December 27, 2017

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

Dear Ms. Alexis 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 internal control and monitoring systems for the biennial period ending December 31, 2017.

Should you have any questions please contact Janeen Dodson, Deputy Director, at (916) 263-7427, janeen.dodson@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 U.S. Department of Housing and Urban Development (HUD) to ensure California’s receipt of millions in federal housing and community development dollars.

Division of Codes and Standards (C&S)

C&S’ 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 registration & 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:
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**

To kickoff the new SLAA year, in September of 2017, Division Deputies attended the SLAA Mandatory Training presented by Department of Finance. As part of the monitoring activities of the Executive Monitoring Sponsors, meetings were facilitated with each Division Deputy to discuss the purpose of SLAA: to provide self-assessment instructions, establish critical timelines, and to review the expectations of each division deputy.

To facilitate risk assessment, a self-assessment questionnaire was provided to all Division Deputies with instructions for completion. Divisions performed their individual risk assessments through brainstorming sessions within their divisions’ management team, risk reports received through the activities of the management information review business unit mapping exercises, and by analyzing and assessing how operations relate to the broader goals, objectives, and mission. Division staff were asked to consider the likelihood and impact of the risks they identified and then to consider what controls are in place or should be in place to mitigate those risks. The management team of each division, which included the divisions’ Deputy Directors, provided their risk information for aggregation into a SLAA matrix. The aggregated information was provided to Executive Management for further analysis of the risks, along with prioritization of the risks and controls that would be evaluated for the SLAA reporting process.

The risk assessment process included management from the four divisions previously noted as well as the divisions of Legal Affairs, Legislative, and Executive.

**ONGOING MONITORING**

As the head of Department of Housing and Community Development, Ben Metcalf, Director, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

**Executive Monitoring Sponsor(s)**

The executive monitoring sponsor responsibilities include facilitating and verifying that the Department of Housing and Community Development internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Janeen Dodson, Deputy Director.

**Monitoring Activities**

Through internal controls and an ongoing monitoring process, referred to as Management Information Reviews (MIR), the Department of Housing and Community Development monitors operational performance by reporting on a quarterly basis on valuable measures within each division to understand the effectiveness of internal operations and performance. This MIR process allows leadership to
evaluate data to make sound business decisions, acknowledge milestones, and provides learning opportunities for improving program operations and supports compliance with California Government Code sections 13400-13407. Roles and Responsibilities As the Director of HCD, Ben Metcalf is responsible for the overall establishment and maintenance of the systems of internal controls. However, the current designated agency executive monitor is Deputy Director, Marc Wilson. In the absence of the Deputy Director, Ben Metcalf, the Director will perform in this capacity. Frequency of Monitoring Activities HCD has 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 meetings held with their divisions. Each division holds regular meetings, either weekly or monthly, depending on the need, for management to review performance measures, discuss operations and potential control issues and make recommendations for improvements based on data derived from performance measures. Through the quarterly review of performance measures, during MIR presentations, Division Deputies report out on their ability to track work in progress to ensure key work activities are meeting expectations. MIR presentations include leading and lagging measures; performance trend and quality of work in each major program area. As a result, the Department is successful in identifying risks and internal control weaknesses as well as the corrective actions associated in mitigating those issues.

Addressing Vulnerabilities

Procedure for Addressing Vulnerabilities Each division routinely reviews existing policies and procedures to identify the need for amendments and updates in order to mitigate risks. HCD’s Audit and Evaluation (A&E) Division conducts internal audits to identify lagging internal controls. Once deficiencies and risks are identified, audit findings are distributed with recommendations for corrective action to each participating division deputy to prepare and implement a corrective action plan. This enables divisions to update policies and procedures and address opportunities for improvement. A&E is responsible for tracking and reporting the progress on formal corrective action plans to the audit committee, Chief Auditor and Executive Sponsor and works with executive management to ensure timelines are adhered to and corrective actions are implemented. The Department Executive Sponsor Monitors are updated on audit proceedings, findings and recommendations and actively monitor progress. The timeframe for correcting deficiencies or findings varies on the complexity of the issue(s).

Communication

HCD strives to reduce the risks inherit in our work through ongoing monitoring. The Department issues enterprise-wide emails, memorandums, and individual tailored meetings to address vulnerabilities and resolve issues before they have the potential to advance. Staff receive information vital to the effectiveness and efficiency of established internal controls by routinely scheduling meetings and other communication forums. Staff are also encouraged to notify management if they discover issues that should be addressed to assist HCD in fulfilling its mission, vision, and objectives. When new policies and procedures are established or updated, changes are communicated by email to all HCD staff. Information is reiterated and shared amongst employees in group staff meetings, on individual basis as needed, and during new employee on-boarding process.

Ongoing Monitoring Compliance

The Department of Housing and Community Development has implemented and documented the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the
Department of Housing and Community Development systems of controls and monitoring.

RISK ASSESSMENT PROCESS

The following personnel were involved in the Department of Housing and Community Development risk assessment process: Executive Management, Middle Management, and Front Line Management.

Risk Identification

- Questionnaires: Developed a risk assessment questionnaire for each division to evaluate and assess business processes and threats to goals and objectives.
- Meetings: Engaged with executive and middle managers to brainstorm, discuss questionnaire results, risk rankings and the internal control environment.
- Developed a listing of SLAA risks through an iterative process that considered prior and emerging risks by way of an environmental scan.

Risk Ranking

- Evaluated the results of the risk and threat assessments.
- Conducted a thorough analysis of the probability and likelihood of each risk.
- Determined the ranking of each risk and impact to the Department.
- Developed senior management and executive team risk evaluation and acceptance for SLAA reporting.

RISKS AND CONTROLS

Risk: Operations - External - FISCal Implementation, Maintenance, Functionality, or Support

FISCal Conversion: HCD may not be prepared for the requirements to fully implement FISCal.

- Lack of cohesive governance practices could result in uninformed decision making with transformational efforts.
- Insufficient time to plan and schedule design requirements, development, deployment and testing.

The complexity of, and staff lack of familiarity with, the FISCal system increases the potential for errors, omissions, and inefficiencies which impacts the Department’s ability to perform key business functions. Many FISCal functions do not align with the legacy system (CALSTARS), and HCD’s Consolidated Automated Program Enterprise System (CAPES), resulting in the need to run parallel systems during the transition period which causes additional workload. In addition, increased workload created by FISCal’s requirement for information from HCD during pre-implementation diverts resources from other administrative tasks. There is additional concern that conversion efforts may not successfully transform HCD data and its business processes within established scope, schedule and/or budget.

Control A

HCD is hopeful that many of these internal control issues will diminish as staff competency grows and as FISCal is able to provide permanent solutions to key business process functionality issues. Mitigation efforts for internal operational issues arising from FISCal conversion include:

- Closely working with the Department’s Training Officer to coordinate all appropriate FISCal
end-user training for staff and working with staff and managers to make sure they are aware of upcoming training opportunities and are provided the time to complete them.

- Continue to use support sessions offered by Fi$Cal and coordinating with the Department’s Fi$Cal Readiness Coordinator on arranging one-on-one meetings with Fi$Cal subject matter experts as needed.
- Periodically requesting End-User Reports from Fi$Cal, reconciling them against the Department’s role-mapping requests, and working with the Fi$Cal Readiness Coordinator to resolve any discrepancies.
- Once the Department’s Fi$Cal functionality issues have been resolved, provide in-house training to all affected staff and additional remedial training that may be required.

**Control B**
Additional mitigation efforts will include procuring consultant services with contractors familiar with Fi$Cal conversion requirements to guide and recommend the most manageable approach in developing a plan for readiness.

**Risk: Operations - Internal - Organizational Structure**
HCD is not operating with an updated Strategic Plan.

Current strategic plan is antiquated and does not reflect the existing HCD environment and culture.

No timely roadmap or consistent application of values and goals to administer daily operations and complete long term objectives.

**Control A**
Develop a fully updated Strategic Plan that fulfills the Mission and Vision of the Department which will improve the allocation of resources and informs decision making by outlining specific strategic goals and objectives.

**Risk: Compliance - Internal - Priorities Affecting Laws or Regulations**
Inconsistent monitoring of Local Enforcement Agencies (LEAs) for the Mobilehome/Special Occupancy Parks Programs.

HCDs current monitoring activities elevates risk exposure to HCD and LEAs through noncompliance with Mobilehome Park Act.

Ineffective monitoring leads to greater risk of an escalation of public complaints and an inability to provide LEA support and tutelage.

**Control A**
Develop consistent and effective monitoring practices for all LEAs by HCD.

**Control B**
Routinely monitor LEAs for compliance with the Mobilehome/Special Occupancy Park Programs requirements.

**Risk: Operations - Internal - Oversight, Monitoring, Internal Control Systems**
HCD is lacking a formalized framework to ensure that best practices are followed and controls are in place for information technology systems’ enterprise governance.
• Systems may be underutilized and/or not optimizing program/performance needs.
• Appropriate internal controls, security protocols and data systems may not be in place and routinely monitored.
• Systems are outdated and no longer serve program needs.
• Staff are not prepared for continuous change management.

**Control A**
Develop adequate, consistent, and appropriate levels of management monitoring for information technology systems.

**Risk: Compliance-External-Priorities Affecting Laws or Regulations**
SB 2 (Chapter 364, statues of 2017) and SB 3 (Chapter 365, statues of 2017) are creating massive change management risks for HCD in the area of hiring, training and logistics.

Implementation of new laws and regulations will adversely impact current staffing resources.

Implementation of new laws and regulations will adversely impact training and logistics.

**Control A**
Develop implementation strategies and program requirements to address staffing needs, as well as maintain current related operational activities.

**Control B**
Identify and secure office space for increased staffing needs.

**Risk: Compliance-External-Priorities Affecting Laws or Regulations**
HCD is not compliant with federal expenditure tracking requirements for the Community Development Block Program (CDBG).

Inability to accomplish and monitor performance outcomes that would verify compliance with federal reporting requirements.

• Need reconciliation between Housing and Urban Development’s (HUD’s) Integrated Disbursement and Information System (IDIS) and HCD data systems;
• Require internal tracking system for federal expenditures by program to better understand expenditure rates and troubleshoot proactively.

**Control A**
Reconcile CDBG data with the Consolidated Automated Program Enterprise System (CAPES), and the California State Accounting & Reporting System (CALSTAR) to ensure consistency with the data entered in IDIS Reports to ensure compliance with federal reporting practices.

**Control B**
Develop internal reconciliation processing procedures that meet federal requirements for ongoing reconciliation and internal control monitoring practices for all federal funding expenditures.

**Control C**
Monitoring to ensure full compliance with the federal requirements for tracking award activity.
**Risk: Operations - Internal Oversight, Monitoring, Internal Control Systems**

Due to workload demands, staff are unable to identify leading indicators for default/delinquencies on assets in portfolios, thereby leading to non-compliance and/or loss of assets.

Internal issues are:

- Necessity to determine appropriate technology or staff resource solution to support data collection.
- Lack of robust documentation for processes and procedures.
- Assets not properly aligned with management’s priorities.
- Decisions made with erroneous data result in poor management decisions, lost opportunities, and excessive costs.

Operational issues result in:

- Mismatch in timing of approving an operating budget and a Schedule of Rental Income (SRI) potentially makes some approvals (of both budgets and SRIs) require additional staff time or may result in approval of inaccurate documents.
- Failure of sponsor to submit required reports, documentation and/or required payments.
- Inaccurate methodologies and assumptions in the portfolio managing process.

**Control A**

Develop a risk-based approach to asset management.

**Control B**

Establish a data supported risk evaluation process.

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**Risk: Operations - Internal Staff — Key Person Dependence, Workforce Planning**

HCD’s Succession Plan currently does not address the department’s potential loss of institutional knowledge and experience due to retirements and attrition.

Internal/operational issues include:

- Risk of losing knowledgeable staff or managers.
- Inability to respond and develop plans to manage and retain a qualified and skillful workforce necessary to carry out our mission.

**Control A**

Maintain and develop subject matter expertise in multiple staff.

**Control B**

Minimize the impact from the loss of key staff through processes, procedures and training.

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**Conclusion**

The Department of Housing and Community Development strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.
Ben Metcalf, Director

CC: California Legislature [Senate (2), Assembly (1)]
   California State Auditor
   California State Library
   California State Controller
   Director of California Department of Finance
   Secretary of California Government Operations Agency