December 23, 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 State Controller 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 David O'Toole, Chief Operating Officer, at (916) 552-8080, DOToole@sco.ca.gov.

GOVERNANCE

Mission and Strategic Plan

Our mission is to strengthen California's fiscal and economic standing by protecting taxpayer dollars, providing sound financial management services, promoting transparency in government, and pioneering policies to further economic development.

To achieve our mission, SCO's strategic plan guides our agency's operational processes. We have a straightforward value-based commitment for improvement within our organization and to our public clients. It is also a living document, which is adaptable to align with our changing environment. Achieving SCO's goals will not happen overnight, but our division chiefs are continuously incorporating the strategic objectives into their operational plans so that SCO can work toward accomplishing its goals.

SCO's strategic plan begins with a vision that SCO strives to be California's trusted source for independent and reliable financial information, and related financial services to both state and local government.

The following five core values are essential to the SCO strategic plan:

- Integrity
- Respect
- Commitment to Excellence
- Innovation
- Teamwork

There are six goals in the SCO's strategic plan as follows:

Goal 1: Promote integrity and accountability by

- Providing sound fiscal control over the state's annual receipts and disbursements of public

funds by determining the legality and accuracy of every claim against the state of California.

- Conducting audits to ensure appropriate receipt and disbursement of public funds.
- Providing timely information to the public regarding the state's financial condition, and the financial transactions of cities, counties, and other local agencies.
- Educating state and local governments about accounting, claiming, and reporting responsibilities.

Goal 2: Provide excellent customer service by

- Promoting a culture that is responsive and accountable and leads our customers to success.
- Listening to input from our customers to improve customer services and satisfaction.
- Continuously improving our business processes to provide better customer service.
- Continually evaluating options for making SCO's services accessible to everyone.

Goal 3: Deliver core services and products effectively by

- Fostering a culture of continuous process improvement.
- Adopting practices that reduce the use of consumable resources.
- Establishing measures to gauge business process improvements.
- Exploring cost-effective delivery methods.

Goal 4: Create a skilled, motivated, and diverse workforce by

- Providing new opportunities for SCO employees for growth and development through workforce and succession planning efforts.
- Honoring our employees' accomplishments, contributions, and innovative ideas.
- Fostering an environment of communication and information sharing to promote a cohesive and unified agency.
- Providing opportunities to broaden our employees' knowledge of SCO's programs and support functions and how they interface with state government.

Goal 5: Enhance communication, transparency and information by

- Improving communications by ensuring information is clear, concise, and understandable.
- Providing timely, accurate, and reliable information.
- Promoting cooperative working relationships with stakeholders.

Goal 6: Provide leadership by

- Designing and implementing a public policy agenda that supports the policies of the State Controller.
- Providing direction to the office on public policy issues pertaining to housing, workforce development, environmental protection, health care cost containment, retirement obligation funding, and related issues.
- Advancing a public policy agenda of fiscal prudence and financially responsible policies.

SCO Statutory Duties and Critical Business Functions:

The State Controller is the elected Chief Fiscal Officer of California, which is currently 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. State Controller also safeguards many types of unclaimed property until claimed by the rightful owners, independently audits government agencies that spend state funds, and administers the payroll system for state government employees and California State University employees.

The SCO is comprised of 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:

SCO's Divisions and Partnerships

Administration and Disbursements Division (ADD)

What does ADD do?

- Provides a broad range of staff support services including budgeting, accounting, personnel, equal opportunity, training, procurement, and space planning and development
- Prepares and issues warrants and/or electronic fund transfers to pay the state's bills and liabilities

Division of Audits (Audits)

What does Audits do?

- Determines the legality and accuracy of all claims against the state through the performance of prepayment audits
- Assures the accuracy of local government claims and financial statements submitted to the state and federal government
- Assists and advises local government officials to promote effective and uniform tax collecting procedures, preserving the local property tax base

State Accounting and Reporting Division (SARD)

What does SARD do?

- Performs statewide accounting and reporting functions
- Issues reports on the financial condition of the state and its entities on a monthly and annual basis
- 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

Local Government Programs and Services Division (LGPSD)

What does LGPSD do?

- Administers Local Mandated Costs and their reimbursement programs and monitors the cash flow of the General Fund
- Administers collection of the Estate, Inheritance and Gift Taxes, delinquent gasoline tax, truck

tax, and insurance tax
- Refunds gas tax on motor fuel, which was not used on highways
- Prescribes accounting, reporting and budget procedures as well as publishes annual financial transaction data for local government entities

Information Systems Division (ISD)

What does ISD do?

- Serves as an information technology (IT) business partner with the SCO's program divisions to solve business problems and provide opportunities through the use of IT
- Offers a full range of IT services to SCO divisions, including application development, desktop support, project management oversight, and technical network support

Personnel/Payroll Services Division (PPSD)

What does PPSD do?

- Administers the Uniform State Payroll System
- Processes payroll and leave accounting for all state civil service and exempt employees, state court, and California State University employees
- Provides information required to manage the personnel resources of the state and to properly account for salary and wage expenditures
- Provides data to the retirement systems necessary for calculation of employee retirement benefits and manages the state's automated travel expense claim system

Unclaimed Property Division (UPD)

What does UPD do?

- Administers the Unclaimed Property Law
- Safeguards unclaimed property turned over to the state
- Ensures unclaimed property is returned to its rightful owner
- Operates an online search tool and toll-free telephone service, processes claims, and provides written notices to property owners and property holders

FI$Cal Project (FI$Cal)

- SCO is a partner agency on the implementation of a statewide accounting, procurement, budget, and cash management system for the State of California.

Control Environment

SCO management is responsible for designing, establishing, and maintaining the internal control environment setting the tone for the organization and demonstrating commitments to integrity and ethical values.

To accomplish the above strategic goals, SCO management continually promotes a positive and supportive attitude toward internal control, ethical conduct and diligent management.

SCO has a clearly defined organizational structure that is easy for SCO employees to understand. The

Controller is responsible for accountability and disbursement of the state's financial resources. SCO functions are coordinated by the Chief of Staff with support from the Chief Operating Officer and the Chief Administrative Officer. Further leadership and policy advice is provided by the Chief Legal Counsel and deputy controllers.

All SCO staff are expected to understand the big picture of the organization, specifically its mission and strategic goals. Additionally, all SCO staff have access to their detailed job descriptions, so that they understand their roles and responsibilites they have within the agency.

Each SCO division is responsibile to maintain and update their written operational policies and procedures. Management is also expected to lead by example, by conducting day-to-day operations with the highest degrees of integrity and professionalism. Staff roles and responsibilities should also be well defined. Strong lines of authority, control, collaboration, and communication are fostered and expected throughout SCO.

Lastly, SCO has formal written policies that explain appropriate workplace expectations for SCO employees, including policies that cover: Conflict of Interest, Sexual Harassment, Drug-Free Workplace, Workplace Violence, and Equal Employment Opportunity. It is also a mandatory requirement that SCO employees attend training courses related to the ethical behavior standards and regulations that govern the official conduct of SCO employees.

Information and Communication

The communication of information is necessary to carry out the internal control responsibilities promoting the achievement of SCO's goals.

SCO utilizes duty statements, expectations memorandum for every SCO position along with organizational charts for the entire organization, divisions, bureaus, and programs. Management uses these tools to communicate and reinforce SCO staff roles and responsibilities.

Duty statements include description of the areas that managers are responsible to manage and review, including monitoring internal controls, and the essential roles of responsibility to implement and monitor those controls. Management also uses relevant and quality information from both internal and external sources to support the functioning of internal control systems.

SCO management is responsible for developing and maintaining an effective information and communication process to ensure SCO staff clearly understand their internal control roles and responsibilities. SCO additionally has a robust mandatory training program for new supervisors and managers on risk management, monitoring internal control systems, process improvement, and the policies and internal controls for which all supervisors share responsibility. There are also training programs available to all staff and supervisors that standardize the communication of proper internal controls, facilitate and encourage compliance with them, as well as to promote an ethical culture that is aware of operational risks.

SCO employees also have resources to communicate vulnerabilities and control inefficiencies through the internal units, such as Management Audit & Review Services (MARS),

Lastly for employees, the Equal Employment Opportunity (EEO) manages the complaint process and conduct investigations.

SCO also strives to keep its various stakeholders external to the agency well informed. Because the SCO represents an elected official of state government, we attempt to do our best and promote accurate, complete and timely information to all and any customers in both private and public sectors.

SCO is responsible for many roles, most importantly involving diverse programs such as the Unclaimed Property Law and the Property Tax Postponement Program. The SCO is also responsible to compile and publish the Comprehensive Annual Financial Report (CAFR) for the state of California. Lastly, the SCO is also responsible to pay claims against the state, and legislatively mandated payments such as reimbursements of costs and apportionments.

SCO utilizes various communication tools to engage its external customers, such as annual meetings, monthly reports, emails, memos, phone calls, press releases and use of its public Web sites to convey messages and discuss issues with the citizens of California.

Lastly, SCO develops and publishes training manuals and provides on-going training to stakeholders in an effort to promote an openness to assist customers (including local and state government entities) in any way possible.

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 State Controller monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to:
David O'Toole, Chief Operating Officer.

The head of the State Controller's Office, the State Controller, is responsible for the overall establishment, maintenance, and oversight of the agency's risk management and internal control systems.

Through ongoing monitoring processes as mandated by the SLAA, the SCO regularly reviews, evaluates, and improves its systems of internal controls and governance, risk and compliance (GRC) monitoring processes. The SCO is also currently in the process of formalizing and documenting our ongoing monitoring and as such, we believe our agency partially complies with the California Government Code sections 13400-13407.

Executive Monitoring Sponsor(s): The executive monitoring sponsor's roles and responsibilities include facilitating and verifying that the State Controller office control monitoring practices are implemented and functioning as intended. The executive monitoring sponsor's roles and responsibilities have been given to Jan Ross, Chief Administrative Officer.

Monitoring Activities: The SCO holds regular executive staff management meetings and bi-monthly senior management meetings. Topics at such meetings includes discussion of current and potential internal control issues that may need to be addressed, specifically what steps are needed to mitigate the issues. These executive management meetings occur while staff continuously monitors SCO programs for issues and corrective actions, and take necessary corrective actions if issues are observed.

Reporting and Documenting Monitoring Activities: The Chief of MARS works with each SCO

division to obtain SCO's prioritized operational processes risks for each new SLAA bienial reporting cycle. This process ensures that the SCO's SLAA monitoring activities address the most current issues facing the SCO, and new bienial reports accurately reflect SCO's efforts to mitigate new emerging operational risks.

SCO publishes SLAA quarterly updates for SCO Division Chiefs, SLAA division contacts, and SCO executive management. Such full disclosure increases transparency and promotes teamwork between SCO divisions to mitigate risks.

Procedures for Addressing Identified Internal Control Deficiencies: The SLAA monitoring process at each division is the dual responsibility of division chiefs and their designated contacts. SLAA monitoring processes utilize input received from divisions, such as policies, procedures, and work flows. Evaluation is on-going and any preliminary inefficiencies are brought to the attention of division chiefs and SLAA division contacts for response and corrective action. Corrective action plans are monitored on an on-going basis.

MARS ensures that all SCO programs are performing in accordance with State, Federal rules, regulations and in accordance with the requirements of the State Controller.

Through MARS' ongoing monitoring efforts, internal control deficiencies and opportunities for improvement are presented to the attention of division program management and SLAA division contacts for their responses and required corrective action plans (CAP). MARS monitors the status of CAPs and formally reports the status of corrective actions to SCO division chiefs, SLAA division contacts, and SCO executive management.

RISK ASSESSMENT PROCESS

The following personnel were involved in the State Controller 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, questionnaires, consideration of potential fraud, performance metrics, 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, tolerance level for the type of risk, and other.

RISKS AND CONTROLS

Risk: Key Person Dependence (KPD) and Staff Turnover

KPD and staff turnover threaten SCO's ability to complete its roles and responsibilities. SCO's workforce is aging and nearing retirement. SCO replacement staff often require years of training to become proficient in their roles and responsibilities. Pay disparity between SCO and other state agencies (or private entities) often attract staff away from SCO for better salaries.

The loss of critical institutional knowledge and/or shortage of competent/experienced staff can adversely impact SCO's ability to complete its roles and responsibilities.

Control: A. Backfill Vacant Positions

SCO attempts to backfill vacant positions quickly, increase training and cross-training opportunities, utilize shadow positions, and use retired annuitians, when appropriate.

Control: B. Consultation with CalHR

SCO continually consults with CalHR to ensure that current classifications and pay are appropriate for SCO job roles and responsibilities.

Control: C. Ensure Policies and Procedures are Current

SCO management continually reviews and revises policies and procedures to ensure that roles and responsibilities are thoroughly documented in concise, clear, and understandable terms.

Control: D. Ensure Succession Plans are Current

SCO management continually reviews and revises succession plans to ensure that current staff can transition successfully, in the event of staff separating from SCO for another opportunity or retirement.

Risk: Inadequate FI$Cal Deliverables

There is a significant risk that FI$Cal deliverables may not satisfy SCO business requirements. Specifically, a lack of appropriate FI$Cal security controls could result in erroneous payments. The SCO also has limited SME staff to complete end-to-end FI$Cal design and testing, not to mention deployment issues now being experienced.

SCO may not be able to provide the necessary fiscal control and reporting with the FI$Cal system.

Control: A. Increased Participation with the FI$Cal Project

SCO pledges its best efforts to work with FI$Cal partners and the vendor to review system designs, participate in FI$Cal testing and offer input to improve the system to ensure SCO's business needs are met by FI$Cal.

Control: B. Increased Staff Availability

SCO pledges its best efforts to make SMEs available to assist with the FI$Cal project, dependent on normal operational workloads.

Control: C. Continue Partnership on FI$Cal Project

As a project partner, SCO pledges its best efforts to work with the project partners to identify and mitigate possible FI$Cal system and security issues.

Control: D. Proactive FI$Cal Deployment Strategy

As a project partner, SCO pledges to coordinate with the project partners to develop a proactive deployment strategy with comprehensive contingency plans in the event of FI$Cal outages.

Control: E. Additional Funding

SCO will continue to obtain additional FI$Cal related funding for approval by DOF and the legislature.

Risk: A. Outdated Payroll Processing System

SCO's Personnel and Payroll Processing System is outdated. System failure and/or lack of current functionality could prevent SCO from timely distribution of an accurate and complete payroll to state employees. This 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. Replacement System

SCO is currently in the preliminary planning stages for a replacement system.

Risk: Replacement of CalATERS

SCO continues to work 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 compatibilty with FI$Cal. Without a travel claim reimbursement system, state employees would be required to revert back to a less accurate manual paper process. The vendor responsible for maintaining its proprietary system is discontinuing its support 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. Replacement System

SCO is currently in process of developing or procuring a replacement system.

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 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.

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