

December 18, 2019

Julie Lee, Acting Secretary
California Government Operations Agency
915 Capitol Mall, Suite 200
Sacramento, CA 95814

Dear Ms. Julie Lee,

In accordance with the State Leadership Accountability Act (Leadership Accountability), the Franchise Tax Board 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 Jeanne Harriman, Chief Financial Officer, at (916) 845-6431, jeanne.harriman@ftb.ca.gov.

GOVERNANCE

Mission and Strategic Plan

The primary function of Franchise Tax Board (FTB) is to administer the California Revenue and Taxation Code. FTB administers two major tax programs, the Personal Income Tax and the Corporation Income Tax, as well as other non-tax programs such as Political Reform Act Audits, Delinquent Vehicle Registration, Court-Ordered Debt, and Labor Law Violations.

Mission Statement:

Our mission is to help taxpayers file timely and accurate tax returns, and pay the correct amount to fund services important to Californians.

To accomplish this mission, we develop knowledgeable and engaged employees, administer and enforce the law with fairness and integrity, and responsibly manage the resources allocated to us through a set of goals and objectives.

Strategic Goals and Objectives:

- **Taxpayer Centric Service:** Enhance our services to help taxpayers fulfill their tax obligations.
- **Effective Compliance:** Fairly administer the law to ensure taxpayers file and pay the correct amount.
- **Strong Organization:** Invest in our employees, challenge and empower them to be experts in their field, and help them achieve their full potential
- **Operational Excellence:** Optimize processes, products, services, and resources to better serve our customers.

FTB has no entities under its reporting responsibilities.

Control Environment

Executive Monitoring Sponsors

The executive monitoring sponsor responsibilities include facilitating and verifying that FTB internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Selvi Stanislaus, Executive Officer, Jeanne Harriman, Chief Financial Officer, Jozel Brunett, Chief Counsel, Chrissy Casale, Bureau Director, Mike Bastien, Section Manager, Christopher Johnson, Unit Supervisor, and Allan Loucks, SLAA Administrator.

The Governance Council

The mission of FTB's Governance Council (GC) is to provide vision, strategic leadership, planning, and enterprise-level decision making for the internal operations of the FTB, which ensures success of the department's programs and activities. The FTB leadership fosters an environment that encourages FTB employees at all levels to consider the effects on the enterprise when making decisions.

GC participates in weekly decision-making, which sets department direction and communicates goals, objectives, and robust performance metrics clearly across the enterprise. The GC provides clarity of their purpose to stakeholders. They work in close collaboration with the Action Committees (AC) and the Joint Action Committee (JAC) to encompass a broad set of management activities that drive effective decision-making. This helps to strengthen the Enterprise Governance Model to achieve balance between committee oversight and policy/process enforcement.

Decisions made by the GC reflect FTB values, as well as any other pertinent FTB directive or policy. Once the GC has reached a decision, the decision is documented and shared with impacted divisions and staff. GC determines a communication method, as appropriate.

FTB's governance structure and framework provides the following benefits:

- It guides how individuals and groups within the FTB collaborate to manage departmental operations.
- It helps define the basis for interaction between functions, roles, divisions, and people within the FTB.
- It helps ensure that resources are targeted to deliver maximum business value through communication and education regarding the use of resources.

Ethical Values

FTB's five organizational values are:

- **Lead with Integrity and Inspiration:** As inspirational leaders, we are committed to pursue the right path, ignite ideas and innovation, communicate clear expectations, and invite everyone to maximize their potential every day.
- **Bring Our Best:** By bringing out best we exemplify honesty, credibility and accountability. We value staff and encourage them to bring their best every day.
- **Deliver Excellent Products and Services:** Quality is best achieved through collaboration with our customers and each other. We deliver excellent products and services that meet the needs of our customers.
- **Contribute to a Caring Community:** We encourage mutual respect kindness, and teamwork.

This creates a supportive work environment that appreciates diversity and allows all of us to flourish in the community we work and live in.

- **Become Experts at What We Do:** We are motivated to continually improve and grow. We take advantage of tools and opportunities to develop in our chosen career path.

Because of the unique nature of the responsibilities of the Department, FTB employees adhere to specific rules of conduct. Every employee is required to comply with these rules.

FTB adheres to California ethics laws, and requires FTB employees to complete an ethics training course within six months of their hiring, and every two years thereafter. FTB also follows proper EEO practices, and assures that complaints of discrimination are brought to the proper authority and given fair and timely consideration.

Documentation and Control Systems

FTB 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 FTB's systems of controls and monitoring. FTB's Enterprise Risk Management (ERM) control process, as an iterative process, continually seeks to improve its internal control processes.

Addressing Vulnerabilities

Internal control deficiencies detected through monitoring activities are reported to executive management. Corrective actions are taken to ensure identified vulnerabilities are corrected, weaknesses identified, and proactive measures are taken. As such FTB has determined that it is in compliance with California Government Code 13401, Sections 13400-13407, the State Leadership Accountability Act.

Information and Communication

FTB leadership fosters an environment that encourages FTB employees at all levels and across organizational lines to consider the effects on the enterprise when making decisions. GC provides the vision, strategic leadership, planning, and enterprise-level decision making for the internal operations of the FTB, which ensures success of the department's activities and decision making.

Channels for Collecting and Communicating Information

The GC oversees seven ACs, which prioritize and support enterprise initiatives, make decisions, and determine when to escalate enterprise policy decisions and requests to the GC for review and approval. In addition, AC's support the initiatives within the department's Strategic Plan, and provides the focus for the enterprise discussions necessary to implement enterprise activities across the department. As part of the Enterprise Governance Model, the Action Committees serve both in an advisory capacity and as decision-making bodies that filter issues to GC and disseminate information across the enterprise.

The seven AC domains are as follows:

The **Joint Action Committee** serves as a forum for the AC's chairs, Enterprise Chief Architect, Communications Services Director, and Strategic Planner to discuss and make decisions and recommendations regarding enterprise strategies, policies and standards.

The **Organizational Development Action Committee** supports FTB's strategic goal of *Strong Organization* by looking for new ways to increase empowerment and engagement of staff, which includes exploring and implementing ways to increase job satisfaction and retain staff by helping them reach their full potential in a positive work environment.

The **Compliance Action Committee** supports the Strategic Goal of Effective Compliance. This team looks for new approaches to gain compliance to ensure all taxpayers pay the correct amount of tax. The scope of this team includes looking at new compliance strategies at the enterprise level, exploring different ways to leverage data, and implement ways to customize and speed up the timeliness of our actions whenever possible.

The **Privacy and Security Action Committee** addresses enterprise-wide policies, practices and issues specific to the security of FTB's information technology systems, the physical security of FTB's workplaces, and the privacy issues concerning the interests of those who provide information to FTB, both internal and external.

The **Customer Service Action Committee** addresses enterprise-wide policies and practices affecting how FTB interacts with our external customers. The Customer Service Action Committee, partnering with GC, other action committees, and various FTB program areas, is responsible for identifying and raising external customer service issues and opportunities.

The **Resource Allocation Action Committee** is responsible for conducting analyses regarding enterprise resource needs and making decisions and recommendations regarding resource priorities, allocations, and other items of critical impact.

The **Internal Business Action Committee** addresses enterprise-wide policies and practices affecting the internal business processes used by FTB's audit, collections, filing, technology, administration, and legal programs. The Internal Business Action Committee addresses operational policies and practices that can increase efficiencies, improve quality, or better leverage infrastructure at the enterprise level.

The **Technology Action Committee** addresses technology architecture, strategies, policies, practices and priorities. The Technology Action Committee also considers issues and proposals that involve technology changes, innovation and technology resource utilization.

Internal and External Communications

FTB's Communication Services Bureau provides direction, oversight, and support to department communications policies and activities, and builds quality communication products and services. They respond to all media contacts; promote departmental programs, products, and services; publish internal and external news articles; and provide up to the minute information to employees regarding emerging issues/projects.

Reporting

FTB's communications process is multi-faceted and inclusive of all FTB staff. All employees are

encouraged to identify areas of concern they may observe. FTB has developed a process for risk identification that will move a concern from identification, up to the enterprise level, should it be warranted.

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 Franchise Tax Board monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to:

Selvi Stanislaus, Executive Officer; Allan Loucks, SLAA Administrator;
Jeanne Harriman, Chief Financial Officer; Jozel Brunett, Chief Counsel; and
Chrissy Casale, Bureau Director.

As the Executive Officer of FTB, Selvi Stanislaus is responsible for the overall establishment and maintenance of the risk management and internal control systems.

Monitoring Activities

FTB practices routine monitoring of enterprise risks, responds to changing conditions as they occur, and performs ongoing risk monitoring in the normal course of its operations and program implementation. Monitoring and controlling risk includes reviewing each risk on a regular basis, no less than quarterly. It also includes assessing its current status, taking further action as necessary – which could include escalation – and reporting on the status of the risk and the status of risks in development. Risk monitoring and control is the responsibility of management, the risk owner, and the risk coordinator.

Through our continuous monitoring processes, FTB routinely reviews, evaluates, and where necessary, implements improvements to the effectiveness of internal controls and monitoring processes. ERM control process, as an iterative process, continually seeks to improve its internal control processes. Monitoring roles are communicated throughout the entity on an ongoing basis. Risk assessments are conducted by the risk owners to monitor and evaluate their controls. The team considers the ability to manage the risk, the risk exposure against the risk tolerance thresholds, and the risk exposure relative to other risks.

Continuous risk activity assessments provide an opportunity to review all open risks for continued vulnerability, and to close risks whose relevance has passed, or whose risk has been mitigated. The SLAA Administrator works with each internal risk owner to review new risks and existing risks for possible changes to status or controls on a regular basis, and no less than quarterly. ERM program activities are communicated by updates provided to the GC on a quarterly basis, or as required in the event of urgency.

Internal Audit

FTB's Internal Audit Section provides independent verification and validation of business functions to ensure: FTB complies with laws, regulations, and policies; accomplishes its goals; records accurate and reliable data; efficiently and effectively uses its resources, and; safeguards its assets. Internal controls are the organizational plans, methods, and procedures adopted by management to meet their goals. Furthermore, internal controls include processes for planning, organizing, directing, controlling,

and reporting on the department's operations.

RISK ASSESSMENT PROCESS

The following personnel were involved in the Franchise Tax Board risk assessment process: executive management, middle management, front line management, and staff.

The following methods were used to identify risks: brainstorming meetings, ongoing monitoring activities, audit/review results, other/prior risk assessments, consideration of potential fraud, and performance metrics.

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, and tolerance level for the type of risk.

Risk Framework

FTB's risk framework describes the procedures of an effective ERM plan. The framework defines the mechanisms by which FTB applies ERM in its governance and strategic planning processes. It describes the techniques FTB uses to identify and manage risk, and it describes the roles of key players in the ERM process. The process includes the planning, organizing, leading, and controlling an organization's activities to better control the effects of risk, specifically through risk identification, analysis, response planning, monitoring and control, and resolution and closure.

The framework seeks to integrate ERM within FTB's governance process, convey FTB's policy, approach, and process for the ERM, communicate the benefits of ERM to all FTB staff members, establish roles and responsibilities, maintain a consistent risk management approach, and identify the resources available to assist those with responsibility for the management of risks.

All employees are encouraged to identify areas of concern they may observe. FTB has developed a process for risk identification that is available on our internal website. The preparation and submittal procedures include a workflow diagram, as well as step-by-step instructions toward moving a concern from identification, up to the enterprise level, should it be warranted.

Risk Identification

FTB completes enterprise wide risk assessments to address strategic, tactical, and operational risks through FTB's executive management, action committees, and the GC.

The GC is a decision-making body responsible for managing information technology (IT) and business issues at the departmental level. FTB's governance structure has evolved toward setting a strategic focus for the entire department for issues that have impacts crossing administrative/divisional lines. The GC is comprised of the Executive Officer, FTB Chief Counsel and six Division Chiefs over the Accounts Receivable Management, Administrative Services, Audit, Filing, Finance & Executive Services, and Technology Services Divisions.

FTB's maturing enterprise risk process consists of components to assist GC and FTB management with the accurate collection of risk data and the appropriate identification of enterprise risks. The risk management framework is designed to ensure that risk management decisions are based on assessments that are conducted using a consistent methodology and that common terminology and

understanding is utilized across FTB.

Initial risk identification is completed on an ongoing basis through a thorough, analytical review of existing watch point reports, as well as management's identification of emerging risks not otherwise identified on a watch point report. The risk assessment provides an opportunity to review all open risks for continuing validity and to close risks whose relevance has passed, or whose risk has been mitigated. Risks are evaluated using quantitative methods (for example, using probability, impact, and timeframe to prioritize the risk).

Once classified as a risk, the risk is then submitted for tracking and management. Risks are monitored to determine whether a risk trigger or threshold is exceeded, the risk timeframe has passed and whether the risk no longer warrants monitoring. All operational or strategic risks are monitored by the risk owner to insure that mitigation strategies are progressing. The results of the ongoing monitoring of FTB's risks are reported quarterly to the GC. Through our ongoing monitoring processes, FTB reviews, evaluates, and improves our systems of internal controls and monitoring processes.

Risk Ranking

The GC's risk assessment is management's determination of FTB's greatest vulnerabilities. An annual deep dive discussion of risks is conducted to determine new risks, as well as prioritize the most pressing risk issues for the department and to assess the impact and probability of any risks that may impact the FTB operations or strategic goals. Risk owners are assigned to each risk, strategies are developed to resolve the issue and reduce risk, and actions are taken to mitigate the risks.

RISKS AND CONTROLS

Risk: Enterprise Workforce/Critical Knowledge Retention

Enterprise Workforce/Critical Knowledge Retention includes all aspects of recruitment, training, and retaining of employees in our organization. Of significant importance is the succession planning component which focuses on preparing our employees to step into roles and responsibilities being vacated through either retirements or the loss of staff to other jobs, whether internal or external to FTB.

The need for enterprise-wide training continues to grow as FTB expands its shared services and we are leveraging the same systems and processes to assist our customers. Failure to properly execute the action items in our enterprise workforce plan could result in the loss of staff and associated knowledge base without having other individuals sufficiently prepared to step into those roles.

This potential loss of institutional knowledge is caused by a combination of 1) employees who have immediate eligibility to retire (based on age and the required number of service years); 2) employees who can/will advance or move internally within the organization, and; 3) employees who could take jobs in other government or private industry organizations. We need to make sure we have the necessary programs and knowledge transfer strategies in place to offset these anticipated losses of staff and their associated knowledge.

Without mitigation by rolling out and monitoring the effectiveness of workforce planning items, the result could negatively impact our ability to continue efficiently and effectively carrying out our department's mission. This is identified as a top priority of our overall Talent Management program.

Control: Effective Workforce Planning

Effective Workforce Planning efforts include rolling out and monitoring effectiveness of workforce planning items.

- Continue to manage risk for critical positions.
- Focus on succession planning, retirements, and expanding knowledge transfer.
- Continue to maintain recruitment as a talent management priority service.
- Continue to develop recruitment pipelines.
- Focus on hiring smart for supervisors, managers, and hard-to-find talent.
- Ensure employees are in appropriate classifications for the workload.

Risk: Data Security and Privacy

FTB's security program focuses on the confidentiality, integrity, and privacy of taxpayer data. Today's world of cyber-attacks and data breaches is in a constant state of change and has evolved into a multi-billion dollar business for cyber-criminals. In order to protect critical data, FTB must become more sophisticated in identifying threats and preventing threats from accessing FTB's data. The information FTB collects, processes and stores is extremely valuable to cyber-criminals who commit fraud.

Cyber-criminals are continuously changing their tactics to get around the security measures that are put in place. Despite deploying numerous controls and a defense in depth strategy, dedicated hackers can breach most systems and gain access to confidential information. Hackers attempt to enter our systems through our firewalls and other lines of defenses. Deciphering the valid self-service taxpayer from the cyber-criminal is also becoming more difficult and requires more sophisticated technology and security analysis, adding another layer of complexity requiring deployment of additional resources.

If FTB's systems or data are breached, potentially millions of taxpayers' data would be disclosed to unauthorized individuals. FTB would lose public trust, the department may face the financial cost of credit monitoring and breach response and recovery, and California's income tax system, which is based on voluntary compliance, could suffer. If the income tax system suffers, this could mean reduction in revenue for the state.

Control: Data Security and Privacy

While all of our previously identified risks have been mitigated, we will continue to mitigate any arising risks through the maintenance and operations (M&O) process. We will continue to report our M&O at a high level within the SLAA. Items to be reported upon are:

- Build security into the system development life cycle, rather than add it later.
- Perform internal and external vulnerability assessments and conduct risk remediation.
- Perform security intrusion detection and monitoring activities.
- Continue to enhance our security intelligence program as it relates to business intelligence modeling to enhance security.
- Seek resources as appropriate.

Risk: FI\$Cal

System challenges during implementation of the FI\$Cal accounting system may create delays in FTB's financial period closing processes, reconciliations, and reporting.

Control: FI\$Cal Processes and Monitoring

- Closely monitor system response time for labor distribution and cost allocation to accelerate the processing of backlog months.
- Monitor response time on issue resolution.
- Manually calculate cost allocation to create preliminary fund condition reports until periods close timely.

Risk: Inability to Recover Critical Systems and Service

If FTB's critical IT services and systems are disrupted, public service and mission critical business functions are likely to be interrupted, potentially resulting in negative impacts to customer service and revenue producing activities.

There is always the potential of a major disruption in the IT systems and services that support the department's mission critical business functions. Potential sources of disruption include, but are not limited to: loss of power; loss of facility; loss of access to the facility; equipment failure; denial of service attack; and, loss of key personnel. The Technology Action Committee will mitigate and/or monitor these risks and the consequences that may result from these risks.

FTB programs oversee the administration and collection of over \$103 billion in General Fund revenues – over 78% of the General Fund account. In the event of a disaster or major service disruption, taxpayers and other external customers may not be able to access FTB's self-service web functionality, and internal applications used by FTB staff could be unavailable. As a consequence, tax returns and payments may not be received and/or processed in a timely manner, and other workloads may be interrupted, resulting in delayed revenue to the state's General Fund.

Control: Business Recovery Processes

Multiple controls are in process to mitigate the potential of a major disruption in the IT systems and services that support the department's mission critical business functions:

- Update FTB's warm site remote recovery plan and contract to reflect FTB's current model.
- Conduct business resumption, technology recovery, and worksite security exercises on a regular basis.
- Review the Business Impact Analysis on a consistent basis for any significant changes to FTB's critical functions.
- Update technology recovery plans to reflect system dependencies.
- Determine replacement strategies for technology recovery software that reached end-of-life.

Risk: Aging Legacy Systems

FTB's aging legacy systems work very well supporting the department's core tax accounting and

compliance functions; however, due to the aging technology designs, these legacy systems struggle to accommodate new initiatives, especially initiatives that do not involve FTB's accounting and compliance functions. FTB has five major legacy systems; two accounting systems will be replaced in the distant future, and three collection systems that are scheduled for retirement as part of the Enterprise Data to Revenue 2 (EDR2) Project.

Control: Legacy Tax Processing Systems

The following mitigation steps will be taken:

Accounting Systems

The two legacy accounting systems will struggle to accommodate initiatives that do not involve core tax accounting functionality. In the interim: Educate our stakeholders and overseers about the limitations on the systems.

- Leverage other FTB systems and architect solutions for new initiatives that more correctly place these solutions in the appropriate functional area, rather than using workarounds in the legacy accounting systems.
- If workarounds must be accepted, reconsider the staffing levels.

Collection Systems

The three legacy compliance systems are being replaced via the EDR2 project; ensure the EDR2 milestones and approvals remain on track so decommissioning of these legacy systems can occur as planned.

CONCLUSION

The Franchise Tax Board 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.

Selvi Stanislaus, Executive Officer

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