



TEXAS GENERAL LAND OFFICE
GEORGE P. BUSH, COMMISSIONER

**REPORT ON THE AUDIT OF VENDOR MANAGEMENT FOR
THE VETERANS LAND BOARD,
LAND AND HOUSING PROGRAMS**

SEPTEMBER 2021

OVERALL CONCLUSION

The General Land Office (GLO), Veterans' Land Board (VLB), Land and Housing Division has established processes and management controls to ensure the adequate management and monitoring of vendor performance for its loan programs. VLB provided reasonable assurance that management controls were operating to ensure vendors were performing in accordance with contractual obligations and Veterans' Loan Program Guidelines.

Although processes are in place to monitor vendor performance, there were areas identified that should be strengthened to ensure the effectiveness of established controls. In general, VLB as the primary administrator of the VLB Land and Housing programs, should coordinate with supporting GLO program areas to develop and update existing procedures to strengthen the control environment and compliance with agency and state requirements to ensure adequate oversight and monitoring of vendor activities.

The areas identified for improvement pertained to the following:

1. Monitoring and Oversight of Servicing Vendors and VHAP Loan Origination Administrator
2. Processes for Reconciling Veterans' Loan Program Borrower Principal and Interest Remittances
3. Invoice Review and Acceptance of Deliverables Procedures and Controls
4. System Security of Critical Vendor Information Systems
5. Timeliness of Vendor Contract and Amendment Execution

As a result of the audit, there were additional areas of opportunities to strengthen internal controls associated with vendor management but, they did not meet the criteria for inclusion in this report. These areas were presented to management in a separate communication.

MANAGEMENT'S SUMMARY RESPONSE

Management for the VLB, Financial Management Division, and the Office of Information Security concurs with the recommendations. The "Detailed Results" section of this report contains management's response to each observation.

ACKNOWLEDGEMENTS

We appreciate the assistance and cooperation provided to us by the management and staff of the divisions reviewed during this audit. For questions about this report, please contact Tracey Hall at (512)463-6078.



September 28, 2021

Tracey Hall, CPA, CISA
Director of Internal Audit

Date

BACKGROUND INFORMATION

The Veterans' Land Board, Land and Housing Division administers three Veterans' loan programs for eligible Texas Veterans and Military Members:

1. Veterans Land Loan Program
2. Veterans Home Assistance Program (VHAP)
3. Veterans Home Improvement Program (VHIP)

The VLB contracts with vendors to provide various services, including loan origination, lending, and servicing. The VLB is responsible for monitoring and oversight of the contracted vendors to ensure performance in accordance with the terms of their contracts and Program Lender and Servicing Guidelines.

Other divisions within the GLO are responsible for additional monitoring and administration activities in support of the VLB Loan Programs consisting of:

1. Investment Management Division:
 - Initiates and maintains bond issuances to fund the loan programs and reviews and approves invoices from the master servicing vendors and the VHAP loan origination vendor.
2. Financial Management, Cash Management Division:
 - Pays vendor invoices, processes and records deposits received for Veteran Borrowers principal and interest payments.
3. Financial Management, Financial Reporting Division:
 - Completes monthly reconciliations of Veteran Borrower principal and interest collections and primary servicing fees.

See Appendix B for additional background information on the Veterans' Loan Programs.

TABLE OF CONTENTS

Overall Conclusion	1
Management’s Summary Response.....	1
Acknowledgments.....	2
Background Information.....	3
Detailed Results with Management Responses	5
Chapter 1: Ensure Adequate Monitoring and Oversight of Vendor Activities.....	5
Section 1.1: Monitoring and Oversight of VHAP/VHIP Master Servicer.....	5
Section 1.2: Monitoring and Oversight of Veterans’ Land Loan Program Servicer	7
Section 1.3: Monitoring and Oversight of VHAP Loan Origination.....	10
Chapter 2: Improve Processes for Reconciling Veterans Loan Program Borrower Principal and Interest Remittances.....	12
Section 2.1: Improve Monthly VHAP & VHIP Reconciliation Processes	12
Section 2.2: Improve Monthly Land Loan Program Reconciliation Processes	14
Chapter 3: Implement Invoice Review and Acceptance of Deliverables Procedures	16
Section 3.1: Invoice Review and Acceptance of Deliverables Procedures	16
Section 3.2: Ensure Invoices are Adequately Supported and Verified.....	17
Chapter 4: Ensure System Security of Critical Vendor Information Systems.....	20
Chapter 5: Ensure the Timeliness of Vendor Contract and Amendment Execution	22
Appendices.....	23
A. Objective, Scope & Methodology.....	23
B. Additional Background Information	24
Distribution List.....	26

DETAILED RESULTS

CHAPTER 1: ENSURE ADEQUATE MONITORING AND OVERSIGHT OF VENDOR ACTIVITIES

SECTION 1.1: MONITORING AND OVERSIGHT OF VHAP/VHIP MASTER SERVICER

VLB's contract with Nationstar outlines a set of monthly and annual servicing reports that Nationstar is required to submit to the VLB to monitor vendor performance and compliance with program guidelines. During the review, auditors found that VLB does not ensure the following contracted deliverables are completed by Nationstar Mortgage in accordance with GLO Contract #17-458-000-A585, Section 1.17:

1. Monthly Servicing Reports

- a. Although VLB provided evidence that Nationstar completed all required monthly VHAP/VHIP servicing reports for all the selected months tested, auditors were unable to determine whether the VLB actively monitored or reviewed 11 out of 25 (44%) servicing reports submitted to ensure the reports were completed, timely reported, and included all required information.

2. Annual Servicing Reports

- a. Of the reports reviewed for FY2020¹, 2 out of 17 (12%) VHAP/VHIP servicing reports were not completed and submitted by Nationstar for review by the VLB. These 2 reports include:
 - i. Summary of VHAP loans by Participant, which provides loan counts and Unpaid Principal Balances (UPB) of loan purchases for the Fiscal Year.
 - ii. Detail by Program, Bond, and Loan Number of Receivables due from Participants with breakdown by Principal and Interest components.
- b. The VLB did not provide support for the active monitoring or review for 14 of the 17 (82%) FY2020 servicing reports tested to ensure the reports were completed, timely submitted, and included all required information. VLB indicated they do not actively monitor or review annual servicing reports for completeness and accuracy of the reported information. However, the three reports are utilized for the development of the Annual Financial Report (AFR), Note 33 Disclosures.

3. Compilation of Annual Participant Reviews

Nationstar is responsible for reviewing and auditing VHAP/VHIP participant servicers to monitor portfolio performance and ensure they are adhering to the servicing guidelines. To monitor this activity, VLB's contract with Nationstar requires them to submit an annual² report to VLB containing data for all participant servicers with known compliance issues and other statistical loan information. The following issues were identified during the review:

¹ Fiscal Year 2020: September 1, 2019 through August 31, 2020.

² Annual submission of the report is required by September following the end of the fiscal year.

- a. The FY2020 annual report was not submitted until July 2021 although the contract requires it to be completed and provided to VLB during September following the end of the fiscal year (9/2020).
- b. The FY2019 report was not submitted until May 2021 when it was identified and requested by auditors for the purpose of this audit.
- c. VLB does not have a monitoring and review process to ensure the annual report is completed, timely submitted, and includes all required information and statistical data.

RECOMMENDATIONS FOR MANAGEMENT

The VLB should:

1. Coordinate with Financial Management to review its contract with Nationstar and determine which reports and monitoring tasks are needed for the GLO to monitor vendor performance effectively and efficiently. Following the review, VLB should revise its master servicing contract with Nationstar to remove unnecessary or duplicative reports that are not critical for VLB or other GLO program area to monitor.
2. Develop a monitoring and control process for reviewing monthly and annual VHAP/VHIP servicing reports to ensure they are submitted timely and include all information outlined in VLB's Master Servicing Contract with Nationstar. The control process should include procedures for resolving any compliance and performance issues identified.

MANAGEMENT'S RESPONSE

To develop more effective and efficient vendor monitoring of Nationstar, VLB Land and Housing will:

1. Coordinate with Financial Management to determine which reports and monitoring tasks are needed for the GLO to monitor.
2. Revise the master servicing contract with Nationstar to remove unnecessary or duplicative reports that are not critical for VLB Land and Housing or other GLO program areas to monitor.
3. Develop a monitoring and control process for reviewing monthly and annual VHAP/VHIP servicing reports to ensure they are submitted timely and include all information outlined in VLB's Master Servicing Contract with Nationstar.

Implementation Date: January 1, 2022

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

SECTION 1.2: MONITORING AND OVERSIGHT OF VETERANS' LAND LOAN PROGRAM SERVICER

VLB's contracts with Dovenmuehle Mortgage Inc. (DMI) outline monthly and annual servicing reports that DMI is required to submit to the VLB to monitor vendor performance and compliance with program guidelines. During the review, auditors found that VLB does not monitor DMI to ensure the following contracted deliverables are completed:

A. Monthly Servicing Reports**1. *Land Mortgage Monthly Servicing Reports*³**

For 61 of the 156 (39%) servicing reports tested, VLB did not provide evidence that DMI completed and furnished servicing reports for the tested periods. Following are the identified reports not supported, per the period reviewed:

- 2019 (*April, June, November*): 48 of 78 (62%)
- 2020 (*March, April, December*): 13 of 78 (17%)

Furthermore, it was identified that 85% of the required monthly servicing reports required by the Servicer contract, are not utilized by the VLB and therefore, are not actively reviewed or monitored to ensure they are completed and include all required information.

2. *Contract for Deed (CFD) Monthly Servicing Reports*⁴

For 10 of the 48 (21%) servicing reports tested, VLB did not provide evidence that DMI completed and provided the reports for VLB for review, in accordance with the contract. Following are the identified reports not supported, per the period reviewed:

- 2019 (*April, June, November*): 7 of 24 (29%)
- 2020 (*March, April, December*): 3 of 24 (13%)

Furthermore, 50% of the required monthly servicing reports listed in VLB's contract with DMI are not utilized by the VLB and therefore, are not actively reviewed or monitored to ensure they are completed and include all required information.

3. *Land Mortgage and CFD Service Quality Reports*⁵

- a. For 16 of the 48 (33%) land mortgage service quality reports (SQRs) tested, VLB did not provide evidence that DMI completed and submitted the reports in accordance with contract terms. All 16 exceptions noted were from June 2019 and November 2019 and

³ GLO Contract #08-121-000-1263 Schedule 2.05(b) *Standard Subservicing Management Reports* outlines a set of standard servicing reports that DMI is required to furnish to VLB monthly.

⁴ GLO Contract #07-325-000-1082 Section 2.02 *Servicing Responsibilities (c) Reporting Related Responsibilities (i-iii)* outlines a set of standard servicing reports that DMI is required to furnish to VLB monthly.

⁵ GLO Contracts #07-325-000-1082 Section 10.1 (c) and #08-121-000-1263 Section 2.07 (a) state DMI will deliver to the VLB a monthly written Service Quality Report detailing customer service telephone call volumes, service levels, task tracking, and delinquency rates. DMI reports this information to VLB in several separate monthly reports.

were unable to be provided due to DMI recovery costs to the agency associated with furnishing the reports.

- b. For 7 of the 48 (15%) Contract for Deed (CFD) service quality reports tested, VLB did not provide evidence that DMI completed and furnished them to the VLB. All 7 exceptions noted were from April 2019 and were unable to be provided due to DMI recovery costs associated with furnishing the reports.

B. Annual Servicing Reports

1. *Contract for Deed Annual Reports*⁶

Although VLB provided evidence that DMI completed all required annual CFD servicing reports selected and tested for FY2020, the VLB indicated they do not utilize any of the annual servicing reports listed in VLB's contract with DMI.

2. *Annual Audited Financial Statements*⁷

Although VLB provided DMI's FY2020 Audited Financial Statements requested during the review, VLB does not request, monitor, or review the annual submission of the report. By not monitoring DMI's financial condition, the VLB may not be aware of any potential financial issues that could affect the vendor's ability to fulfill contractual obligations.

Overall, the VLB indicated that monthly and annual servicing, financial, and other reports requested by auditors, were not provided due to either the reports not being completed or submitted by the vendor, or due to costs associated with recovering the reports; DMI purges the Fidelity System of servicing reports that are over a year old, and VLB only retains reports that are actively monitored and tracked by the Program Area.

According to *Section 8.0, Period of Retention* clauses included in both Land Mortgage and CFD contracts state that the vendor is to retain all records for a minimum of four years with the period of retention beginning at the date of payment by the VLB for the goods or services received. When discussed with management of the VLB, it was asserted that the retention clause was only applicable to physical records not digital records for which the requested servicing reports fall under. However, the contract does not make the distinction between the retention of physical versus digital records.

⁶ GLO Contract #07-325-000-1082 Section 2.02 Servicing Responsibilities (c) Reporting Related Responsibilities (iv) outlines a set of standard servicing reports that DMI is required to furnish to VLB annually.

⁷ GLO Contracts #07-325-000-1082 Section 2.03 (a) and #08-121-000-1263 Section 8.01 state DMI must furnish to the VLB a detailed, audited statement of its financial condition as of the fiscal year end, prepared in accordance with GAAP no later than 120th day after the end of the fiscal year.

RECOMMENDATIONS FOR MANAGEMENT

VLB should:

1. Coordinate with Financial Management to review its contracts with DMI and determine which reports and monitoring tasks are needed for the GLO to monitor vendor performance effectively and efficiently. Following the review, VLB should revise its servicing contract with DMI to remove unnecessary or duplicative reports that are not critical for VLB or other GLO program area to monitor.
2. Implement monitoring controls to ensure required servicing and other reports include all necessary information and that DMI retains all digital and physical contract documentation as required by the contract.

MANAGEMENT'S RESPONSE

To develop more effective and efficient vendor monitoring of DMI, VLB Land and Housing will:

1. Coordinate with Financial Management to determine which reports and monitoring tasks are needed for the GLO to monitor.
2. Revise the servicing contract with DMI to remove unnecessary or duplicative reports that are not critical for VLB Land and Housing or other GLO program areas to monitor.
3. Revise the servicing contract with DMI to clarify the retention schedule for both physical files and digital files.
4. Implement monitoring controls for reviewing all servicing reports to ensure they are submitted timely and include all information outlined in VLB's Master Servicing Contract with Nationstar.

Implementation Date: January 1, 2022

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

SECTION 1.3: MONITORING AND OVERSIGHT OF VHAP LOAN ORIGINATIONS

Auditors were unable to determine whether Gateway Mortgage Group completed and submitted the following reports to VLB in accordance with contract terms⁸ for all six months sampled and tested:

1. Monthly Fallout Reports
2. Weekly First File Review Pipeline Reports
3. Weekly Second File Review Pipeline Reports

During the review it was determined that the VLB has not established a process to monitor the completion of the identified reports related to originating VHAP loans. As a result, Gateway may not be fulfilling contractual obligations and performance standards related to the development and submission of the reports and therefore, may be paid for services not rendered.

RECOMMENDATIONS FOR MANAGEMENT

VLB should:

1. Review its contract with Gateway and determine which reports and monitoring tasks are needed for the VLB to monitor vendor performance effectively and efficiently. Following the review, VLB should revise its contract with Gateway to remove unnecessary or duplicative reports that are not critical for VLB to monitor.
2. Implement a monitoring and control process to ensure Gateway submits required VHAP and VHIP reports with all required information outlined in VLB's contract with Gateway.

MANAGEMENT'S RESPONSE

To develop more effective and efficient vendor monitoring of Gateway, VLB Land and Housing will:

1. Determine which reports and monitoring tasks are needed for VLB Land and Housing to monitor vendor performance.
2. Revise the contract with Gateway to remove unnecessary or duplicative reports that are not critical for VLB Land and Housing to monitor.
3. Implement a monitoring and control process to ensure Gateway submits required VHAP and VHIP reports with all required information outlined in VLB's contract with Gateway.

⁸ GLO Contract #17-455-000-A581 Attachment B Section 1.14 Ongoing Reporting to the TVLB Related to Loan Originations states Gateway shall deliver the following reports related to loan origination activities on a regular basis:

- a) Monthly Fallout Reports
- b) Weekly pipeline reports: (ii) First Files, (iii) Second Files

Implementation Date: January 1, 2022

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

CHAPTER 2: IMPROVE PROCESSES FOR RECONCILING VETERANS LOAN PROGRAM BORROWER PRINCIPAL AND INTEREST REMITTANCES

SECTION 2.1: IMPROVE MONTHLY VHAP & VHIP RECONCILIATION PROCESSES

The Financial Reporting section of the Financial Management Division completes a monthly reconciliation of MIP (GLO's system of record for the agency's financials) accounting data to loan activities reported by Nationstar, the Master Servicer for both VHAP and VHIP, to ensure the balances of the principal and unapplied account balances in MIP are accurately and properly recorded. Financial Reporting maintains written procedures for performing the monthly reconciliation. In testing a sample of months from January 2019 to December 2020, the following items were identified:

1. All 6 (100%) monthly reconciliations tested identified variances between loan account balances in MIP and data provided by Nationstar. Journal voucher entries for these variances were not posted until several months and in some cases a year after the reconciliation was completed. Furthermore, there are aged adjustments that are tracked in each reconciliation tested that have not been posted. For example, the December 2020 reconciliation contained adjustments that have been carried forward from 2016, that have not been either posted into MIP or resolved with Nationstar.

In speaking with Financial Reporting staff, the following were determined as causes for the reconciliation variances:

1. Not properly recording loan sales to Nexbank into MIP/USAS,
 2. Staff turnover and lack of training in Financial Reporting,
 3. Lack of formalized procedures for tracking and resolving variances, and
 4. Applying principal and interest payments to the incorrect account due to Lag⁹ number (i.e. Bond Issuance number) changes.
2. For 2 of the 6 (33%) monthly reconciliations tested did not have supporting documentation indicating they were reviewed and approved by Financial Reporting management.

These errors may have significant impacts on MIP account balances which could result in inaccurate information presented in the agency's financial statements.

⁹ As defined by Investment Management, "Lag" numbers are assigned for each bond issue by Gateway. The lag number serves as an identifying "bucket" in which to place loans originated with the proceeds from the corresponding bond issue. A bond issue can have multiple lag numbers associated with it.

RECOMMENDATIONS FOR MANAGEMENT

The Financial Reporting section should:

1. Implement controls and update its procedures to ensure variances identified from the reconciliation are promptly resolved and reconciliations are completed, reviewed by management, and documented in a timely manner. Financial Reporting should coordinate with VLB, Investment Management, and Nationstar, to develop a process to ensure variances resulting from Lag number discrepancies are promptly resolved.
2. Ensure adjustments identified and carried forward from previous reconciliation periods are either corrected in MIP or resolved with Nationstar if the adjustment is a result of a reporting error.

MANAGEMENT'S RESPONSE

Financial Reporting concurs with these recommendations and will work to implement processes to strengthen its controls and update procedures to address timely resolution of variances identified during the reconciliation process and management's review. Financial Reporting will coordinate with VLB, Investment Management, and servicing agents to develop a process for communicating and resolving Lag number discrepancies across affected parties and systems.

Implementation Date: August 31, 2022

Contact:

Jessica Johnston, Director of Financial Reporting & Accounting

SECTION 2.2: IMPROVE MONTHLY LAND LOAN PROGRAM RECONCILIATION PROCESSES

The Financial Reporting section of the Financial Management Division completes two monthly reconciliations of MIP accounting data to loan activities reported by DMI, the Master Servicer over the Veterans' Land Loan Program. The reconciliation ensures the balances of the principal and unapplied account balances in MIP are accurately and properly recorded. Two separate reconciliations are completed for the Contract for Deed and Land Mortgage portfolios. Financial Reporting maintains written procedures for both reconciliation processes. In testing a sample of months from January 2019 to December 2020 the following items were identified:

Land Mortgage Reconciliation Testing:

1. For 5 of the 6 (83%) monthly reconciliations tested, variances were identified between loan account balances in MIP and data provided by DMI. However, there was no documentation provided indicating that either adjusting entries were made in MIP or variances were resolved if caused by a DMI reporting error. At the time of testing, the oldest variances identified date back to June of 2017 and have been carried forward each month without corrections being made.
2. For 3 of the 6 (33%) monthly reconciliations tested did not have supporting documentation indicating they were reviewed and approved by Financial Reporting management.

Contract for Deed Reconciliation Testing:

1. For all 6 (100%) monthly reconciliations tested, variances were identified between loan account balances in MIP and data provided by DMI. There was no documentation indicating that either adjusting entries were made in MIP or variances were resolved if caused by a DMI reporting error. In addition, reconciliations tested did not include the W48_P139 Summary report¹⁰ as support as required by Financial Reporting's written procedures.
2. For 2 of the 6 (33%) monthly reconciliations tested did not have supporting documentation indicating review and approval by Financial Reporting management.

During the review the following were determined to be the causes associated for the items identified above:

1. Turnover within Financial Reporting.
2. Need for improvements to formalized procedures for tracking and timely resolving variances.
3. Incorrect recording of loan sales into MIP accounts.
4. Potential issues with the operation of automated SSIS package processes for allocating remittance collections from DMI.

¹⁰ According to Financial Reporting's *Land Principal and Interest Reconciliation Procedures*, the W48_P13 Summary is a report provided by DMI that Financial Reporting utilizes to reconcile CFD principal balances.

RECOMMENDATIONS FOR MANAGEMENT

Financial Reporting should:

1. Revise its procedures to ensure the timely completion, review, resolution of variances identified, and maintenance of supporting documentation of reconciliations.
2. Ensure adjustments identified from reconciliations are completed within the fiscal year that they are identified.
3. Coordinate with Master Servicer (DMI) to ensure the correction of errors identified from reconciliations that are a result of DMI reporting issues are corrected within DMI's records.

MANAGEMENT'S RESPONSE

Financial Reporting concurs with these recommendations. Management will work with staff to update procedures to ensure internal and external variances are communicated to responsible parties and resolved timely and supporting documentation is retained.

Implementation Date: August 31, 2022

Contact:

Jessica Johnston, Director of Financial Reporting & Accounting

CHAPTER 3: IMPLEMENT INVOICE REVIEW AND ACCEPTANCE OF DELIVERABLES PROCEDURES

SECTION 3.1: INVOICE REVIEW AND ACCEPTANCE OF DELIVERABLES PROCEDURES

The GLO's Acceptance of Deliverables Policy requires each Program Area "to develop a written policy that describes their processes for accepting deliverables, reviewing contractor documentation, and reviewing/approving vendor invoices". During the review, it was identified that the VLB does not maintain written procedures for the review and approval of vendor invoices and acceptance of deliverables for the following contracted vendors:

1. Two monthly invoices from *DMI* for the servicing of VLB's (1) Contracts for Deed, and (2) Land Mortgages for the Veteran's Land Program.
2. Monthly invoice from *Gateway Mortgage* for the performance of first and second file reviews of loans originated by participant lenders in the Veteran's Home Assistance Program.
3. Monthly invoice from *Nationstar Mortgage* for the administration of master servicing for Veterans Home Improvement Program and Veterans Home Assistance Program loans.

Maintaining written procedures for invoice review and acceptance of deliverables ensures consistent application of tasks performed so staff can review invoices in the same manner as someone else in the event of staff turnover. Additionally, written procedures help ensure invoices are adequately reviewed and approved by the appropriate management.

RECOMMENDATIONS FOR MANAGEMENT

VLB should develop written invoice review and acceptance of deliverables procedures to include the standard policy elements required of the GLO's Acceptance of Deliverables Policy.

MANAGEMENT'S RESPONSE

To ensure compliance with the GLO's Acceptance of Deliverables Policy, VLB Land and Housing will:

1. Develop written invoice review and acceptance of deliverables procedures for DMI, Gateway, and Nationstar to include the standard policy elements required of the GLO's Acceptance of Deliverables Policy.

Implementation Date: November 1, 2021

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

SECTION 3.2: ENSURE INVOICES ARE ADEQUATELY SUPPORTED AND VERIFIED

In accordance with the *State of Texas Contract Management Guide*¹¹ and *GLO's Acceptance of Deliverables Policy*¹², invoices should be reviewed to ensure they are adequately supported and that services performed comply with contract requirements. During the audit it was identified that there are additional steps that could be taken in the review of invoices from DMI, Gateway, and Nationstar to ensure they are adequately supported and that deliverables are inspected and approved prior to payment. Specifically, the following items were noted:

1. DMI:

- a. Although Investment Management verifies the calculation of the "Primary Servicing Fees" for both CFD and Land Mortgage invoices to ensure the appropriate contract rates are charged, loan volume and principal balance numbers used in the calculations are not verified by VLB.
- b. In the calculation of the "Net Remittance Due Client", there are items that are not verified or supported upon submission of invoices, including:
 1. Beginning Loan Count (Used in Primary Servicing Fee Calculation for CFDs),
 2. Ending Loan Count,
 3. Ending Principal Balance (Used in Primary Servicing Fee Calculation for Land Mortgages),
 4. Income Distribution,
 5. Subservicing Fees and Reimbursable Expenses,
 6. Ancillary Income,
 7. Escrow and Foreclosure Advances Outstanding
- c. Section 2.10 of the Master Servicing contract requires DMI to provide supporting documentation to VLB detailing the use of the VLB's funds for all escrow and foreclosure advances funded. However, in testing monthly Land Mortgage invoices, auditors were unable to determine whether escrow advances funded were adequately supported for all 6 invoices tested.
 1. For 4 invoices, VLB provided the P188 W82 report containing loan escrow advance information for the month; however, the reporting format was unreadable, and auditors were unable to verify the invoiced escrow advance amount listed on the invoice.
 2. For 2 invoices, VLB did not provide the P188 W82 report due to DMI recovery costs.
- d. In testing both Land Mortgage and CFD invoices for the six sample months, auditors were unable to determine whether foreclosure advances funded to DMI were adequately supported for 3 of the 12 (25%) invoices tested. For the invoices tested, Land Mortgage and CFD, VLB

¹¹ Under the *State of Texas Contract Management Guide* agencies are required to (1) inspect and evaluate at the time of receipt of goods or services that the agency receives to determine whether the good or services comply with the contract under which they were purchased, and (2) certify, if true, that the goods or services comply with contract requirements and that the invoice for them is correct.

¹² *Texas GLO's Acceptance of Deliverables Policy's* Standard Policy Elements for Invoice Review/Approval include defining the Approval Authority Contract Comparison, Date Approved, and Supporting Documentation.

was unable to provide support due to DMI recovery cost to the agency associated with retrieving the requested reports. Specifically, the following was identified:

1. For 1 of the 6 (17%) Land Mortgage invoices tested, auditors were unable to determine whether the foreclosure advance amount to DMI was adequately supported as VLB was unable to provide the supporting W82 Foreclosure Advances Outstanding report.
2. For 2 of the 6 (33%) CFD invoices tested, auditors were unable to determine whether foreclosure advances to DMI were adequately supported as VLB was unable to provide the W48 Foreclosure Advance Report.
2. Gateway:
 - a. Investment Management completes a review of rates charged per First File Review and Second File Review to ensure accuracy and recalculates the total fee due to the provider. However, the VLB does not verify that the First and Second File reviews listed in the invoice were completed by the vendor during the period.
3. Nationstar:
 - a. the VLB reviews the billing statement to ensure the supporting invoice documentation (i.e. total principal balance) for which the fee is based, is accurate.

By not verifying supporting documentation for invoiced expenses or ensuring proper acceptance of deliverables, the agency may pay for services not performed or allowed per the contract terms. Furthermore, the agency could be overpaying for services rendered as invoices are paid based on vendor-provided information.

RECOMMENDATIONS FOR MANAGEMENT

VLB should establish a process to review invoices to ensure they are adequately supported and verify that the deliverables conform to contract requirements prior to payment.

MANAGEMENT'S RESPONSE

To ensure compliance with the State of Texas Contract Management Guide and GLO's Acceptance of Deliverables Policy, VLB Land and Housing will:

1. Establish a process to review invoices to ensure they are adequately supported and verify that the deliverables conform to contract requirements prior to payment.
2. Coordinate with vendors, DMI, Gateway, and Nationstar to begin receiving all monthly invoices together with supporting documentation for the program area's review and approval.

Implementation Date: November 1, 2021

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

CHAPTER 4: ENSURE SYSTEM SECURITY OF CRITICAL VENDOR INFORMATION SYSTEMS

The VLB Land and Housing Program has not reviewed major information systems utilized by its vendors that are critical to the administration of the Veterans' loan programs. Those systems include:

1. Fidelity System – *Dovenmuehle Mortgage, Inc.*
2. Master Servicing System – *Nationstar Mortgage LLC*
3. VHAP Loan Origination Administration System – *Gateway Mortgage Group LLC*

The Office of Information Security (OIS) confirmed the noted vendor information systems have not been reviewed in the Office's Risk Management Plan. As a result, OIS has not completed a review of SOC 2 or SSAE-18 reports or performed an Information Security Risk Assessment for any of the identified vendors or information systems¹³.

In addition, the above-mentioned vendor contracts do not include the *GLO Information Security Appendix for Vendors* which offers assurances that vendors will implement safeguards to protect GLO-owned data.

These information systems contain Veterans' Personal Identifiable Information (PII), loan-level data, and perform functions critical to the objectives of VLB loan programs. By not assessing information security risks and ensuring that the proper security controls and safeguards are in place, the agency opens itself to unforeseen or foreseeable risk. Additionally, if a system were to be compromised due to a lack of security controls, the VLB and its vendors may be unable to perform essential program functions.

RECOMMENDATIONS FOR MANAGEMENT

1. OIS should consider the risks associated with critical IT systems utilized by VLB's vendors for inclusion in its Risk Management Plan. If determined to be high risk, OIS should complete an Information Security Risk Assessment on those systems in accordance with TAC §202.25.
2. The vendor contracts identified above should be reviewed and updated by the VLB to ensure the inclusion of the *GLO Information Security Appendix for Vendors*.

MANAGEMENT'S RESPONSE

1. OIS will review and perform an Information Security Risk Assessment of the vendors identified. OIS will also work with the program area, General Counsel, and Contract Management to amend and include the Information Security Appendix in the contracts.

Implementation Date: August 31, 2022

¹³ Texas Administrative Code Rule §202.25 - *Managing Security Risks* requires state agencies to perform and document a risk assessment of the agencies' information and information systems.

Contact(s):

Sharon Matthews, Risk Analyst, Office of Information Security
Arturo Montalvo, Director, Office of Information Security

2. For assurance that vendors will implement safeguards to protect GLO-owned data, VLB Land and Housing will review and update vendor contracts for DMI, Nationstar, and Gateway to ensure the inclusion of the GLO Information Security Appendix for Vendors.

Implementation Date: January 1, 2022

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

CHAPTER 5: ENSURE THE TIMELINESS OF VENDOR CONTRACT AND AMENDMENT EXECUTION

Contracts and amendments are required to be executed by both parties prior to the commencement or receipt of associated services or goods. However, VLB Land and Housing vendor contracts and amendments were executed days, weeks, months, and in some cases, over a year after the contract/amendments' "effective" or start date. As a result, services outlined in the contracts' scope of work were performed without an executed agreement between the agency and vendors.

The *State of Texas Contract Management Guide*¹⁴ states that contract managers are not authorized to allow the contractor to commence work before the contract is fully executed. Allowing vendors to provide services prior to executing a formal written contract could open the agency up to contract disputes and litigation associated with contractual terms and services performed.

RECOMMENDATIONS FOR MANAGEMENT

VLB should establish controls to ensure the appropriate and timely execution of contracts and/or amendments, prior to the commencement of vendor services and activities associated with the contract or amendment.

MANAGEMENT'S RESPONSE

To ensure compliance with the State of Texas Contract Management Guide VLB Land and Housing will work together with Contract Management and Legal to establish controls to ensure the appropriate and timely execution of contracts and/or amendments.

Implementation Date: December 1, 2021

Contact(s):

Stephanie Gilliam, Staff Services Officer, VLB Land and Housing
Kimilia Mangum, Interim Deputy Director, VLB Land and Housing

¹⁴ *The State of Texas Contract Management Guide Contract Manager Responsibilities* (pg. 92-93) states "Contract Managers are not authorized to allow the contractor to commence work before the contract is fully executed."

APPENDICES

APPENDIX A

OBJECTIVE

To determine if the Veterans' Land Board (VLB), Land and Housing Program has effective processes and controls to ensure adequate management and monitoring of vendor performance for its loan programs.

SCOPE & METHODOLOGY

The scope of the audit consisted of reviewing the existence and effectiveness of vendor management and monitoring controls for the VLB Land and Housing Programs (Veterans Land Loan Program, Veterans Home Improvement Program (VHIP), and the Veterans Home Assistance Program (VHAP)) during the period FY 2019 through FY 2021 for the following activities:

1. Loan Origination, Processing, and Servicing
2. Master Servicing
3. Participant Lender Administration
4. Reporting

The methodology included observing processes, interviewing knowledgeable staff, collecting information, performing tests, and analyzing and evaluating the information.

The audit was conducted in accordance with *Government Auditing Standards* and *International Standards for the Professional Practice of Internal Auditing*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B

ADDITIONAL BACKGROUND INFORMATION

The following information provides an overview of VLB Veterans' Loan Programs, contracted services provided, and GLO/VLB monitoring activities:

1. ***The Veterans Land Loan Program*** provides qualifying Texas Veterans and Military Members with the opportunity to borrow funds to purchase land at competitive interest rates. Veteran eligibility determinations, loan originations, and loss mitigation activities are all performed by the VLB.

The VLB contracts with vendors to conduct the following loan origination activities:

- Design, set up, and maintenance of VLB's Loan Origination System, Mortgage Builder Software Inc.
- Verification of employment and income of loan applicants.
- Owner title search and foreclosure full title search.
- Flood zone certificate determination services.
- No-cost administration agreement to perform collection and remittance to Minnesota Life of premiums for insurance plans, verification of premiums paid and assistance with all premium billing operations.
- Subservicing of loans for both (1) Loan Mortgage and (2) Contract for Deed (CFD) portfolios. DMI's performance is monitored by the VLB through the receipt and review of weekly, monthly, and annual servicing reports that are furnished through, DMI's automated mortgage loan servicing system, the Fidelity System.

The Chief Investment Officer (CIO) of Investment Management is responsible for issuing and maintaining bonds to fund the purchase of these loans. Additionally, the CIO reviews and approves two monthly invoices for CFDs and Land Mortgages.

2. ***The Veterans Home Assistance Program*** provides qualifying Texas Veterans and Military Members with the opportunity to purchase a home with a competitive, low-interest loan with little or no down payment. Veterans, Military Members, and their spouses may receive up to \$548,250 on a fixed-rate loan for conventional loan terms.

The VLB contracts with vendors to conduct the following activities:

- *Gateway Mortgage, LLC*: Administration of the VHAP Loan Originations and Primary Servicing of VHAP and VHIP loans.
- *Nationstar Mortgage, LLC*: Performs all services related to the administration of VHAP and VHIP Master Servicing and to oversee the VLB-owned housing and home improvement portfolio serviced by participant servicers.

The VLB monitors vendor performance through the receipt and review of weekly, monthly, and annual reports submitted through either email or a secure File Transfer Protocol (FTP) site.

3. ***The Veterans Home Improvement Program*** provides qualifying Texas Veterans and Military Members with below-market interest rate loans for home repairs and improvement to their existing homes. Like the Veteran Land loan Program, VHIP loans are originated in-house by the VLB utilizing the same vendors mentioned above.

The VLB contracts with vendors to conduct the following activities:

- Sole Primary Loan Servicing for the VHIP portfolio.
- Master Servicing for the VHIP Portfolio.

The VLB is tasked with monitoring the performance of contracted vendors for the services provided.

DISTRIBUTION LIST

TEXAS GENERAL LAND OFFICE & VETERANS LAND BOARD

George P. Bush, Texas Land Commissioner

Mark Havens, Chief Clerk & Deputy Land Commissioner

Jeff Gordon, General Counsel

Kim Mangum, Interim Deputy Director of VLB Land and Housing

Rusty Martin, Chief Investment Officer, Investment Management

David Repp, Senior Deputy Director & Chief Financial Officer, Financial Management

Brent McNguyen, Deputy Chief Financial Officer, Financial Management

Jessica Johnston, Director of Financial Reporting & Accounting

Arturo Montalvo, Chief Information Security Officer

VLB BOARD MEMBERS

Grant Moody

Judson Scott

GOVERNOR'S OFFICE OF BUDGET AND PLANNING

LEGISLATIVE BUDGET BOARD

TEXAS STATE AUDITOR'S OFFICE