State Board of Equalization
2015 **SLAA REPORT**

December 28, 2015

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

Dear Mr. Cohen,

In accordance with the State Leadership Accountability Act (SLAA), the State Board of Equalization submits this report on the review of our systems of internal control and monitoring processes for the biennial period ended December 31, 2015.

Should you have any questions please contact David Gau, Executive Director, at (916) 327-4975, David.Gau@boe.ca.gov.

BACKGROUND

The Board of Equalization (BOE) is the nation's only elected tax board, composed of five Board Members who serve concurrent four-year terms. Four of the members are elected from districts, each representing approximately one fourth of the State's population (each with approximately 9.5 million people in 2015). The fifth member is the State Controller, an ex-officio member representing the State at large.

The BOE is charged by the State Constitution and the State Legislature with administering the state's sales and use tax, fuel, alcohol, tobacco, and other taxes, and collecting fees to fund specific state programs in addition to property taxes and fees. More than one million California businesses are registered with the agency to engage in retail sales in the state.

In addition to administering more than 36 state tax and fee programs, the BOE hears appeals from various business tax assessments, Franchise Tax Board actions, and public utility assessments, and plays a significant role in the assessment and administration of property taxes.

In fiscal year 2013-14, the BOE administered programs that generated more than 60 billion in tax revenue to support state and local government.

The mission of the BOE is to serve the public through fair, effective, and efficient tax administration.

BOE's three primary goals include:

· Maximize Voluntary Compliance
· Enhance Operational Effectiveness
· Invest in the Organization

Our vision is "A BOE where people and technology achieve the mission of the agency and deliver superior customer service through transformed business processes and organization structure."

RISK ASSESSMENT PROCESS

In 2013, a Board-wide risk assessment was initially performed. BOE management from each business area was asked to complete a risk assessment for their respective areas of responsibility. Key processes, objectives, risks, controls and related information were captured in the BOE's Risk Assessment SharePoint site. However, monitoring and updating of these risks to ensure a comprehensive assessment has not been regularly performed. In 2015, the BOE's Executive Team

(Executive Director, Chief Deputy Director, Deputy Directors, various Division Chiefs) participated in meetings to identify risk factors using the SLAA guidelines provided by Dept. of Finance. Impact and likelihood were key factors in identifying risks to BOE operations. The BOE is currently in the process of implementing ongoing monitoring procedures to manage, update, and track risks to BOE operations. As part of the ongoing monitoring process, the BOE established a risk assessment workgroup (consisting of program level managers) that will regularly report to the Executive Team.

EVALUATION OF RISKS AND CONTROLS

Operations- Internal- Staff—Key Person Dependence, Succession Planning

The BOE is facing a substantial loss of experienced and knowledgeable staff currently performing key functions and managing essential operations, which will impact the agency's ability to sustain optimal performance while transitioning its future workforce into leadership roles. Approximately 35 percent of the BOE's current workforce is eligible to retire today. The five year forecast is even more devastating as 49 percent of the workforce will be eligible to retire. The loss of institutional knowledge resulting from the retirement of managers and key personnel will be detrimental to BOE operations.

> BOE created a Workforce and Succession Plan that identifies critical positions and establishes knowledge transfer strategies within each department/division. BOE is in the midst of implementing many of the succession planning strategies to ensure documentation and communication of historical knowledge. For example, and just to name a few, the BOE has implemented a mentoring program, updated/created desk and procedure manuals, and utilized SharePoint sites to communicate information and document procedures. Further, the Workforce and Succession Plan will also ensure qualified candidates are identified, trained, and equipped with the knowledge, skills, and abilities necessary for success when tasked with assuming high-level leadership and/or mission critical positions. The next phase of the Workforce and Succession Plan includes conducting workforce analyses that will help project future workforce needs.

> BOE is also preparing to implement a new technology solution to replace its current legacy system. As BOE implements this new solution, critical institutional knowledge will be shared and documented. BOE has already documented thousands of business rules and processes. In addition, throughout the implementation, subject matter experts will be evaluating new workload processes and making recommendations for shifting staffing resources accordingly. These efforts are in line with the strategies outlined in BOE's Workforce and Succession Plan.

Operations- Internal- Oversight, Monitoring, Internal Control Systems

In 2013, BOE's Risk Assessment site in SharePoint was created to serve as the formal site for capturing, managing, and monitoring all risks to BOE's key processes. However, the site has not been used to its full potential and monitoring of these risks has not regularly been performed. The BOE is in the process of implementing ongoing monitoring procedures and updating the risk assessment site in SharePoint to include greater monitoring capabilities. Also, as additional unmitigated risks are identified by the BOE management, the Internal Audit Division, or external auditors such as the California State Controller's Office (SCO); they will be incorporated into the risk assessment site to ensure corrective action plans are developed to effectively address and monitor risk mitigation strategies.

> The BOE leadership will enhance and further develop the internal control framework and policies to formalize the risk assessment process across the entire agency. Moreover, the BOE has recently adopted the United States Government Accountability Office's Standards for Internal Control in Federal Government (also referred to as "Green Book") as its internal control framework and is in the process of establishing policies and procedures to implement, educate, communicate and monitor the BOE systems of internal control. Leadership plans to: create a

risk assessment workgroup; identify risks to BOE's mission and key processes; evaluate and rank risks according to likelihood and impact; identify key controls; assign responsibility; monitor controls; determine effectiveness and status of controls; and ensure the ongoing monitoring of risks. When additional areas of weakness are identified, as in the SCO audit, a corrective action plan will be prepared to address the specific issues noted in the findings.

Operations- Internal- New System Implementation (Other Than FI$Cal)

The BOE is preparing to replace two outdated computer systems (Integrated Revenue Information System (IRIS) and Automated Compliance Management System (ACMS)) that have been relied upon for over 15 years to administer more than 36 tax and fee programs. The diversity of the BOE's tax and fee programs quickly outpaced the technological features of the current system. This has rendered it obsolete prompting a renewed urgency for replacement as advances in technology continue.

With the current legacy IT system, BOE must devote significant program and information technology staffing resources to implement statutory changes that involve modifying and/or creating tax forms; develop new program policies and procedures; notify impacted customers; reprogram existing sub-systems; and add system applications and reports for new tax and fee programs. Additionally, there are numerous minor modifications and the ongoing routine maintenance work that takes place each year. These technology limitations make it difficult to recruit and retain qualified IT staff with specific knowledge, skills and desire to support such an aged/aging system.

BOE's IT staff currently maintains and continues to develop ancillary systems to address the technology needs in implementing new programs. Utilizing ancillary systems to conduct business activities that cannot be accommodated within the aging legacy system creates extra workload, produces inconsistent or duplicate processes and makes it more difficult to gather program data.

CROS will replace the BOE's legacy computer systems (IRIS and ACMS) with an innovative and intuitive customer-centered solution. This new solution will maximize operational effectiveness, generate an estimated annual net revenue increase of $40 million to $190 million, and provide efficiencies that will benefit our program registrants and all BOE staff. In addition to efficiencies, the BOE expects the new system to increase the speed and reduce the effort to implement new tax programs or changes.

BOE is currently in the procurement process for CROS. Final Proposals were received October 19, 2015 and the Notice of Intent to Award will be issued March 2016. The Implementation Phase begins in June 2016.

Several initiatives are currently underway in preparation for implementation including: Program Area Readiness, Data Readiness and Technology Readiness.

Operations- Internal- Organizational Structure

BOE's current organizational structure has created silos that hinder communication, limited the ability to attain operational efficiencies, and contributed to a territorial perspective rather than an agency perspective. Currently, the program areas are comprised of four departments: Sales and Use Tax Department (Sales tax, use tax, lumber fee, mobile telephony surcharge); Field Operations Department, Property Tax Department, and Special Taxes and Fees Department. Issues are often viewed as audit vs. compliance, headquarters vs. field, and special taxes vs sales and use tax. Often times, staff does not understand the purpose or benefits of BOE's initiatives which results in confusion, disengagement and low employee morale.

These silos have established a territorial viewpoint versus an organizational viewpoint among staff. This territorial viewpoint contributes to inconsistencies in policies, practices and often extends to HR related

issues. In addition, the lack of shared information creates an environment and potential for duplicate work efforts in multiple silos, which increases the workload for BOE staff.

The BOE will prepare and implement an Organizational Change Management (OCM) Plan which will assist BOE staff in preparing and implementing CROS, assist with implementing the new Strategic Management Plan, and functionally aligning a number of business processes. Communication and stakeholder analysis are all key aspects of OCM. By establishing an OCM team, internal communications can be continual and consistent. The OCM team will also develop and manage critical feedback loops to keep BOE Executives and Managers connected with frontline staff.

Implementing CROS will require departments to work as a team and consider solutions from an organizational perspective. Program area staff will participate in all aspects of CROS that will define our current "as-is" state and create our future state.

Implementing the new Strategic Management Plan will drive BOE to think and act more organizationally. Functionally aligning our organizational structure to more effectively manage our business processes is one of the strategies.

The OCM efforts will ensure that BOE effectively engages the entire organization in a process that will improve employee morale and personally connect them to BOE's initiatives

Operations- Internal- Workplace Environment

BOE's Headquarters building issues (i.e., glass panels falling out; water leaks; elevators stopping between floors, potentially dangerous contaminants, etc.) have been well-documented in a series of reports, memos, and through use of the occupant survey. These issues have resulted in some staff not being comfortable with the current working environment which can lead to decreased productivity.

BOE continues to develop a holistic, comprehensive, and cohesive analysis of its headquarters relocation costs and benefits of operating in a campus setting versus the current high-rise plans. Until the HQ Renovation Project begins in 2017, the BOE and the Department of General Services (DGS) continue to coordinate and address immediate repair needs in the 450 N Street building. The basis of the scope of work for this project began in June 2015, and it includes repair, replacement, and upgrades of building systems, such as the HVAC, primary electrical systems, fire life safety systems, and replacement of the exterior glass panels. BOE consultant, Hygiene Technologies Inc. (HTI) continues to monitor the building indoor air quality to assure that health and safety requirements are met for all staff.

Operations- External- Technology—Data Security

The security of confidential taxpayer data is critical to the ongoing mission of the BOE. A breach of confidential taxpayer data would hurt the reputation of the BOE and decrease taxpayer's confidence in the services that BOE provides.

An intrusion prevention/detection system was added to the BOE's information security controls. These devices and software constantly provide information to the Board's security incident and event management system (SIEMS). The BOE has hired one-full time security analyst at the System Software Specialist II level to monitor these systems to ensure threats and vulnerabilities to BOE's valuable data resources are identified, mitigated or eliminated. This system, along with regular active vulnerability scanning, help ensure a much lower surface of vulnerability to the BOE's valuable information assets.

ONGOING MONITORING

Through our ongoing monitoring processes, the State Board of Equalization reviews, evaluates, and improves our systems of internal controls and monitoring processes. The State Board of Equalization is in the process of formalizing and documenting our ongoing monitoring and as such, we have determined we partially comply with California Government Code sections 13400-13407.

Roles and Responsibilities

As the head of State Board of Equalization, Cynthia Bridges, Executive Director, is responsible for the overall establishment and maintenance of the internal control system. We have identified Cynthia Bridges, Executive Director, David Gau, Executive Director, as our designated agency monitor(s).

Frequency of Monitoring Activities

Under the direction of the Chief Deputy Director, the Executive Team (ET) will be responsible for establishing the general framework and policies regarding internal controls and implementing procedures to continuously monitor and evaluate controls. Ongoing monitoring will ensure these internal controls remain aligned with changing objectives, environment, laws, resources, and risks. Each Deputy Director will designate a person responsible for identifying and monitoring risks in their program area. Among other things, designated staff will meet as a Risk Assessment (RA) workgroup.

The RA workgroup will meet with staff from their respective program areas on a monthly basis and will identify and monitor risks. The RA workgroup will meet regularly to share findings, prioritize risks, and prepare quarterly status reports for the ET. The RA workgroup will initially meet monthly, but at minimum every three months.

The ET will also meet on a regular basis to review quarterly reports or identified deficiencies. Initially, the ET will meet every month but as the process becomes more stable, the meetings can occur at minimum every six months (and more frequently if needed.)

Reporting and Documenting Monitoring Activities

The RA Workgroup will prepare and submit quarterly status reports to the ET. The reports will inform the ET of the monitoring practices being conducted, improvements needed, and the overall monitoring success or weakness within each program area.

The Internal Audit Division will provide training to the RA workgroup and, in conjunction with the Chief Information Security Officer, will provide independent assurance that the controls developed and implemented by leadership effectively mitigate risk and are operating as intended.

Procedure for Addressing Identified Internal Control Deficiencies

Corrective Action Plans will be submitted to the ET to address internal control deficiencies. The corrective action plans will be discussed at the ET meetings to evaluate whether the deficiency has been adequately resolved.

CONCLUSION

The State Board of Equalization strives to reduce the risks inherent in our work through ongoing monitoring. The State Board of Equalization accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies. I certify our systems of internal

control and monitoring processes are adequate to identify and address material inadequacies or material weaknesses facing the organization.

Cynthia Bridges, Executive Director

cc: Department of Finance
Legislature
State Auditor
State Library
State Controller
Secretary of Government Operations