DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2005

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Department of Housing and Community Development, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System; and

- one matter involving internal control and its operations and noncompliance with applicable laws and regulations that requires management's attention and corrective action.

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AUDIT FINDING AND RECOMMENDATION

Comply with the Commonwealth of Virginia Technology Security Standard

The Department of Housing and Community Development (Department) does not have documented policies and procedures for security over its critical information systems that comply with Commonwealth of Virginia Information Technology Security Standard (COV ITRM SEC 2001-01.1). The Application Supervisor and Information Security Officer were not aware of the standard. Therefore, the Department has not implemented appropriate controls, such as a change management process for automated information systems or written policies and procedures for authorizing access to their Fiscal Management Database.

Without these policies and procedures, the Department increases the risk of not identifying or protecting critical financial and operational data. For example, not having a change management process increases the risk of someone incorrectly altering production data that the Department uses to make financial decisions, causing unnecessary delays and additional costs. The lack of policies and procedures authorizing access to their accounting system places it at an increased risk of intrusion and other security threats.

The Department administers at least two critical systems. The Fiscal Management Database is an SQL database that front ends financial transactions into the Commonwealth Accounting and Reporting Systems (CARS.) The Integrated Disbursement and Information System is a grants management system used to manage the various housing assistance programs that the Department administers. In addition, other divisions within the agency use additional systems to help apportion the Department's resources.

The Information Technology Security Standard sets minimum requirements related to all aspects of the information technology environment including; a business impact analysis, risk assessment, disaster recovery program, security awareness program, data security, monitoring and controlling systems activities. Top management and key personnel should be familiar with and employ controls to satisfy the current Information Technology Security Standard. The Department has prepared a Continuity of Operations Plan (COOP) in response to Executive Order 7 (2002) and Executive Order 69 (2004) that specifically addresses how the Department will continue to operate in the case of a disaster. However, this plan addresses only the barest minimum of requirements set out in the Information Technology Security Standard. The COOP does not focus in detail on the information technology aspects that the Information Technology Security Standard requires.

The Department should create formal policies and procedures that adhere with the Information Technology Security Standard. Proceeding forward, the Department should review the draft copy of the revised Security Standard (COV ITRM SEC 501-01) that the Virginia Information Technologies Agency plans to release in July 2006. Since a compliance date is not set for the new draft standard, the Department should follow the status of this new standard for future security requirements.

AGENCY HIGHLIGHTS

The Department administers programs to improve housing, encourage community development, and ensure compliance with the Commonwealth's building code. Major areas of responsibility include community development, community revitalization, affordable housing, homeless assistance, building and fire safety, and rural development. The Department receives most of its funding through federal grants and the General Fund, and transfers a large portion to subrecipients including localities and nonprofit organizations.

FINANCIAL OPERATIONS

The Department's actual expenses were approximately 15 percent less than its adjusted budget, in large part because of the differences in the General and Federal Funds. The differences between original and adjusted budgets and actual expenses for these two funds are due to the nature of some grants that the agency administers. For several federal grants, the Department bases its budget on total available funds. Because many of these federal grants may be available over a period of years, not all expenses occur in one given year. Similarly, some state programs are available for more than one fiscal year and require mandatory re-appropriation for funds not used in the prior year. The mandatory re-appropriation increases the adjusted budget.

Budget and Expense Analysis Fiscal Year 2005

	Original Budget	Adjusted Budget	Actual Expenses
General Fund	$23,718,516	$ 31,144,314	$25,126,494
Special Revenue Funds	3,238,500	3,500,654	2,276,269
Dedicated Special Revenue	400,000	400,000	82,282
Federal Fund	67,685,291	67,685,291	60,344,778
Total	$95,042,307	$102,730,259	$87,829,823

Sources: Commonwealth Accounting and Reporting System
2005 Original Budget-Appropriation Act, Chapter 951

Analysis of Expenses

In fiscal year 2005, transfer payments to subrecipients accounted for a majority of the Department's expenses, nearly 87 percent. Personal Services accounted for just over nine percent of the agency's total expenses in 2005. Combined, the remaining five activities accounted for less than four percent of the Department's expenses.

Expenses by Activity Fiscal Year 2005

Activities	Expense	Percent of Total
Transfer Payments	$76,377,681	86.96%
Personal Services	8,118,678	9.24%
Contractual Services	2,045,477	2.33%
Continuous Charges	867,681	0.99%
Equipment	275,210	0.31%
Supplies and Materials	125,311	0.14%
Plant and Improvements	19,785	0.02%
Total	$87,829,823	100%

Source: Commonwealth Accounting and Reporting System

Six programs drive the Department's organization and activities: Housing Assistance Services; Economic Development Research, Planning and Coordination; Regulation of Structure Safety; Administrative and Support Services; Industrial Development Services; and Government Affairs Services. Together, Housing Assistance Services and Economic Development, Research, and Planning accounted for almost 90 percent of the agency's expenses.

Expenses by Program

	Expense	Percent of Total
Housing Assistance Services	$39,390,917	44.8%
Economic Development Research, Planning, and Coordination	39,639,761	45.1%
Regulation of Structure Safety	4,052,137	4.6%
Administrative and Support Services	2,453,009	2.8%
Industrial Development Services	1,960,000	2.2%
Government Affairs Services	333,998	0.4%
Total	$87,829,823	100%

Source: Commonwealth Accounting and Reporting System

Housing Assistance Services Program

The Division of Housing manages the Housing Assistance Services program, which provides affordable housing opportunities through the administration of state and federal grants. These grants provide funding, training, and technical assistance. Listed below are the larger grants in this program.

- The HOME Investment Partnership Program: is a multi-purpose, federally funded grant with fiscal year 2005 expenses over $12 million. This program seeks to expand the supply of decent and affordable housing for low and very low-income individuals by implementing strategies and providing financial and technical assistance to participating localities.

- The Low-Income Energy Assistance Program: provides weatherization to homes of families who live within the federal poverty guideline. The grant totaled $6.5 million in expenses during fiscal year 2005.

- The SHARE Homeless Intervention Program: provides grants to nonprofit organizations and local governments for grants and loans for temporary mortgages and rental assistance for low-income families that are homeless or at an imminent risk of becoming homeless. This program also provides security deposit assistance for homeless households. The Department spent $4.5 million towards this program in fiscal year 2005.

- The Weatherization Assistance Program: provides funds to reduce the heating and cooling costs for low-income families and to ensure their health and safety. The services are for low-income households, particularly for the elderly, individuals with disabilities, and families with children. The Department spent $4 million towards this program in fiscal year 2005.

- Temporary Assistance for Needy Families (TANF): provides assistance to needy families so that children may be cared for in their own homes or in the homes of relatives; end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage; and encourage the formation and maintenance of two-parent families. The Department's expenses for TANF totaled $4.9 million in fiscal year 2005.

Economic Development Research, Planning, and Coordination Program

The Division of Community Development manages the Economic Development Research, Planning, and Coordination program. This program supports various grants and activities designed to address a broad range of community and economic development needs and enhance economic vitality in communities. Listed below are the two largest grants in this program.

- The Community Development Block Grant: is the Division of Community Development's largest federally funded grant with fiscal year 2005 expenses over $28 million. This grant helps develop communities by providing decent housing and a suitable living environment, eliminating blighting conditions in deteriorated areas, and creating job and business opportunities for low to moderate-income persons. Specific activities include acquisition of real property, and rehabilitation, relocation, and demolition of homes and buildings.

- The Indoor Plumbing Rehabilitation Program: provides loans to cities and counties not receiving Community Development Block Grant (CDBG) assistance directly from the U.S. Department of Housing and Urban Development. These loans fund the installation of indoor plumbing to owners of substandard housing where plumbing does not exist, or where existing water delivery or waste disposal systems have failed. The Department spent $2.8 million towards this program in fiscal year 2005.

Regulation of Structure Safety Program

The Division of Building and Fire Regulation administers the Regulation of Structure Safety programs and provides technical assistance and staffing to the boards responsible for development and adoption of building and fire prevention codes. The Division administers such codes, manages the Virginia Building Code Training Academy, and administers the provisions of certification standards for building/fire officials and technical assistance.

Administrative and Support Services Program

The Division of Administration provides departmental and administrative support services and functions. These services and functions include computer services, financial management of grants, personnel services, budgeting, research, procurement, payroll, and processing financial transactions.

Industrial Development Program

This program carries out the provision of the "Enterprise Zone Act", and encourages new business activity and expansion by providing state and local tax relief and grants, local regulatory flexibility, and local infrastructure development in selected economically depressed areas.

Government Affairs Services

The Government Affairs Services program reviews the boundary change and governmental transition issues for localities and courts, and provides technical assistance to local governments, state agencies, and the public on boundary change and transition issues. The Commission also prepares an annual report analyzing the revenue capacity, revenue effort, and fiscal stress of the Commonwealth's cities and counties. In addition, the report provides an annual update on the Catalog of State and Federal Mandates on Local Governments, which documents a state agency assessment of mandates on localities. Additionally, the Commission prepares fiscal impact statements on proposed state legislation and provides research assistance to the General Assembly and legislative study committees.

Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

May 17, 2006

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited selected financial records and operations of the Department of Housing and Community Development (the Department) for the year ended June 30, 2005. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal controls, and test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Federal grant revenues and expenses
Payroll expenses
Network security

We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of vouchers, grant agreements, subrecipient payments and reviews, payroll and personnel records, and observation of the Agency's operations. We tested transactions and performed analytical procedures, including budgetary analyses.

Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted one matter involving internal control and its operation and compliance with applicable laws and regulations that requires management's attention and corrective action. This matter is described in the section entitled "Audit Finding and Recommendation."

EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with management on May 30, 2006. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

DBC:sks
sks: 46

AUDITOR OF PUBLIC ACCOUNTS' COMMENTS

The COV ITRM SEC 2001-01.1 is a security standard issued to Executive Branch departments by the former Department of Information Technology in 2001 and adopted and carried forward by the Virginia Information Technology Agency upon their creation. The standard addresses the documentation and compliance standards for information security for all executive branch agencies. The Auditor of Public Accounts does not set compliance and documentation standards with any Executive Branch agency, but does review that the agencies have met the standards.

COMMONWEALTH of VIRGINIA

DEPARTMENT OF
HOUSING AND COMMUNITY DEVELOPMENT

Timothy M. Kaine
Governor

Patrick O. Gottschalk
Secretary of
Commerce and Trade

William C. Shelton
Director

June 7, 2006

Mr. Walter J. Kucharski
Auditor of Public Accounts
James Monroe Building
101 North 14th Street
Richmond, Virginia 23219

Dear Mr. Kucharski:

Thank you for allowing me the opportunity to include an Agency Response in the Audit Report for FY 2005 for the Department of Housing and Community Development (DHCD). Your comments and recommendations are appreciated and are given the highest level of importance by me and the rest of the administration of DHCD.

This finding was somewhat of a surprise to the agency. The Department was not aware that APA was going to audit for compliance to technology standards administered by VITA. This item was not included in the entrance conference nor was it included in any previous audit of DHCD. Not being aware of the standard that was being applied, it was difficult to determine what processes and documentation the agency should have in place. Although there is not a printed policy within the agency on how the development staff handles change requests, there is a process in place to which staff must adhere. This process requires the development team to get written or verbal approval from the owner of the system to which changes were to be made. All changes to the fiscal database were made with the knowledge and approval of the Fiscal Director and/or the Associate Director or the Deputy Director of Administration which, in our opinion, maintained internal control, fiscal integrity, and security of the database. After the changes have been made in the development environment, the changes were put in a test environment for the end users to test. After successful testing and modifications are made, the system owner would give approval to put the changes into production, either verbally or in writing. We felt that we had taken sufficient actions to protect the integrity of databases. We do acknowledge that we did not have our preventive measures in written form.

Before I address the corrective measures that we have initiated, I would like to mention certain circumstances that may have contributed to this finding. There was a Security Plan drafted in 2002 but due to the retirement of our IT Manager it has not been updated since that time. When VITA assumed control of our IT assets on July 1, 2004, we were left without an IT Manager. Our IT staff consisted of one data base developer and one VITA employee (Senior Systems Engineer) to manage our entire IT operations. We have subsequently hired an Applications Supervisor to coordinate data base development. There was never a Service Level Director (SLD) assigned to DHCD by VITA. The Senior Systems Engineer served as the SLD and also maintained all systems for almost a year. An SLD was finally assigned but he coordinates the efforts of several agencies as well. We had to rely on our Deputy Director of Administration (who is not trained in IT operations) and the VITA employee to manage all compliance matters. Our staff frequently attended VITA meetings where there was discussion on security issues and the fact that agencies would receive an audit to assess their risks. However, there was no communication from VITA addressing the format or standards for security plans or technical assistance offered to DHCD to address this matter. The draft VITA policy was developed within the last year and received numerous comments from agencies, which has delayed its final issuance.

DHCD is aware that state information technology policy makes all agency heads responsible for the security and safeguarding of all databases, information, and information technology assets. As you noted, over the past two years the Commonwealth has moved the information technology infrastructure supporting these databases and information to VITA. Since VITA has assumed responsibility for the information technology infrastructure, agency heads must evaluate the agency's capabilities for determining the level of assurance needed from VITA and have VITA provide assurance that their infrastructure provides the safeguards and controls needed to protect information and databases as required by state policy.

In summary, I am concerned that this finding was based on a standard that had not been clearly delineated, and at a time of transition between when the agency had significant control over its IT environment to a time when VITA and the agency shared responsibility. Absent clear communication and training, I am not sure how DHCD would have been able to fully comply with the standard on which we were audited.

As noted in your report, while agencies and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in a shared environment, the current MOU does not address the security levels required by individual agencies. It is our understanding that the Auditor of Public Accounts (APA) addressed this issue with VITA and that VITA is working on draft language for agencies to use as guidance when addressing this issue. DHCD has begun an analysis of security level safeguards and controls needed to protect its information and databases. This information will be addressed in a revised or supplemental MOU with VITA and will require VITA to provide, at least annually, written assurance related to such security requirements. In the interim, and in anticipation of the final MOU guidelines, the following corrective measures will be implemented by DHCD:

1. The Department has sent APA a draft of Change Management Policy and Procedures for their review and comment. These procedures will provide an orderly method in which changes to the IT environment are requested and approved prior to their installation or implementation.

2. The Department will review the functions and assignments of the Information Security Officer (ISO) and the Agency Information Technology Resource (AITR) to strengthen the roles of these functions in order to properly maintain oversight of VITA Policies and Standards. The same person currently serves as the AITR and ISO, which may not be the best arrangement. We are reviewing these assignments and the possible comments with our VITA contact to make sure that we adhere to these policies and standards.

3. The Department will create formal policies and procedures that adhere to the Information Technology Security Standard (COV ITRM SEC 2001-01.1). The Department will review the draft copy of the revised Security Standard (COV ITRM SEC 501-01) that the Virginia Information Technologies Agency plans to release in July 2006. Because a compliance date is not set for the new draft standard, the Department will follow the status of this new standard for future security requirements.

Thank you for the opportunity to respond to your comments and recommendations. I will ensure that the appropriate staff address this issue and continue to work with VITA to maintain the proper level of security at DHCD. It is of the utmost importance to me that all IT systems are properly maintained and protected to the highest level possible while working within current budget constraints and under VITA's guidance.

Sincerely,

Bill Shelton

ljm

AGENCY OFFICIALS

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
As of June 30, 2005

William C. Shelton, Director

Basil Gooden, Principal Deputy Director

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