

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
Internal Audit of the 10% Test (HTC) function at Asset Management Division

Audit Report # 26-001

Executive Summary

The Office of Internal Audit (OIA) performed an audit of the 10% Test function at Asset Management Division, to assess and evaluate the internal controls of the activities related to this function, as well as compliance with applicable rules and regulations.

Based on our review and testing, the 10% Test function seems to be operating effectively in reviewing and accepting development packets and requests for extensions. We identified some areas for improvement and made recommendations to the staff. Details of our recommendations and management responses are included in the report.

Observations and Recommendations

- OIA recommends that the Asset Management division revise and update the current SOPs to include more details and clear guidelines.
- OIA recommends that the Asset Management division revise its internal procedure to providing time frames with deficiency letters, to align with the instructions provided in the Post Award Activities Manual.

Objective, Scope, and Methodology

Our scope included a review of the Texas Administrative Code (Section 10.400-408 of the Rules in 10 TAC Chapter 10), Post Award Activity Manual, US Treasury Regulations (Section 1.42-6), and SOPs related to 10% Test. We conducted interviews with several division staff and performed testing and analysis of the processes involved in receiving and reviewing developments' 10% packets, including requests for extensions.



Mark Scott, CPA, CIA, CISA, CFE, MBA
Director, Internal Audit

3/2/26
Date Signed



TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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February 24, 2026

*Writer's direct phone # 512.475.3813
Email: mark.scott@tdhca.texas.gov*

Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: Internal Audit of the 10% Test (HTC) function of Asset Management division

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "Internal Audit of the 10% Test (HTC) function of Asset Management division". This audit was conducted in accordance with the applicable audit standards. It included the objectives to assess and evaluate the internal controls of the activities related to this function, as well as compliance with applicable rules and regulations. The 10% Test (HTC) function was identified during the fiscal year 2026 risk assessment and rated high on the risk assessment matrix due to its importance in ensuring compliance with State and Federal rules governing Multifamily programs.

For this audit we reviewed applicable Texas Administrative Code¹, applicable US Treasury Regulations², function specific SOP, internal documents such as Post Award Activity manual, and other applicable rules and regulations. We conducted interviews with several division staff and

¹ TAC 10, Chapter 10, §10.400 - §10.408

² Section §1.42-6

performed testing and analysis of the processes involved in receiving and reviewing developments' 10% packets, including requests for extension.

This report includes the following sections:

- A. Overall Result
- B. Background Information
- C. Scope and Methodology
- D. Roles and responsibilities
- E. Testing and Recommendations

A. Overall Results

Based on our review and testing the 10% Test (HTC) function at Asset Management division seems to be operating effectively in reviewing and accepting development packets and requests for extensions. We identified some areas for improvement and made recommendations to the staff. Details of our recommendations and management responses are included in the later sections of this report.

B. Background Information

The Asset Management Division at TDHCA is responsible for monitoring and processing all post-award activities, including the 10% Test (HTC), for multifamily developments that receive funding from the Department. The funding sources include Housing Tax Credits, HOME funds, National and State Housing Trust Funds, and Neighborhood Stabilization Program (NSP) funds.

Submission of a 10% Test is required of all awardees of a competitive Housing Tax Credit allocation. A 10% Test file is provided by TDHCA, located on Asset Management webpage, for developers to use when submitting all the required documentation. All submissions are reviewed by Department staff to verify compliance with applicable rules, including reconciliation of all the information provided in the submission with the corresponding or related information in other documents. If staff identifies any deficiencies in the documentation submitted by the development the Department will notify the owner.

In general, the 10% Test will be due no later than July 1 of the year following the submission of the Carryover Allocation Agreement. However, the development has the option to request extension of this deadline if circumstances beyond developer's control contributed to the delay in meeting the 10% Test requirements. Details of the extension request requirements and associated fees, if applicable, are provided to the developers in the Post Award Activities Manual.

C. Scope and Methodology

Our scope included a review of the Texas Administrative Code (Section 10.400-408 of the Rules in 10 TAC Chapter 10), Post Award Activity manual, US Treasury Regulations (Section 1.42-6), and SOP related to 10% Test. We conducted interviews with several division staff and performed testing and analysis of the processes involved in receiving and reviewing developments' 10% packets, including requests for extension. The result of our reviews and testing is provided in the Testing section of the report.

An SOP is a procedure specific to the operation of an entity or function that describes the activities necessary to complete tasks in accordance with applicable rules and regulations. It defines expected practices in a process where quality standards exist. SOPs play an important role in any organization and division. They are policies, procedures and standards needed to operate in a successful way. They can create efficiencies, consistency and reliability, fewer errors, and add value.

OIA reviewed two SOPs related to this function: SOP 2400.02 (10% Test Review), and SOP 2400.07 (Extension Request Review). We noted that the SOPs were signed in 2013 and could benefit from being updated to include more details and clear guidance on the processes.

| Observation Number | Status Pertaining to the Recommendations and Action to be Taken | Target Completion Date | Responsible Party |
|--------------------|--|------------------------|---------------------------------------|
| 26-001-01 | OIA recommends that the Asset Management division revise and update the current SOPs to include more details and clear guidelines. | July 1, 2026 | Director of Asset Management division |

Management Response

Asset Management division will review and update related SOPs by July 1, 2026.

D. Roles and Responsibilities

Development Owners

Developments that receive a Competitive Housing Tax Credit Commitment Notice and Carryover Agreement must submit required documentation for the 10% Test to support those expenditures comprising a part of the taxpayer's basis in the Development were incurred in excess of 10% of the total reasonably expected basis by the deadline established in the Qualified Allocation Plan (QAP) and 10 TAC §10.401(a). It is Development Owner's responsibility to deliver the necessary documents in a timely manner, any delay in submission will result in additional requirements such as extensions and possible fees imposed as a result.

Asset Management division / TDHCA

The mission of the 10% Test function at Asset Management is to confirm that a Development that receives a Competitive (9%) Housing Tax Credit award meets the federal requirement specified in Treasury Regulation Section 1.42-6 and in Internal Revenue Code Section 42(h)(1)(E). The requirement states that a project must incur more than 10% of the Taxpayer's Reasonably Expected Basis (REB) no later than the end of the second year following the allocation. The Carryover Allocation Agreement specifies the 10% Test must be met by July 1st following the year of the award.

Internal Revenue Services, Treasury §1.42-6

Verification of basis by Agency; An agency that makes a carryover allocation to a taxpayer must verify that the taxpayer has met the 10percent basis requirement. An Agency may verify that a taxpayer has incurred more than 10 percent of its reasonably expected basis in a project by obtaining a certification from the taxpayer, in writing and under penalty of perjury, that the taxpayer has incurred by the close of the calendar year of the allocation more than 10 percent of the reasonably expected basis in the project

Independent Accountant's Report

The Development owner is required to submit an Independent Accountant's Report and Taxpayer's Basis Schedule with their 10% Test packet. This report must be submitted by a third-party accountant on the accounting firm's letterhead and with original signature. The report should provide an Effective Date that is not later than July 1 of the year following the Department's signature of the Carryover Allocation Agreement, as well as all the information about Development owners, or their affiliates, and the individual CPA who actually produced the report.

The Taxpayer's Basis Incurred referred to in the report and all figures referenced in the report must be consistent with the 10% Test Taxpayer's Basis Schedule, and the Taxpayer's Basis Schedule must be completed showing the taxpayer's basis incurred and percentage of total reasonably expected basis incurred. The forms must be signed by the development owner.

E. Testing and Recommendations

For this audit we randomly selected 12 developments that were subject to 10% Test requirements in 2025 to review and test for accuracy, completeness, and their compliance with applicable rules and regulations. The review included verification of all documents provided by the owner, date of submissions, extension requests as applicable, any deficiencies identified, and all other correspondence between the staff and the development owners.

In reviewing the internal documents of the division, we noticed that the Post Award Activities Manual states that "the Development Owner will be given a specific length of time to correct deficiencies. If the Development Owner does not correct the deficiencies within the time allowed, the Department may terminate the Carryover and the Commitments of the allocation". However, in reviewing our sample we found that the deficiency letters do not provide a time frame to the development owners.

| Observation Number | Status Pertaining to the Recommendations and Action to be Taken | Target Completion Date | Responsible Party |
|--------------------|--|------------------------|---------------------------------------|
| 26-001-02 | OIA recommends that the Asset Management division revise its internal procedure to providing time frames with deficiency letters, to align with the instructions provided in the Post Award Activities Manual. | July 1, 2026 | Director of Asset Management division |

Management Response

Asset Management division will address this recommendation in the Post Award Activities Manual and in the SOP by July 1, 2026.

We conducted this performance audit in accordance with applicable auditing standards. We provided our observation and recommendation based on evidence obtained through our reviews and based on our audit objectives.

We extend our appreciation to Asset Management division and its staff for their cooperation and assistance during course of this audit.

Sincerely,

A handwritten signature in cursive script that reads "Mark Scott". The signature is written in black ink and is positioned above the printed name.

Mark Scott, CPA, CIA, CISA, CFE, MBA
Internal Audit Director

MS/NS