December 21, 2015

Alexis Podesta, Acting Secretary  
California Business, Consumer Services and Housing Agency  
915 Capitol Mall, Suite 350-A  
Sacramento, CA 95814

Dear Ms. Podesta,

In accordance with the State Leadership Accountability Act (SLAA), the Department of Housing and Community Development submits this report on the review of our systems of internal control and monitoring processes for the biennial period ended December 31, 2015.

Should you have any questions please contact John Hiber, Acting Chief Deputy Director, at (916) 263-7400, John.Hiber@hcd.ca.gov.

BACKGROUND

Department of Housing and Community Development (HCD)

HCD is a department within the California Business, Consumer Services, and Housing Agency (BCSH) that develops housing policy and building codes, regulates manufactured homes and mobilehome parks, and administers housing finance, economic development, and community development programs.

HCD’s Mission, Vision, Goals, Values/Principles, and Core Business Functions

Mission

Provide leadership, policies, and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians.

Vision

Recognizing that housing is a basic element of a just and successful society, HCD will provide leadership towards achieving vibrant communities with quality and adequate housing for all Californians.

Goals

- Increase the housing supply for all Californians.
- Establish a permanent funding source for affordable housing.
- Maintain the health and safety of housing stock.
- Strengthen communities by improving infrastructure and attracting, expanding, and retaining businesses and jobs for Californians.

Values/Principles

- Employees are HCD’s greatest asset.
- Diversity is strength.
- All work is done with honesty, integrity, and personal responsibility.
- Work as one team to accomplish HCD’s mission and goals.
- Continuously improve.

HCD’s Core Business Functions

HCD is organized around three operational divisions that provide the core business functions through which HCD accomplishes its mission. The divisions are:

- Housing Policy Development
- Financial Assistance
- Codes and Standards
These divisions are primarily supported by the Administration and Management Division.

**Division of Housing Policy Development (HPD)**
HPD accomplishes its mission by engaging in a variety of outreach, planning, policy, and research activities with federal, state, regional, and local agencies and stakeholders. Examples of activities include identifying California’s regional housing needs; determining regional and local government housing plans’ compliance with State housing element law; developing housing policies; implementing community development and housing-related grant and loan programs; preparing federal and State plans and reports; and assisting governmental agencies, housing advocates, developers, and the public.

**Division of Financial Assistance (DFA)**
DFA administers approximately 15 programs, both State and federal, that award loans and grants for the construction, acquisition, rehabilitation, and preservation of affordable rental and ownership housing, homeless shelters and transitional housing, public facilities and infrastructure, and the development of jobs for lower-income workers. Additionally, some awards are for projects that reduce greenhouse gas emissions and make public transit more accessible to lower-income populations. All loans and grants are made to local public agencies, non- and for-profit housing developers, or services providers. DFA also prepares and submits the federal Consolidated Planning and Performance Report, which is required by HUD to ensure California’s receipt of millions of federal housing and community development dollars.

**Division of Codes and Standards (Codes)**
Codes’ mission is to provide protection for the public in areas of health, safety, and general welfare in buildings and structures designed for human occupancy through the enforcement of the California Health and Safety Code, including:
- State Housing Law
- Employee Housing Act
- Mobilehome Parks Act
- Special Occupancy Parks Act
- California Factory-Built Housing Law
- Mobilehome/Manufactured Housing Act of 1980

Codes also enforces federal and State standards for the construction, safety, sales, and titling of manufactured homes, mobilehomes, and commercial modulars.

**Administration and Management Division (AMD)**
AMD provides support to all business operations within HCD. AMD includes the following areas:
- Accounting Office
- Business and Contract Services Branch
- Fiscal Management Office
- Information Technology Branch
- Human Resources Branch

AMD provides HCD with its operational infrastructure and often creates single points-of-contact by which business is conducted with other state agencies. Most, if not all of these agency-to-agency interactions are governed by state-established policies and procedures (e.g., State Administrative Manual, State Contracting Manual, Budget Letters, etc.)

**RISK ASSESSMENT PROCESS**
The risk assessment process began with divisions familiarizing themselves with the requirements of Department of Finance and using self-assessment tools provided by the Audit and Evaluation Division (AED), in order to facilitate the process. Divisions performed their individual risk assessments through brainstorming sessions, interviews, and analyses of their operations and how those operations relate to the broader goals, objectives, and HCD's mission. Divisions were asked to consider the likelihood and impact of the risks they identified and then to consider the controls that are in place or should be in place to mitigate those risks, should they occur. The management teams of each division, which included the divisions' deputy directors, provided their risk information to AED for aggregation. The aggregated
information was provided to Executive Management for further analysis of likelihood/impact of the risks and prioritization of the risks and controls that would be evaluated for the reporting process, particularly those deemed likely and high impact and those for which controls need to be implemented to mitigate the risks appropriately.

The risk assessment process included management from the four divisions previously noted as well as the divisions of Legal Affairs, Legislative, and Executive. Prior external audit findings, including those issued by the California State Auditor during 2015, as well as risks for which control implementations were outstanding as of June 30, 2015 for the 2013 Financial Integrity and State Manager’s Accountability reporting period, were also considered as part of the risk assessment process.

**EVALUATION OF RISKS AND CONTROLS**

**Operations- Internal- Staff—Key Person Dependence, Succession Planning**

The Department continues to work toward adequate succession planning. HCD potentially faces a significant loss of institutional knowledge and experience due to retirements and attrition; however, HCD is still in the process of developing and implementing an adequate succession planning strategy that considers how to best address HCD’s needs at the most critical, at-risk positions.

- A project manager was named in May 2015 to head a team formed in June 2015 to work on developing an adequate succession plan.

- The team has been working on identifying succession criteria, such as core competencies and key skills and abilities, and intends to provide training to managers on the succession planning criteria.

- HCD will finalize its succession plan and develop an implementation plan, including a pilot plan by July 2016, and roll-out by December 2016.

**Operations- Internal- Technology—Data Security**

HCD does not have a documented process in place for review of systems access rights nor a policy for an annual review of systems access rights.

- The IT Branch has developed procedures for an annual network access rights review and installed a network software tool that provides the ability to monitor the HCD network and reports on employee systems access rights.

- HCD will implement a system of review administered by the IT Branch.

**Operations- Internal- Technology—Inadequate Support, Tools, Design, or Maintenance**

HCD has not conducted regular tests and exercises to assist in identifying any deficiencies in its Disaster Recovery Plan (DRP); HCD does not adhere to its policy to conduct annual testing of the DRP.

- HCD has a Technology Recovery/Business Continuity Plan in place.

- HCD will explore hiring a vendor to develop a testing plan. Testing will be performed once the full scope and focus of the test is developed.

**Operations- Internal- Oversight, Monitoring, Internal Control Systems**

For the Office of Migrant Services (OMS) Program, weak administrative controls, delayed contract executions caused by delayed budget negotiations, from (a) untimely contractor submission of proposed budget requests and supporting documentation and (b) contractors requesting more funds than available, and delayed receipt of Housing Authority/non-profit board resolutions could adversely affect HCD’s
To mitigate against delays, OMS implemented two-year contract terms to allow for resolution. OMS requests Housing Authority/non-profit board resolutions during the boilerplate review process, to collect resolutions prior to contract routing.

OMS is in the process of analyzing internal controls and developing a corrective action plan.

Operations- Internal- Organizational Structure

Lack of adequate planning for Chapter 397, Statutes of 2015 (AB 325) could prevent HCD from meeting the requirements of the statute.

To ensure timely disbursements in accordance with AB 325, a separate disbursement team has been set up in the Fiscal Reporting and Evaluation Division (FRED) within the Asset Management and Compliance (AMC) Section to address issues that include contracts and payments.

Additionally, processes have been developed to ensure timely disbursement. Disbursement requests are to be processed by FRED the same day or no later than two days from the receipt of request by pulling request and processing by oldest date first. A Fiscal Representative will log funds requests, review the attached HCD Form 51a, notify the program representative of corrections, process requests through the necessary systems, and provide the information to the FRED Disbursement Processing Manager within two days.

Going forward, HCD will enhance its Consolidated Automated Program Enterprise System (CAPES) database system to include a disbursement tracker. This will allow the ability to generate weekly reports on the status of disbursements.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

Lack of adequate oversight for DFA’s contracting processes could prevent the Department from ensuring its contracts are accurate, complete, and timely.

DFA has processes in place to ensure oversight occurs. DFA reviews applications for compliance with all eligibility as outlined in the Notices of Funding Availability, rates and ranks all applications using set criteria, and makes awards based on the highest ranking applicants and funds available. Prior to award, all contract conditions must be entered into the CAPES database. Funding availability is verified through FRED section. The boilerplate is written, reviewed, and approved by the program, Contracts Office, Legal Affairs Division, and Accounting Office. Award Encumbrance Summary, Form ADM. 47, is submitted to and reviewed by the Budget and Accounting offices.

HCD will create an Award/Contract Status report that will track the progress of contracts from the time of award through execution. The report will be run a weekly basis to ensure all contracts are issued within the required timelines. If contracts are at risk, a "priority status" will be implemented in order to meet deadlines.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

Lack of a comprehensive administrative manual may hinder the HCD's ability to ensure timely, consistent communication of policies and procedures.

To ensure timely, consistent communications, the written HCD Administrative Manual has been replaced and the related information has been made available on HCD's intranet;
updates to policies will be posted online.

- Going forward, HCD will implement an annual review process to ensure information remains up-to-date and comprehensive.

**Operations- Internal- Oversight, Monitoring, Internal Control Systems**

Deficiencies in the employee transfer or separation processes, including the lack of timely notification of Business Services Office (BSO) and lack of retrieving key cards from departing employees, could pose a threat to safeguarding HCD's assets.

- BSO is listed on the employee exit checklist and is the area that controls all supplies/equipment, including key cards; when employees leave HCD, BSO is notified that key cards are deactivated.

- Going forward, HCD will implement cubicle audits and a tracking database to account for items that had been issued to an employee who has left HCD.

- Additionally, HCD will provide training to management to make them aware of the requirement to notify BSO when an employee leaves HCD.

**Operations- Internal- Oversight, Monitoring, Internal Control Systems**

Failure of divisions to utilize the record retention schedule could result in records being lost, misfiled, or destroyed/recycled in error.

- BSO maintains copies of retention schedules and has written procedures in place to notify programs when schedules need to be updated or renewed.

- To ensure divisions are complying with the record retention schedules, AMD will develop and provide training to division staff regarding proper records management.

**Operations- Internal- Oversight, Monitoring, Internal Control Systems**

HCD's policies for Employee Pull Notices (EPN) and work-at-home agreements as well as safety manuals for field representatives may not be in place or may require updating.

- Currently, HCD conducts enterprise-wide training on health, safety, and wellness.

- HCD will establish or update policies and train field staff on EPN, safety, and work-at-home arrangements.

**Operations- Internal- Technology—Data Security**

In order to mitigate against systems vulnerabilities, HCD should continue to improve its security posture.

- The Information Technology Branch (ITB) has implemented both internet security and vulnerability scanning software.

- HCD is looking to implement an even more robust system of vulnerability assessment through new tools and processes.

**Operations- Internal- Resource Management**

Current methodology for cost allocation to certain cost pools could potentially lead to some funds absorbing more than their equitable share of costs.
• HCD has processes in place to perform reallocations and year-end corrections to ensure costs are appropriate.

• To improve effectiveness and efficiency of the process, HCD will implement a new method of cost allocation that will ensure indirect or distributed costs are allocated proportionately and/or as authorized by budget.

Operations- Internal- Resource Management

HCD appears to be collecting decreased amounts of revenue from selected programs, as a result of manual systems.

• The implementation of Codes and Standards Automated System (CASAS) 2.0 will ensure proper data collection and provide verifiable statistics to determine revenue that is due but not yet received or collected. Additionally, CASAS 2.0 has online functionality that will allow customers to pay fees, perform ownership transfers, request inspections, and obtain permits; the convenience of which should help improve the effectiveness and efficiency of collections.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

Codes may have ineffective, inefficient programs due to a lack of a systematic analysis and justification of performance.

• To ensure programs are operating effectively and efficiently, Codes will develop a plan to keep Program Managers focused on critical areas of responsibility, engage them in collection, review, and analysis of program statistics, and formulate a continuous review process.

• Codes will implement a statistical presentation/review process to assess program performance on a regular basis.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

Lack of adequate processes to ensure checks received in divisions throughout HCD are forwarded to the Accounting Office timely may lead to lost, damaged, or delayed-deposit/undeposited checks, threatening revenues and HCD’s ability to issue refunds in a timely manner when necessary.

• All-staff emails are sent periodically, and verbal instructions are given when applicable, to remind staff to bring payments to the Accounting Office in a timely manner.

• A department-wide policy will be created and enforced to ensure appropriate, timely transfer of checks to the Accounting Office.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

For HPD, absence of a research unit, in order to research and evaluate programs, may present challenges and obstacles to implementing policies and achieving HCD’s mission.

• To improve operations, HPD hired a Research Program Specialist to create a research and evaluation unit.

• HCD is implementing methods to develop and address potential staffing and resource issues for the research unit.

Operations- Internal- Technology—Inadequate Support, Tools, Design, or Maintenance
The IT Branch does not have a written software management plan, which could lead HCD to incur unnecessary expense or to go without necessary software or be in violation of licenses.

- The IT Branch currently uses the software management practices included in its problem tracking/ticketing application, which provides tools for software tracking and license management, including daily audits of installed software on all HCD computers. Excess software copies are either de-installed or additional licenses are purchased, as required. The IT Branch also uses an automated tool to deploy software patches on a routine basis. Software installations can only be performed by staff with authorized credentials, and further controls prevent staff from copying software.

- The IT Branch will develop a software management plan, following the guideline of the State Information Management Manual Section 120. The plan will include written policies and procedures for software management.

- Additionally, the IT Branch plans to purchase additional tools for managing desktop software licenses in 2016.

**Operations- Internal- New System Implementation (Other Than Fi$Cal)**

Transition of the legacy database, CASAS, to the new system, CASAS 2.0, could temporarily disrupt operations until full implementation has been completed and all technical issues have been identified and resolved.

- CASAS will be maintained in a "read only" state until it is certain that all data transferred correctly and none was lost.

- To aid with the learning curve for the new system, Codes will have specific trainers and "super users" to help train staff during the transition.

**ONGOING MONITORING**

Through our ongoing monitoring processes, the Department of Housing and Community Development reviews, evaluates, and improves our systems of internal controls and monitoring processes. The Department of Housing and Community Development is in the process of formalizing and documenting our ongoing monitoring and as such, we have determined we partially comply with California Government Code sections 13400-13407.

**Roles and Responsibilities**

As the head of Department of Housing and Community Development, Susan Riggs, Acting Director, is responsible for the overall establishment and maintenance of the internal control system. We have identified John Hiber, Acting Chief Deputy Director, as our designated agency monitor(s).

**Frequency of Monitoring Activities**

Each division holds regular meetings, either weekly or monthly, depending on the type of meeting, for staff and management to discuss operations and potential control issues.

HCD holds weekly Executive Management meetings. During these meetings, discussions occur regarding risks and emerging, potential internal control issues; the information is brought forward by deputy directors from the meetings held within their divisions.

Going forward, HCD will implement a quarterly review of all outstanding items requiring correction, including those related to the SLAA reporting process.

**Reporting and Documenting Monitoring Activities**
Although HCD communicates results of its monitoring activities through regular meetings held at various levels, it is creating a process for formally documenting and reporting the results of its monitoring activities.

**Procedure for Addressing Identified Internal Control Deficiencies**

HCD develops corrective action plans for internal control deficiencies that have been identified. A formal Audit Committee is in place to follow up on outstanding corrective actions. When warranted, HCD forms a task force, made up of members of the management team, to explore appropriate, timely corrective action implementations.

**CONCLUSION**

The Department of Housing and Community Development strives to reduce the risks inherent in our work through ongoing monitoring. The Department of Housing and Community Development accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies. I certify our systems of internal control and monitoring processes are adequate to identify and address material inadequacies or material weaknesses facing the organization.

Susan Riggs, Acting Director

cc: Department of Finance
    Legislature
    State Auditor
    State Library
    State Controller
    Secretary of Government Operations