

December 26, 2025

Joe Stephenshaw, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Director Joe Stephenshaw,

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, 2025.

Should you have any questions please contact Frances Parmelee, Program Budget Manager, Oversight and Accountability Unit, at (916) 322-2985, frances.parmelee@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 its 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.

- **Forecasting**, which is comprised of three units, is 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.
- **Accounting Policies and System Support** is provided by the Fiscal Systems and Consulting unit (FSCU). FSCU sets statewide fiscal and accounting policies and procedures, provides fiscal and accounting training, advice, and consulting services to departments to ensure that the state's assets are protected, and maintains the department's accounting records. FSCU also provides guidance on statewide fund reconciliation, administers the federal Cash Management Improvement Act, and statewide cost allocation plans. The unit participates in the development of statewide financial systems and represents the state on a variety of accounting and federal issues.
- **Oversight and Accountability** unit promotes transparency, effectiveness, and efficiency within the state's operations and programs through the work of two distinct offices: Office of State Audits and Evaluations (OSAE) and Research and Analysis Unit (RAU). 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 the 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. RAU conducts "mission-based reviews" to address complex and cross-cutting problems within state government. This unit works collaboratively with state departments and Finance budget staff to examine processes, program data, and underlying statutory requirements to make recommendations on the most efficient and effective way to deliver government services.
- **Administrative Services** provides Finance employees with support and customer service in many areas such as business services; human resources; information technology; learning and development; recruitment, retention and employee development; and

Finance's operating budget.

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, 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 (Budget and Policy), Chief Operating Officer (COO), Chief Counsel, Deputy Director of Legislation, and Deputy Director of External Affairs are the department's executive management team and oversight body. The Deputy Director of Administrative Services and the 11 Program Budget Managers (PBM), who report directly to the COO, are the senior operating management team. Executive and senior 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, 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 the Administrative Policy Manual, unit specific policy and procedure manuals, and Finance's intranet (known as DOF Insights). 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, onboards, and provides ongoing training to all employees to help meet competency expectations. The department provides routine training for all operations to develop the necessary competence level, knowledge, skills, and abilities 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 the importance and impact of employee recognition and uses several methods to celebrate successes by recognizing employee contributions at department-wide teambuilding activities and events, in the quarterly newsletters, and via emails from the executive and senior operational management team. Some units have additional methods they use to recognize staff such team lunches, social gatherings, and more formal recognition programs. Management values the critical work performed by all employees and makes an effort to timely recognize these efforts.

Management motivates employees by providing ongoing, specific, and actionable feedback on their performance. Finance staff receive informal guidance and formal probationary and annual performance 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 follow 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, all staff meetings, department-wide emails, newsletters, the DOF Insights, and Microsoft Teams (both video conferencing or chats). 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. Specifically, the COO has three reporting mechanisms for staff: 1) a risk monitoring email account (Risk.Monitor@dof.ca.gov), 2) an anonymous reporting portal on the DOF Insights, and 3) a telephone call or a meeting either virtual or in-person with the COO. These methods provide direct access to the COO without jeopardizing the chain of command.

The department is aware of the importance of relationships with members of the Administration, Legislature, agencies and departments, 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: Jennifer Whitaker, COO.

A component of complying with the State Leadership and Accountability Act includes implementing and documenting the entity-wide, continuous process to ensure internal control

systems are working as intended. Finance's "Ongoing Monitoring Framework" (Framework) was developed with the following guiding principles in mind:

- Establish active oversight processes, including regular and ongoing monitoring processes, for the prevention and early detection of fraud and errors in program administration.
- Maintain effective systems of internal control to provide the basic foundation upon which a structure of public accountability is built.
- Ensure that state resources are adequately safeguarded, monitored, and administered.

The Framework describes Finance's approach to ongoing monitoring which involves (1) establishing a foundation for monitoring, (2) designing and executing monitoring activities, and (3) monitoring and reporting the results. It also incorporates communication strategies regarding the monitoring of controls.

The executive monitoring sponsor take steps to successfully monitor the department's controls and risks. Such steps include mandatory Risk Intelligence training for all staff to emphasize not only the State Leadership Accountability Act but also to communicate that all employees have a role in the success of the controls' effectiveness. The executive monitoring sponsor sends biannual department-wide emails to remind employees of the importance of submitting risks or concerns to the the confidential risk monitoring email, utilizing the anonymous reporting link on the DOF Insights, or reaching out directly to the COO. The COO monitors the email inbox and anonymous risk reporting portal frequently and promptly addresses suggestions or concerns.

Biannually, both the executive and senior operational management team attend an off-site meeting to review the department's risks, processes, and controls. The off-site meetings provide an opportunity to suggest changes to department processes and controls to mitigate potential risks. On an as-needed basis, additional off-site meetings could be scheduled. The executive monitoring sponsor captures all the suggested changes and monitors them to ensure they are implemented. The department's controls are also monitored by outside audits or reviews. Specifically, the State Personnel Board conducts a triennial audit of human resources practices and the Department of Military reviews information technology controls. Further, the department is audited by the California State Auditor on a biannual basis for any identified high risk areas. 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, employee engagement surveys, ongoing monitoring activities, audit/review results, other/prior risk assessments, external stakeholders, and consideration of potential fraud.

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.

RISKS AND CONTROLS

Risk: Workforce Development and Retention

Finance's culture and workload is defined by constitutional deadlines, heavy volume, and complex work. These factors contribute to unsustainable workload, inconsistent succession planning, and at times, reduced readiness for promotion opportunities, which contribute to staff development and retention challenges. Frequent turnover results in a loss of institutional knowledge and history, and an increased likelihood of errors.

Control: Retention

1. Implement "stay" interviews with current employees to identify potential issues before the issues lead to dissatisfaction or an employee leaving. Use the feedback from these interviews to improve retention and engagement strategies.
2. Continue administering "exit" interviews to help identify areas for improvement in the organizational culture, management, and overall employee satisfaction.
3. Implement an annual employee engagement plan that includes

opportunities for wellness, teambuilding, recognition, and professional development.

4. Continue promoting Finance's Upward Mobility Program through informational sessions/materials, and one-on-one discussions with interested employees.

Control: Recruitment

1. Continue administering a robust recruitment strategy, including partnering with various colleges and universities (in California and across the country) to promote job opportunities, offering information sessions/presentations to interested candidates, consulting with potential candidates on a one-on-one basis, attending career fairs/networking events, and hosting the annual Department of Finance Policy and Recruitment Conference (DOFCON).
2. Continue employing summer interns, executive fellows, student assistants, and retired annuitants to help recruit new employees and fill existing vacancies.
3. Continue utilizing LinkedIn, Handshake, and various job promotion platforms to reach a broad candidate pool.
4. Continue partnering with Finance employees to request feedback on the recruitment process so that the department continuously improves overall outreach efforts and initiatives.

Control: Training and Workforce Development

1. Provide training and professional development opportunities for employees at all stages and levels of their careers, including technical skills, soft skills, and leadership training.
2. Implement a biennial training needs assessment to identify soft skill learning needs across the department and utilize the results to develop courses

in-house.

3. Continue to utilize the department's learning management system to administer Finance's overall training program and provide employees with a user-friendly space to manage learning activities, requests, information, and records.
4. Continue administering the Mentorship Program (open to all employees) to support Finance's succession planning and overall knowledge transfer efforts.
5. Continue administering the Mentorship Program for New Leaders, in which new leaders are mentored by executive level leaders.
6. Onboard new and newly promoted employees to lead/supervisor roles with the tools and resources to be successful.

Risk: Information Security

Finance works with a high volume of confidential data including budget, audit, and accounting. Keeping this data secure is difficult when it is mostly electronic and the staff currently operate under a hybrid telework environment. The risk of inadvertently sharing confidential data (either verbally or via email) is elevated in an exclusively electronic environment. Frequent electronic communication increases Finance's risk for cybersecurity threats, such as phishing and ransomware attacks. Further, as Finance begins to explore the use of Artificial Intelligence in the workplace, new risks are introduced. Lack of human oversight can create false assumptions, inaccurate estimates, and non-factual information being used to make critical decisions.

Control: Training and Guidance

1. Continue requiring ongoing cybersecurity training courses for all employees.

2. Continue issuing periodic department-wide emails, offering reference material on the DOF Insights' Cyber Guard page, and conducting regular phishing campaigns.
3. Develop a robust new employee onboarding cybersecurity program.

Control: Oversight

1. Continue implementing information security policies to ensure security requirements, controls, and responsibilities are defined.
2. Review and update retention policies and communicate any changes.
3. Participate in periodic audits conducted by other state entities (California Department of Technology and California Military Department) to review Finance's policies and procedures.

Control: Governance Framework

1. Develop an Artificial Intelligence governance framework and test the functionality to see where it can be helpful in Finance's operations. This framework will require an adequate level of human review to ensure information produced and utilized for decision-making is accurate.

Risk: Statewide Budget and Fiscal Integrity

The integrity and quality of the data used in accounting, forecasting, and budget development processes rely on: 1) information provided by departments, 2) forecasting data based on numerous uncertain variables, 3) unpredictable budget revenues, and 4) a significant volume of fiscal and policy issues. Any of these variables could cause the data to be inaccurate or incomplete, resulting in mistaken assumptions as part of the multiyear budget.

Control: Communications

1. Continue ongoing and constant communications with agency and department budget units.
2. Continue encouraging Finance staff to foster good working relationships with agency and department budget offices.

Control: Guidance and Training

1. Provide detailed budget memos.
2. Provide realistic budget deadlines including a budget calendar.
3. Develop and provide robust statewide training and resources.
4. Continue utilizing Finance's Best Practices Group to ensure processes are current, efficient, and effective.
5. Develop internal cross-unit training, assign dedicated unit back-ups, and develop comprehensive desk manuals.

Control: External Stakeholders

1. Leverage outside experts.
2. Continue hosting the fall Economic Forecast Conference.
3. Continue convening and leveraging the expertise of the Governor's Council of Economic Advisors.

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.

Joe Stephenshaw, Director

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