

December 29, 2017

Michael Cohen, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Mr. Michael Cohen,

In accordance with the State Leadership Accountability Act (SLAA), the Department of Finance submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2017.

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

BACKGROUND

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. The plan supports Finance's business and program priorities, increase operational efficiencies, and further Finance's overall mission. 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 operation 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.
- **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 to departments as the

- state transitions to the Financial Information System for California (FI\$Cal).
- **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 SLAA 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.
 - **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.
 - **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.
 - **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 Controller, the Treasurer, and the Department of General Services, collaboratively develop, implement, utilize, and maintain the FI\$Cal system.

ONGOING MONITORING

As the head of Department of Finance, Michael Cohen, Director, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

EXECUTIVE MONITORING SPONSOR(S)

The executive monitoring sponsor responsibilities include facilitating and verifying that the Department of Finance internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Jacqueline Wong-Hernandez, Chief Deputy Director, Policy.

MONITORING ACTIVITIES

Finance is in the process of adopting formalized procedures to document its ongoing monitoring practices. Finance is currently piloting the procedures, which include identifying key processes and related controls within each unit and documenting the monitoring activities performed over those controls. The monitoring of each activity is identified and lists the person(s) responsible for monitoring the activity as well as the frequency and how the monitoring results are communicated. The adoption of a formal communication strategy regarding the monitoring of controls with the executive monitoring

sponsor is in progress.

ADDRESSING VULNERABILITIES

Key Finance management identified significant risk areas within the organization and tasked OSAE with reviewing and evaluating the significant risk areas. In addition to the review and evaluation conducted, it is intended that the monitoring plan currently in progress will assist each unit in monitoring areas of concern and communicating those monitoring efforts to the executive monitoring sponsor.

COMMUNICATION

Finance's communication plan is still in progress; however, Finance plans to communicate monitoring activities to key members of management through the utilization of the executive monitoring sponsor through executive management meetings. It is planned that each unit provide the executive monitoring sponsor their monitoring communication plan. The monitoring communication plan identifies the controls, the monitoring activity over the controls, the frequency the control is being monitored, the person(s) responsible for the monitoring activity, and how the results are being communicated. The monitoring communication plan is envisioned to be forwarded to the executive monitoring sponsor for review and action, where applicable, and discussions held between the executive monitoring sponsor and Finance executive management.

ONGOING MONITORING COMPLIANCE

The Department of 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.

RISK ASSESSMENT PROCESS

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

RISK IDENTIFICATION

In accordance with SLAA requirements and at the request of Finance's COO, the COO and 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 sub-controls. At my discretion, all controls and sub-controls were tested.

To assist in the evaluation of the controls and sub-controls, Finance employees were sent a survey designed to assess certain aspects of their position and work experience. The survey was sent to 440 employees of which 351 (80 percent) responded. OSAE staff also interviewed senior management and staff, reviewed policies and procedures, and observed walk-throughs of control processes in place.

RISK RANKING

OSAE staff facilitated a meeting with the COO and senior management to rank the agreed upon risks using OptionFinder voting technology for instant results. 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: OPERATIONS-INTERNAL-PROGRAM/ACTIVITY—CHANGES, COMPLEXITY

The integrity and/or quality of the data used in the forecasting and budget development process may be inaccurate or incomplete resulting in the release of a multi-year budget that relies heavily on:

- Information provided by departments, and not having a complete understanding or control over their quality control processes
- Forecasting data that is based on numerous and uncontrollable variables

This could lead to inaccurate policy advice, poor budget decisions, and loss of credibility with the Governor's Office, Legislature, and stakeholders.

CONTROL A

Maintain ongoing communication between budget units and departments to obtain the most timely and accurate data.

CONTROL B

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

CONTROL C

Collect and evaluate multiple sources of data to assist in the development of revenue forecasts and fiscal estimates.

RISK: OPERATIONS-INTERNAL-STAFF—KEY PERSON DEPENDENCE, WORKFORCE PLANNING

The lack of adherence to the State's hiring processes and the department's workforce strategies to hire, develop, and retain skilled staff could result in a poorly developed workforce and an increase in reliance on key managers and staff. This would result in burnout from long hours and increased turnover from key positions.

CONTROL A

Formalize and implement a comprehensive workforce development plan. The components of the plan should include:

- Recruitment and hiring strategies
- Training, coaching and leadership programs
- Performance evaluations and improvement strategies
- Promotional processes

RISK: OPERATIONS-INTERNAL-OVERSIGHT, MONITORING, INTERNAL CONTROL SYSTEMS

A lack of policies and procedures, that specify the documentation needed, and the required retention periods for such documents, may result from insufficient essential records that document recruitment, hiring and appointment actions. This could lead to our inability to withstand a control agency compliance review and also hinder our ability to respond to potential employee exam and/or merit-based appeals.

CONTROL A

Finalize development of departmental policy and procedures consistent with recently established records retention regulations.

CONTROL B

Provide departmental staff who have responsibility for records management with appropriate training.

CONTROL C

Inventory current records, purge outdated information, identify storage needs and obtain internal and external storage space to adequately secure documents.

RISK: OPERATIONS-INTERNAL-OVERSIGHT, MONITORING, INTERNAL CONTROL SYSTEMS

Not following audit standards or OSAE's internal quality control processes could lead to poor quality work products that are not objective and result in inaccurate conclusions, guidance, and advice for the intended client and stakeholders. This could compromise OSAE's credibility and integrity.

CONTROL A

Create and communicate a system of quality control.

- Review working papers and findings by all levels of management and conduct periodic update meetings.
- Provide ongoing training and templates.

CONTROL B

Maintain professional independence and neutrality during engagements.

RISK: REPORTING-EXTERNAL-INFORMATION COMMUNICATED—ADEQUACY, ACCURACY, INTERPRETATION, TIMELINESS

Inaccurate interpretation and utilization of data submitted could result in inaccurate forecasts and analyses of the population, K-12 enrollment, and census data produced by the Demographic Research Unit. This could result in faulty planning, decision-making, and funding allocations at state, regional, and local levels as well as a loss of credibility for the Unit and the Department.

CONTROL A

Manage and maintain documentation on data sources and reporting schedules.

- Improve data management
- Develop contingency plans
- Provide ongoing training
- Improve and periodically update the processes to validate data.

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 controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Michael Cohen, 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