

December 26, 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 State Controller 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 Tom Yowell, Chief Administrative Officer, at (916) 327-8299, tyowell@sco.ca.gov.

BACKGROUND

The State Controller is the elected Chief Fiscal Officer of California, one of the largest economies in the world. The Controller ensures the State's budget is spent properly, helps administer two of the nation's largest public pension funds, and serves on State boards and commissions that are charged with duties ranging from protecting our coastline to helping build hospitals.

The SCO has the following seven divisions and one significant project (FI\$Cal) in which SCO is partnered with the Department of Finance, Department of General Services and the State Treasurer's Office:

Administration and Disbursements Division

- Pays the State's bills and liabilities with warrants and electronic fund transfers
- Provides budgeting, accounting, personnel, equal opportunity, training, procurement, and space planning and development support services

Audits Division

- Assists and advises local government officials in tax collecting procedures
- Assures accuracy of local government financial statements
- Audits all claims against the State
- Audits State and Federal programs
- Audits the use of highway users' tax funds and the allocation and apportionment of local property taxes

Information Systems Division

- Provides a full range of services including application development, desktop support, project management oversight, and technical support to SCO Divisions to address their existing and emerging information technology needs

Local Government Programs and Services Division

- Apportions funds to local governments
- Administers collection of the Estate, Inheritance and Gift Taxes, delinquent gasoline tax, and insurance tax
- Administers Local Mandated Costs and their reimbursement programs
- Administers a Property Tax Postponement Program
- Prescribes accounting, reporting and budget procedures and publishes annual financial transaction data for local government entities
- Refunds gas tax on motor fuel not used on highways to claimants, such as farmers and offhighway recreational vehicle users

Personnel/Payroll Services Division

- Administers the Uniform State Payroll System
- Audits and processes all personnel and payroll transactions for State civil service and exempt employees and the California State University and College System
- Properly accounts for salary and wage expenditures
- Provides data to the retirement systems necessary for calculation of employee retirement benefits
- Provides information required to manage the personnel resources of the State
- Planning for the implementation of a new California State Payroll System to replace the existing legacy Uniform State Payroll State system

State Accounting and Reporting Division

- Issues reports on the financial condition of government entities and the state on a monthly and annual basis
- Monitors the cash flow of the General Fund
- Maintains uniform and systematic control accounts of all receipts, payments, balances in state funds, and bonded indebtedness to assure compliance with all Constitutional and Statutory provisions
- Performs statewide accounting and reporting functions

Unclaimed Property Division

- Administers and enforces the California Unclaimed Property Law
- Reunites lost and abandoned property with its rightful owners and safeguards these properties from being used by private interests for personal gain

FI\$Cal Project

Is a key partner on the impementation of a statewide accounting, procurement, budget and cash management system for the State of California

ONGOING MONITORING

As the head of State Controller, Betty T. Yee, State Controller, 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 State Controller internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Tom Yowell, Chief Administrative Officer, and George Lolas, Chief Operating Officer.

MONITORING ACTIVITIES

Internal auditors used the following methods to review the effectiveness of internal control systems for divisions:

- Requested divisions to self-assess their operational risks
- Distributed internal control questionnaires to capture staff input
- Completed walk-throughs of operational processes with subject matter experts to discuss, identify and document internal controls, potential problems and/or operational process risks
- Documented the agreed requirements for internal controls, possible risks, and confirmed observations with divisions
- Closely worked with divisions to complete a corrective action plan, if needed
- Monitor and evaluate the risk management system

Specific management SLAA monitoring activities are occurring on a regular basis as follows:

- Conduct regular meetings with all Divisions to discuss current and potential internal risk and control issues requiring resolution for SLAA requirements
- Work with Divisions to create and implement realistic and measurable corrective action plans to address potential risks, if any
- Meet routinely with all Divisions to discuss the status of their corrective action plans
- Provide quarterly report to the Executive Management on the status of all Division's potential risks, controls and best practices, and corrective action plans.

ADDRESSING VULNERABILITIES

The SCO uses the following process to respond to an operational vulnerability: · Vulnerability Discovered: Staff reviews, analyzes and identifies potential risks · Notify Management: Results of vulnerability review and analysis are communicated to management · Management Investigates Vulnerability and Develops Corrective Action Plan: Management reviews reported vulnerability, confirms existence, and closely works with responsible staff to develop a corrective action plan. · Implement Corrective Action Plan and Monitor Progress: Management implements corrective action plan and monitors resolution progress.

COMMUNICATION

The SCO defines operational roles in duty statements, organization charts, policies and procedures. The SCO primarily uses the following specific methods to communicate its business requirements and SLAA monitoring roles, activities and results: · Continuous Email Updates · Focus Groups · Intranet Website Dedicated to Change Management · Panel Discussions (across organizational lines) · Questions and Answers Sessions · Team Meetings (up, down and between staff to management)

- Provides quarterly reports to the Executive Monitoring Sponsors

ONGOING MONITORING COMPLIANCE

The State Controller has implemented and documented 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 State Controller systems of controls and monitoring.

RISK ASSESSMENT PROCESS

The following personnel were involved in the State Controller risk assessment process: Executive Management, Middle Management, Front Line Management, and Staff.

RISK IDENTIFICATION

SCO Divisions use individual operational reviews to identify the risks affecting their goals and objectives, which are communicated to managers. Meetings between staff and managers consider prior and emerging risks, findings from previous audits, and changing environmental factors.

RISK RANKING

To determine its risk rankings, SCO management estimated the probability and severity of loss from each known or potential vulnerability and assigned individual scores to each risk.

During the risk ranking process, SCO considers the following probability categories for each risk ("likelihood"):

- Frequent
- Likely
- Occasional
- Seldom
- Unlikely

In addition, SCO considers the following severity categories for each risk ("operational process impact"):

- Catastrophic
- Critical
- Moderate
- Negligible

Using the subjective final risk scores, SCO Divisions then rank its risks from highest to lowest priority.

RISKS AND CONTROLS

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

Key person dependency and staff turnover can impact SCO's ability to complete its responsibilities.

A significant section of the workforce is aging and nearing retirement. Replacement staff often require multiple years of training to become proficient in their responsibilities. Pay disparity between other state agencies, external entities, and SCO attracts employees away from SCO.

Loss of critical knowledge and shortage of experienced staff can impact SCO's ability to complete its responsibilities.

CONTROL A

Backfill vacant positions quickly, increase training and cross-training opportunities, utilize shadow positions, and use retired annuitants, where appropriate.

CONTROL B

Consult with CalHR to ensure current classifications and pay are appropriate for jobs.

CONTROL C

Ensure policies and procedures are updated for all operational processes.

CONTROL D

Review and update succession plans

RISK: OPERATIONS -EXTERNAL-FISCAL IMPLEMENTATION, MAINTENANCE, FUNCTIONALITY, OR SUPPORT

FISCAL deliverables may not adequately satisfy SCO business needs. Lack of appropriate security controls could enable unauthorized payments.

Limited SME staff to complete end-to-end system design and testing as well as unexpected and/or unresolvable FISCAL system deployment errors and security issues.

SCO may not be able to provide necessary fiscal control and reporting using the FISCAL system. Lack of appropriate security controls could enable unauthorized payments to be made.

CONTROL A

SCO will work with partners and the vendor to review designs, participate in FISCAL testing and implementation of the system to ensure SCO's business needs are met.

CONTROL B

SCO will identify staff availability based on operational workloads and work with the project to coordinate testing dates.

CONTROL C

SCO to work with partners to identify and remediate possible system and security issues.

CONTROL D

SCO will coordinate with partner agencies to develop a proactive deployment strategy that includes comprehensive contingency plans in the event of FISCAL outages.

CONTROL E

Get appropriate funding approved by DOF and the Legislatures.

RISK: OPERATIONS -INTERNAL-TECHNOLOGY—COMP TIBILITY

The existing Personnel and Payroll Processing System is outdated and unable to perform all current requirements. System failure and/or lack of current functionality could prevent SCO from timely distributing accurate payroll to state employees.

SCO's 40+ year old legacy system was built using COBOL language, and prior to the establishment of bargaining units, which adds significant complexity to processing payroll. The legacy system does not have the functionality and flexibility expected in a modern payroll system.

SCO has begun the California State Payroll System project to replace the legacy systems. SCO is documenting current processes. Upon completion, SCO will enter a phase of business process engineering, then alternative analysis, before suggesting a replacement system.

CONTROL A

N/A. The process is under planning phase.

RISK: OPERATIONS -INTERNAL-TECHNOLOGY—COMP TIBILITY

SCO is working with current stakeholders using CalATERS to procure and implement a new travel claim reimbursement system solution for participating State departments that includes SCO control functionality, and is compatible with FI\$Cal.

Without a travel claim reimbursement system, state employees would revert back to a slower, less accurate paper process.

The vendor responsible for maintaining its proprietary system is discontinuing its service. SCO is unable to operate the system without the service.

SCO is engaged in the Project Approval Lifecycle (PAL) process to replace the system.

CONTROL A

N/A. The process is under planning phase.

CONCLUSION

The State Controller 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.

Betty T. Yee, State Controller

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
