



December 31, 2011

**DEPARTMENT NAME:** Department of Finance  
**ORGANIZATION CODE:** 8860

## **INTRODUCTION:**

In accordance with the Financial Integrity and State Manager's Accountability (FISMA) Act of 1983, the Department of Finance (Finance) submits this report on the review of our systems of internal control for the biennial period ended December 31, 2011.

Should you have any questions please contact Todd Jerue, Chief Operating Officer, at (916) 445-4923, [Todd.Jerue@dof.ca.gov](mailto:Todd.Jerue@dof.ca.gov).

## **BACKGROUND:**

Finance's mission is to serve as the Governor's chief fiscal policy advisor, promote responsible resource allocation through the state's annual financial plan, and ensure the financial integrity of the state. The Director of Finance is responsible for carrying out the Department's mission with emphasis on maintaining a fiscally sound and responsible Administration. The Director is appointed by the Governor and sits as a member of the Governor's cabinet and senior staff. In addition, the Director sits on numerous boards and commissions which directly impact a broad array of state activities.

Finance's principal functions are to:

- Establish appropriate fiscal policies to carry out the state's programs.
- Prepare, enact, and administer the state's annual financial plan, which the Governor is required to present by January 10 of each year in accordance with the State Constitution.
- Analyze legislation which has a fiscal impact.
- Develop and maintain the California State Accounting and Reporting System.
- Participate, as one of four partner agencies, in the design, development, implementation, utilization, and maintenance of the integrated Financial Information System for California (FI\$Cal) project.
- Monitor/audit expenditures by state departments to ensure compliance with law, approved standards, and polices.
- Develop economic forecasts and revenue estimates.
- Develop population and enrollment estimates and projections.

Finance has a strong history of laudably fulfilling its responsibilities. That history of performance has garnered respect from successive administrations and legislatures and earned it a reputation as a venerable institution. The foundation of this reputation is a set of core values that guide the actions of the employees who collectively are the Department of Finance.

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 seven major units and numerous sub-units within Finance.

## **VACANT POSITIONS:**

We have reviewed our records for fiscal years 2009-10 and 2010-11 and determined Finance is in compliance with California Government Code section 12439.

## **RISK ASSESSMENT:**

Finance executive management identified and reported its significant department-wide risks in the 2009 FISMA report. For the 2009-2011 FISMA reporting period, executive management decided to perform risk assessments at the unit level to determine whether the department-wide risks documented in the 2009 report were consistent with the unit level risks. Risk assessments were performed at each of five budget units that are significant to Finance's mission.

The Office of State Audits and Evaluations (OSAE) assisted the budget units with their risk assessment using a control self-assessment process. Through a series of meetings, management for each unit identified risks that could adversely impact achievement of the unit's objectives and Finance's mission. In performing the risk assessment, OSAE staff used a combination of surveys, interviews, facilitation techniques, and Option Finder voting technology to assist management.

Risk statements were prepared, revised, and then ranked, based on both the severity and possibility of occurrence. Mitigating controls were identified for all risks, regardless of ranking. Unit management met to review and discuss the identified risks and controls. Further, management reviewed the results of the unit level risk assessments to determine whether the risks identified were unique to the unit or in line with the department-wide risk assessment.

For most of the risks identified, corresponding existing controls were identified that, if working as intended, would provide reasonable assurance that risks would be mitigated. In addition, management identified controls that, once established, would help mitigate the risks. In some instances, the risks facing Finance are outside its control, and therefore, management has made an informed decision to accept the consequences and likelihood of those risks.

Finance management is implementing a system of continuous assessment and evaluation of its control structure. Throughout each subsequent reporting cycle, management will reassess the risks it faces and evaluate the controls identified to mitigate those risks. While a number of risks were identified, this review focuses on the highest ranked risks and a sample of mitigating controls.

## **EVALUATION OF RISKS AND CONTROLS:**

As part of the Governor's Administration, Finance prepares, explains, and administers the state's annual financial plan, the California Budget. Many of the risks identified focus on these objectives and are further heightened by California's current economic and budgetary challenges.

The following risks were found to be common throughout the Department:

- Increased workloads and short turnaround times combined with efforts to reduce overtime among staff analysts has shifted work to more experienced staff, to help mitigate inaccurate budget projections or recommendations. This can result in less experienced staff not being afforded the opportunity to become engaged in or gain experience from important and challenging work and policy development.

- Finance relies on specific individuals with significant knowledge and expertise in key areas making the Department vulnerable if they leave, retire, or are temporarily absent for an extended period. Institutional knowledge can be lost and achievement of Department objectives could be delayed or not accurately completed. This could impact the quality of results and policy decisions made.
- In order to complete the budget process, Finance depends on budget information provided by outside departments. The information received can, at times, be inaccurate, incomplete, or untimely which could lead to inaccurate and untimely budget conclusions or projections, hindering Finance from fulfilling its objectives.

The following are significant risks unique to specific budget units:

*Natural Resources, Energy, Environment, and Capital Outlay Unit (RECO)*

The Capital Outlay sub-unit within RECO manages the state's capital outlay and infrastructure plans, including the funding of those plans. The following significant risks identified are unique to Capital Outlay:

- Finance relies on other state agencies for project management, construction oversight, and compliance with budget requirements. Reliance on these agencies runs the risk that the project scope, cost, and schedule may not be adequately monitored.
- Due to limited interim financing options, Finance needs to “pre-sell” bonds for projects before knowing the exact project cost, with the resulting risk of underselling and not having sufficient cash to cover actual project cost, or overselling and incurring debt financing costs. Both options result in additional cash management and oversight.

*Education Services Unit (ESU)*

ESU works with education departments (University of California, California State University, and the Department of Education) that are either independent or quasi-independent of the Governor's control. Although the unit's objectives may be the same as other budget units, they identified the following unique risk due to this relationship:

- Quasi-independent education departments sometimes bypass ESU and go directly to the Legislature with BCPs or similar budget issues, allowing only a short, limited review by ESU. This diminishes the Administration's oversight and policy compliance, which could lead to a veto by the Governor.

*Business, Transportation, and Housing/Forecasting (BTH/Forecasting)*

Demographic Research and Financial Research, two sub-units within BTH/Forecasting, perform research functions for Finance that require unique skills. The risk noted below relates to those specialized skills:

- The specialized education, knowledge, and skills needed to perform the unit's functions and complete its objectives make it difficult to recruit qualified candidates, especially in a competitive field.

Finance management identified mitigating controls addressing the above risks. OSAE plans to test significant controls listed below during the next reporting cycle. Following are some of the significant controls identified:

*Extensive training curriculum*—Finance administers an extensive training program to develop employees' knowledge and skills for promotional readiness. In addition to training, management ensures staff development by delegating a significant portion of the workload to analysts while managing overtime. Further, staff are required to attend Capital Office meetings during drills and are provided with management feedback on the entire process as a training exercise.

*Cross training*—To protect against the possible inability to carry out critical activities should key individuals leave or retire, Finance cross trains employees, maintains stringent hiring practices to increase the likelihood that only the most qualified candidates are hired, maintains historical material in a central location for easy and quick access, rotates assignments when opportunities arise, and uses on the job mentoring.

*Data verification process*—In an effort to obtain accurate and timely information from outside departments, Finance promotes continuous and constructive communication with departments. Communication takes the form of timely feedback, informal training sessions, assistance on the forms to be filled out, and clearly communicating all expectations. To verify information received, budget data goes through an extensive review process. Staff are informed of the multiple sources of data available to help verify information, including documented historical data.

*Monitoring of departments' project management*—To help ensure capital projects are being managed properly by outside agencies, Finance provides clear expectations to the outside oversight agency before a project starts. Finance also requires quarterly reports which are discussed with the oversight agency in regularly scheduled monthly meetings. In addition, Finance also trains agency project staff when deemed necessary.

*Strong working relationships with quasi-independent departments*—Finance maintains constant communication with outside departments, developing key relationships. All expectations and consequences of inactions are clearly communicated to the departments.

*Stringent hiring practices*—Finance's stringent hiring practices increase the likelihood that only the most qualified employees are hired. For positions requiring specialized skills, management is involved in the recruitment process to assist with selection of qualified candidates. To attract qualified applicants, Finance attends recruiting fairs at colleges offering studies in specialized skills.

A majority of the controls identified are effective measures in mitigating the risks when working as intended.

**CONCLUSION:**

I certify that our systems of internal controls are adequate to mitigate potential threats identified in the Evaluation of Risks and Controls section above.

Original signed by:

Ana J. Matosantos, Director

cc: Governor  
Legislature  
State Auditor  
State Library  
State Controller  
State Treasurer  
Attorney General