

January 16, 2024

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, 2023.

Should you have any questions please contact Frances Parmelee, Program Budget Manager - OAU, 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.
- **Demographic, Economic, and Financial Research** 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.

- **Oversight and Accountability** is a new unit that merges three similar units into one with vast statewide oversight responsibilities. This unit includes the Office State Audits and Evaluations (OSAE), the Research and Analysis Unit (RAU), and the Federal Funds Accountability and Cost Tracking (FFACT) unit. 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. FFACT supports the coordination of federal stimulus tracking, federal reporting and transparency, and accountability for federal COVID-19 funds, including the \$27 billion in State Fiscal Recovery Funds from the American Rescue Plan. The unit is responsible for certain federal disaster cost recovery activities in coordination with the California Office of Emergency Services and closely coordinates with Finance budget units.
- **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** is provided by the Fiscal Systems and Consulting Unit (FSCU) who sets statewide fiscal and accounting policies and procedures. The unit provides fiscal and accounting training, advice, and consulting services to departments to ensure that the state's assets are protected, and that accurate and timely financial information is maintained. FSCU 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.

## **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 (Budget and Policy) Chief Counsel, Chief Operating Officer (COO), Legislative Director, and Deputy Director of External Affairs are the department's executive management team and oversight body. The nine Program Budget Managers (PBM), who report directly to the COO, are the senior operating management team. 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 the Administrative Policy Manual, unit specific policy and procedure manuals, and the DOF Insights (Finance 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 the importance and impact of employee recognition and uses several methods to recognize and celebrate employee successes including department-wide teambuilding activities and events, and emails to the executive management team recognizing employee contributions. Some units have additional methods they use to recognize staff such team lunches, social hours, and more formal recognition programs. Management values the critical work performed by its employees and makes an effort to timely 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 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 two mechanisms for staff to report: 1) a risk monitoring email account or 2) an anonymous reporting function on the DOF Insights. Both 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: 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 Finance's 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 continues to 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 (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 sends biannual department-wide emails to remind employees of the importance of submitting risks or concerns to the confidential risk monitoring email or utilizing the anonymous reporting link on the DOF Insights. Both the email inbox and anonymous risk reporting are monitored frequently and suggestions or concerns are promptly addressed.

Biannually, both the executive management team and operational 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 implemented.

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. Further, the department is audited by the California State Auditor for any identified high risk areas such as the state management of COVID-19 Federal Funds. 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, and middle management.

The following methods were used to identify risks: brainstorming meetings, ongoing monitoring activities, audit/review results, and other.

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.

### **The following personnel were involved in the Department of Finance risk assessment process:**

- Executive management (COO)
- Operational management (PBMs) with input from unit staff

### **The following methods were used to identify risks:**

- Brainstorming meetings
- Results of audits/reviews
- Ongoing monitoring activities (COO risk monitoring tools)
- Employee exit interviews

### **The following criteria were used to rank risks:**

- Likelihood of occurrence,
- Potential impact to mission/ goals/objectives
- Timing of potential events
- Potential impact of remediation efforts
- Tolerance level for the type of risk

The COO and the nine PBMs met numerous times 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. 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. After determining the risks and rankings, the corresponding controls and subcontrols were discussed and determined.

## **RISKS AND CONTROLS**

### **Risk: Workforce Development and Retention**

Finance's culture and workload is defined by the heavy volume, constitutional deadlines, and complex work. These factors lead to burn out, inadequate work life balance, insufficient job shadowing or training, lack of succession planning, and reduced readiness for promotion, 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. Finance is currently implementing two approved Budget Change Proposals (BCP) that provide additional resources throughout the department. These resources will allow Finance to better align the resources with the workload.
2. Continue to offer the hybrid telework policy.
3. Continue to offer social, volunteer, and wellness activities that promote a supportive and fun work culture.

**Control: Recruitment**

1. Continue to employ summer interns, executive fellows, student assistants, and retired annuitants to help recruit new employees and fill existing vacancies.
2. Continue to host the DOFCON Policy Conference, attend college career fairs, and participate in CalHR statewide recruiting events to attract and recruit potential candidates.
3. Modify our existing exam process by developing in-house recruiting exams and utilizing statewide exams/lists to recruit and hire to reduce the time it takes to hire candidates.
4. Utilize recruiting tools like LinkedIn and other online social media to reach a broader candidate pool.

**Control: Training and Workforce Development**

1. Provide a robust training program for all staff that includes both technical and leadership training opportunities.
2. Create a department-wide coaching and mentoring program.
3. Implement employee stay interviews, consider conducting 360 evaluations, and continuing exit interviews to determine what things can assist with employee retention.
4. Onboard new employees and newly promoted to lead/supervisor role with the tools and resources to be successful.
5. Continue to work on succession planning.

**Risk: Statewide Budget and Fiscal Integrity**

The integrity and 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 on and is based on: 1) information provided by departments, 2) forecasting data based on numerous uncertain variables, 3) unpredictable budget revenues, and 4) an significant volume of fiscal and policy issues.

**Control: Communication**

1. Continue ongoing and constant communication with agency and department budget units.

2. Ensure our staff develop good working relationships with agency and department budget analysts.

### **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 to utilize the Best Practices Group to ensure processes are current, efficient, and effective.
5. Develop formalized cross-unit training, dedicated unit back-ups, and comprehensive desk manuals.

### **Control: External Stakeholders**

1. Leverage outside experts.
2. Continue to host the fall and spring Economic Forecast Conferences.
3. Continue to participate in the Governor's Council of Economic Advisors.

### **Risk: Cyber and 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 definition of workplace differs by staff because of the hybrid telework policy. 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, the use of Artificial Intelligence in the workplace creates the risk of confidential data being shared with public websites.

### **Control: Training and Guidance**

1. Continue ongoing cybersecurity training including periodic department-wide emails, reference material on the DOF Insights Cyber Guard page, and conduct regular phishing campaigns.
2. Develop a robust new employee onboarding cybersecurity onboarding program.
3. Implement the Finance BCP that adds more resources to the Information Security team for more coverage and oversight.
4. Continue the Finance Retention Team to ensure retention policies are updated, communicated, and followed to reduce Finance's electronic footprint
5. Participate in periodic audits by other state entities (California Department of Technology and Military) to review our policies and procedures.
6. Develop an Artificial Intelligence governance framework and test the functionality to see where it can be helpful in Finance's operations.

## **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

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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