December 31, 2019

Keely Martin Bosler, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Ms. Keely Martin Bosler,

In accordance with the State Leadership Accountability Act (Leadership Accountability), the Department of Finance submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2019.

Should you have any questions please contact Jennifer Whitaker, Program Budget Manager, at (916) 445-3274, Jennifer.Whitaker@dof.ca.gov.

GOVERNANCE

Mission and Strategic Plan

The Department of Finance's mission is to serve as the Governor's chief fiscal policy advisor and promote long-term economic sustainability and responsible resource allocation. The Director of Finance (Director) is appointed by the Governor and serves as a member of the Governor's cabinet and senior staff. In addition, the Director sits on numerous boards and commissions that make significant fiscal policy decisions. Government Code section 13070 provides Finance general authority over all financial and business policies to conserve the rights and interest of the state.

Through its strategic plan, Finance fulfills its mission by focusing on commitment in the areas of leadership, workforce, and accountability. Finance works collaboratively with the Legislature, other state departments, and external stakeholders to meet the priorities of the Governor and the State of California. Finance's history of performance is driven by a set of core values and defined roles and responsibilities to guide the actions of its employees. Management leads by example, conducting day to-day operations with the highest professionalism. Roles and responsibilities are well defined. Strong lines of authority, control, collaboration, and communication are fostered and maintained throughout Finance.

Finance's principal areas of responsibility are described as follows:

- **Budget and Policy Units** are responsible for a wide range of fiscal policy responsibilities, including the preparation, enactment, and administration of the Governor's Budget. Staff work with top management of state government and legislative staff regarding fiscal and programmatic policies of the Administration. Budget and policy staff also provide fiscal and programmatic analyses of legislative bills and make recommendations to the Governor and the Legislature.
- **Demographic, Economic, and Financial Research** units are responsible for monitoring and forecasting the state's population, economic, and tax revenue trends to support all fiscal and

policy decisions. The Demographic Research unit is designated as the single official source of demographic data and enrollment and population projections for state planning and budgeting. The Economic Research unit develops and maintains California economic data, prepares economic forecasts, and provides advice on economic policy issues. The Financial Research unit builds and maintains revenue forecasting models, provides revenue forecasts to assist the Executive Branch in preparing the state budget, and analyzes regulations and developments affecting tax laws.

- **Audits and Program Evaluations** are performed by the Office of State Audits and Evaluations (OSAE). OSAE supports Finance in supervising the state's financial and business policies and conserving the state's rights, interests, and resources through independent financial audits and objective evaluations of state programs and policies, and other related services. Also, OSAE monitors and coordinates statewide State Leadership Accountability Act compliance, issues Audit Memos to provide instruction to departments and internal audit organizations, promotes bond accountability through ongoing oversight activities, and coordinates and carries out the state's responsibility related to the federal Single Audit Act.
- **Information Technology** consists of two units with various responsibilities. Information Services designs, develops, implements, and supports the numerous information technology system and applications of Finance's technical infrastructure. Information Technology Consulting Unit (ITCU) serves as Finance's primary liaison to the California Department of Technology. ITCU conducts fiscal analyses of proposed statewide information technology (IT) policies and enterprise initiatives, performs oversight of critical IT projects, and provides IT-related consulting services for budget analysts.
- **Accounting Policies and System Support** includes the Fiscal Systems and Consulting Unit (FSCU), responsible for setting statewide fiscal and accounting policies and procedures. The unit provides fiscal consulting and training services to departments to help ensure the state's assets are protected and accurate, and timely financial information is maintained. Also, Finance maintains and provides support for the California State Accounting and Reporting System (CALSTARS), which has been the primary accounting system used by most state departments for over 30 years. Staff continue to maintain CALSTARS and provide system and accounting training until departments are fully transitioned to the Financial Information System for California (FI$Cal).
- **Financial Information System for California** integrates the management of resources and funds in the areas of budgeting, accounting, procurement, cash management, financial management, and financial reporting. To optimize the financial business management of the state, Finance, along with the State Controller, the Treasurer, and the Department of General Services, collaboratively develop, implement, utilize, and maintain the FI$Cal system.

Control Environment

Finance management values, demonstrates, and communicates the importance of upholding a high standard of integrity and ethics. To demonstrate the importance of upholding standards for integrity and ethical behavior the Department has established the following core values: problem solving, teamwork, respect, integrity, and expertise. These core values help focus the nature of employee actions while striving to achieve the department's mission. Finance communicates core values and standards of conduct through several mechanisms such as: thoughtful recruiting and hiring; thorough on-boarding; regular staff training; written communication about important notices and updates to policies; access to

administrative and operational guidance documents; and regular team meetings where important values, guidance, and decisions are announced and discussed. Management communicates and emphasizes the importance of meeting legal and regulatory requirements and respectful, timely communication with colleagues, the state leadership, other department representatives, and stakeholders. Management's tone helps ensure challenges and opportunities are recognized and communicated, attention is given to developing and implementing responses to challenges and opportunities, and regular monitoring of control systems occurs.

The Director, Chief Deputy Directors, Chief Counsel, and Chief Operating Officer are the department's executive management and oversight body. The Program Budget Managers are the senior operating management. Executive and operational management represent key positions within the department and these individuals possess the knowledge and expertise to oversee and evaluate departmental operations. These key members of management possess capabilities and characteristics including integrity, ethical standards, leadership, critical thinking, and problem solving abilities, an internal control mindset, and programmatic and operational expertise. The key members of management provide oversight of the design and implementation of the department's control environment, the risk assessment process, control activities, the information and communication systems, and monitoring of key systems.

Finance management has organized the department into discrete units and sub-units to facilitate meeting its mission, goals, and objectives. As part of this organizational structure, management considers how units communicate and interact. Key positions are assigned as unit leaders and they have responsibility for fulfilling the unit's duties. As such, key members of management further delegate duties to subordinates and evaluate the effectiveness of delegated authority to ensure proper segregation of incompatible duties. Documentation of internal control systems is developed and maintained at both the organization-wide and unit level depending on the need. Internal control documentation is communicated to employees via several channels such as policy and procedure manuals and the department Intranet. Further, internal control documentation communicates duties and facilitates monitoring. The department routinely assesses the need to update documentation as changing conditions and business needs evolve.

Management establishes competency expectations for department employees through Duty Statements and Expectation Memos. Duty Statements include the employee's role in maintaining the department's systems of internal control. The department recruits, hires, on-boards, and provides ongoing training to all employees to help meet competency expectations. Management considers incentives and motivation in assessing employee performance and providing feedback. The department provides routine training for all critical operations to develop the necessary competence level, knowledge, skills, and abilities. The goal of this training is to assist in the smooth transition to key positions as employees advance through the organization. Cross training is emphasized and encouraged for staff development and to allow for sudden departures of key positions.

Management understands importance and impact of employee recognition and uses several methods to recognize and celebrate employee successes from handwritten thank you notes from the Director to department-wide teambuilding activities and events. Management values the critical work performed by its employees and makes an effort to recognize these efforts.

Finance staff receive regular job performance feedback and formal annual evaluations. In addition, the

department takes seriously the enforcement of accountability through disciplinary actions for employee behavior, which may compromise the department's control systems. Disciplinary actions are designed to instruct and guide employees on the proper course of action while protecting the employee's rights. Further, employees receive mandatory training about behaviors for which the Department has adopted a zero-tolerance policy. In addition, management routinely evaluates working conditions and strives to eliminate excessive pressures resulting from the cyclical nature of the workload.

Information and Communication

Management oversees the use of information critical to department operations. Management ensures needed information is developed internally as required. Further, management requests and works with others to obtain information from outside the organization. A high level of attention is given to the timeliness and accuracy of information deemed necessary to meet internal and external operational objectives. Management does this by requiring units to report the necessary information through the Department's chain of command. The accuracy and adequacy of the information is routinely evaluated by all staff. Attention is given to the completeness, timeliness, and relevance of data.

Management communicates information through established channels about policies, programs, and operations. The communication channels follows the chain of command to ensure employees throughout the organization receive information. In addition to the chain of command communication, the department uses a variety of methods to communicate important and relevant information. Examples of such methods include regular management and team meetings, bulletin boards, all staff meetings, e-mail blasts, newsletters, and intranet postings. Further, the department communicates via email and through bulletin board postings regarding the state's Whistleblower hotline for reporting ethical issues. Additionally, staff are instructed to go around the traditional chain of command reporting structure if the communication line is compromised.

The department is aware of the importance of relationships with members of the Administration, Legislature, local governments, and other stakeholders. Staff, within their appropriate lines of authority, devotes significant effort pursuing appropriate communication with these parties. Two-way information is evaluated and used to meet operational objectives and to manage and monitor challenges, opportunities, and the related internal controls.

MONITORING

The information included here discusses the entity-wide, continuous process to ensure internal control systems are working as intended. The role of the executive monitoring sponsor includes facilitating and verifying that the Department of Finance monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to:
Richard Gillihan, Chief Operating Officer.

Finance is in the process of implementing and documenting 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 Finance systems of controls and monitoring.

The adoption of a formal communication strategy regarding the monitoring of controls with the executive monitoring sponsor is in progress. However, the executive monitoring sponsor has taken

some steps to successfully monitor the department's controls and risks. Such steps include a planned all staff mandatory training (in the first quarter of 2020) facilitated by OSAE to emphasize not only the State Leadership Accountability Act (Act), but also to communicate that all employees have a role in the success of the effectiveness of the department's controls. The executive monitoring sponsor also plans to highlight the Act requirements on the department-wide intranet and establish a confidential email inbox for employees to submit concerns or improvements directly to him.

Biannually, the executive management team attend an off-site meeting to review the department's risks, processes, and controls. The off-site meetings provide an opportunity for the executive management team to suggest changes to department processes and controls to mitigate potential risks. The executive monitoring sponsor captures all the suggested changes and monitors to ensure they are executed.

The department's controls are also monitored by outside audits or reviews. More specifically, the State Personnel Board conducts a triennial audit of the Human Resources practices and the Department of Military reviews the Information Technology controls. Any deficiencies in controls found during these audits or reviews are monitored by the executive monitoring sponsor until the corrective action plans are fully implemented.

RISK ASSESSMENT PROCESS

The following personnel were involved in the Department of Finance risk assessment process: executive management, middle management, front line management, and staff.

The following methods were used to identify risks: brainstorming meetings, audit/review results, and other/prior risk assessments.

The following criteria were used to rank risks: likelihood of occurrence, potential impact to mission/ goals/objectives, timing of potential event, potential impact of remediation efforts, and tolerance level for the type of risk.

In accordance with State Leadership Accountability requirements and at the request of the Director, the COO, other Executive Staff (including Chief Counsel, Chief Deputy Director of Budgets, and Legislative Director) and all eight Program Budget Managers (senior management) met to identify and discuss significant department-wide risks that could adversely impact the achievement of Finance's objectives and mission. Risk statements were prepared, documented, and evaluated, with input from affected unit managers and staff. Senior management reviewed all the risk statements and determined corresponding controls and subcontrols.

OSAE staff facilitated several meetings with the COO and senior management to finalize and rank the agreed upon risks. The risk ranking was based on the risk's perceived severity, the possibility of occurrence, and the speed of onset for the risk event to manifest itself.

RISKS AND CONTROLS

Risk: Statewide Budget Preparation and Fiscal Integrity

The integrity and/or quality of the data/information used in accounting, forecasting, and budget development processes may be inaccurate or incomplete resulting in the release of a multi-year budget

that relies heavily on 1) information provided by departments who may not have a complete understanding of control over their quality control processes and 2) forecasting data based on numerous uncontrollable variables. This risk could lead to inaccurate policy advice, legal ramifications, inadequate budget decisions, and loss of credibility with the Administration, Legislature, and stakeholders.

Control: A

Maintain ongoing and constant communication between budget units and departments to obtain the most timely and accurate budget and accounting data. This includes providing detailed budget memos and deadlines as well as encouraging Finance budget staff to develop good working relationships with departmental budget analysts.

Control: B

Regularly assess and monitor data collected, internal review processes, and policies to ensure consistency with Administration goals and direction.

Control: C

Coordination within Finance to collect and evaluate multiple sources of data to assist in the development of revenue forecasting models and evaluation of data projections.

Control: D

Continue to partner through EWG and the Steering Committee to monitor FI$CALs success in meeting the final milestones and ensuring statewide accounting information is produced timely and accurately.

Risk: Workforce Development

Staff development can be hindered by the heavy volume, tight deadlines, and complexity of the work performed. This culture leads to burn out, inadequate work life balance, insufficient job shadowing or training, and reduced readiness for promotional opportunities.

Control: A

Adopt realistic due dates and adhere to them. Setting expectations and targets up front provides an employee the opportunity to plan for the deadlines and encourages the deadlines to be met.

Control: B

Incorporate wellness opportunities into the the department as well as Alternate Work Week Schedules and teleworking options. Providing wellness activities during the work week helps reduce stress and increases productivity. Also, Alernate Work Week Schedules and teleworking allows employees options to balance work and life.

Control: C

Provide more options for training and job shadowing as well as coaching and mentoring opportunities during non-busy times.

Risk: Communication

Communication of critical information may not always reach the intended parties timely due to the volume and speed of information and the number of cross-cutting unit issues. This could result in ineffective and incomplete information being used for statewide decision making or duplication of efforts.

Control: A

Develop both an internal and external communication plan to ensure all parties are informed and aware of critical and confidential information timely.

Risk: ADA Accessibility Standards

Finance's public website does not fully meet the ADA accessibility standards because of the resources needed to remediate the volume and complexity of documents housed on the website. Without an ADA accessible website, Finance may be at risk of fiscal liability.

Control: A

Continue to develop and adhere to our work plan to remediate the website to be ADA accessible.

Control: B

Continue to provide training to content developers to ensure employees are aware of the ADA accessibility standards.

Control: C

Aquire additional tools and resources to aid in remediating the website.

CONCLUSION

The Department of Finance strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies as appropriate. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Keely Martin Bosler, 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