MR. WILLIAMS: Is it appropriate to ask -- I mean, we're very well aware that management is capable of identifying projects that are out there, but what if they can't find a project?

MR. ROMELL: That's a very good question. Usually, in those cases that's when you have --

MR. WILLIAMS: So, they can't just try to throw it out there, you can't do that.

MR. ROMELL: Right, exactly. That's where management has to then reach out -- which they've done -- reach out to this granting agency and, really, kind of figure out a way to resolve the issue, whether it be we don't have an eligible project under the current guidance, is there something else we could use it for. But that's the communication that has to be had between management and the granting agency, because you want to make sure you're not spending the money on something you can't. That's the main concern.

But, there are times, not just with this program but with a lot of federal programs, obviously, it's making sure that communication you're having so the granting agency is aware of the potential issues and also what can be done to resolve it as quickly as possible.

MR. WILLIAMS: Okay.

MR. ROMELL: So, before I move on to the other two documents I mentioned, any further questions on the audit report?

MS. CARDENAS: So, you stated on the audit report that overall --

MR. ROMELL: Yes, overall clean unmodified opinion, except for the compliance issue, it's a timing issue. Because of the communication between TSAHC and the granting agency, we actually didn't feel it warranted any kind of internal control recommendation for compliance. A lot of times with findings, you have no compliance but there's also a process that's not working, so in most cases you actually have both a compliance finding and internal control finding, where in this scenario we only had a compliance finding because the control itself was still working because TSAHC was communicating and trying to commit those funds as of the end of the fiscal year.

MS. JOHNSON-ROSE: Very good job.

MR. ROMELL: And so, as I mentioned, the other two items that we typically go over with the Board is what's called a governance letter that is, basically, kind of, a summary of the overall process. Included in that governance letter is communication of the new accounting standard that was implemented during the fiscal year. So, if there's anything that's new from an accounting standards perspective, we are also required to include that in the governance communication.

But, we also want to report that we had no difficulties in performing the audit. We also want to thank Nick, Melinda, Betsy, and everyone here at the Corporation for all their assistance. Many of you recall last year we were here in December; the fact that we're here in November is definitely -- we can only do this with the information that's provided.

The fact that we were given the information timely and be able to make this meeting definitely is a very good sign as far as how staff got us this information and we were able to complete this audit on a timely basis. No disagreements during the audit process, no adjusting entries overall.

And then, lastly, as I mentioned, every other year we're required to include a report on compliance with the Public Funds Investment Act, and so there's a one-page report also included that indicates that we reported no instances of non-compliance under the PFIA.

MS. CARDENAS: Good. Anyone have any questions?

MS. JOHNSON-ROSE: Great job.

MS. CARDENAS: Great job to the team. I know they put in a lot of work, so thank your entire team. Obviously, the results speak for themselves, so great job.

If we have no other discussion, I guess we need an approval for the annual independent financial audit. Do I have a motion for approval?

MR. WILLIAMS: Chairwoman, this is Lem. I would like to approve tab item 2 of the independent financial audit for fiscal year ending in August of 2023.

MS. CARDENAS: Okay. Do I have a second?

MR. LONG: Second.

MS. CARDENAS: Do we have any public comment at this time?

(No response.)

MS. CARDENAS: Okay. Seeing that there's none, all in favor signify by saying aye.

(A chorus of ayes.)

MS. CARDENAS: Any opposed?

(No response.)

MS. CARDENAS: Tab item 2 is approved as presented.

Do we have any other items for discussion?

MR. LONG: We do not, Madam Chair.

MS. CARDENAS: Okay. Seeing that there's none, it is now 10:02, and I adjourn the Audit Committee meeting. Thank you.

(Whereupon, at 10:02 a.m., the meeting was adjourned.)

C E R T I F I C A T E

MEETING OF: TSAHC Audit Committee
LOCATION: Austin, Texas
DATE: November 14, 2023

I do hereby certify that the foregoing pages, numbers 1 through 31 31, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Elizabeth Stoddard before the Texas State Affordable Housing Corporation.

DATE: November 17, 2023

(Transcriber)

On the Record Reporting
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