December 13, 2021

Yolanda Richardson, Secretary
California Government Operations Agency
915 Capitol Mall, Suite 200
Sacramento, CA 95814

Dear Secretary Yolanda Richardson,

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, 2021.

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:

- **Exceptional Service:** Strive to continuously enhance our customers' experience.
- **Effective Compliance:** Fairly administer the law to ensure taxpayers file and pay the correct amount.
- **Strong Organization:** Value, invest in, challenge, and empower our employees to have an enterprise view, be experts in their field, and achieve their full potential.
- **Operational Excellence:** Optimize our processes, products, services, and resources to better serve our internal and external 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, Allan Loucks, SLAA Administrator, and Mayra Quinones Ledesma, SLAA Coordinator.

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. Their leadership fosters an environment that encourages our employees at all levels to consider the effects on the enterprise when making their 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 Bes**t: 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 Equal Employment Opportunity (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, the ACs 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 ACs 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;
Chrissy Casale, Bureau Director; and Mayra Quinones Ledesma, Information Technology Specialist I.

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 owners, and the risk coordinators.

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 the 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, ACs, 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 of the Legal Division, 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 process provides an opportunity to review all open risks for continued validity, and to close risks whose relevance has passed, or whose risk has

been mitigated. Risks are evaluated using quantitative methods (for example, using *Likelihood*, *Impact*, and *Speed of Onset* to prioritize the risk). The Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as COSO, sets international standards for enterprise risk. FTB adopted COSO standards during the early stages of FTB's ERM program, and continues to monitor COSO for any changes to international trends or standards.

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 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.

By rolling out workforce planning items without a mitigation strategy, resulting consequences could negatively impact our ability to continue efficiently and effectively carrying out our department's mission.

Control: Effective Workforce Planning

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

- Continue to manage risk for critical positions.
- Focus on succession planning, retirements, and expanding knowledge transfer.

Risk: Enterprise Workforce-Recruitment & Classification

Enterprise Workforce / Recruitment and Classification includes the need to identify recruitment optimization tools to target identified gaps in competencies, knowledge, skills, and abilities as well as hard-to-find talent in the workforce. Succession planning is of significant importance and is a priority for FTB.

In addition, FTB's Workforce Plan provides direction for the continued development of the workforce, and to ensure there is an inclusive work environment that values diversity. Failure to manage this risk could negatively impact our ability to continue efficiently and effectively carrying out our department's mission.

Control: Recruitment and Classification

Mitigation efforts include:

- 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: Aging IT Systems and Components

FTB relies on a range of specialized information technology tools and systems to carry out its mission. In addition to our core work of taxation, FTB has also been asked to implement many legislatively mandated solutions in support of critical state services such as Health Care Mandate, Golden State Stimulus, and Earned Income Tax Credit. As FTB's portfolio of services increases, so does our dependence on the resiliency of our IT systems and infrastructure. FTB's aging systems and components make it difficult to accommodate new initiatives, especially initiatives involving new complex functionality and data exchanges outside of FTB's normal tax return processing methods and functions. Further, additional effort is required to keep systems up-to-date, secure, and able to interface effectively with newer systems and technologies.

Control: Legacy Tax Processing Systems

Accounting Systems

The two legacy accounting systems will struggle to accommodate initiatives that involve interfaces with new systems and data sources (especially external data sources), involving new calculations and processes not easily incorporated into existing functionality. Additional effort is required to keep these systems up-to-date and able to interface effectively with newer systems and technologies. To mitigate these risks, FTB will:

- Educate our stakeholders and overseers about the limitations of 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.

Compliance Systems

The three legacy compliance systems are on aging platforms that are either not supported by the software vendors or do not interface effectively with newer systems and technologies. To mitigate these risks, FTB is:

- Replacing these systems via the EDR2 project. As such, the EDR2 project team will ensure the EDR2 milestones and approvals remain on track so decommissioning of these legacy systems can occur as planned.

Control: Legacy Non-Tax Processing Systems

Non-Tax Debt Systems

The two non-tax systems require additional effort to keep up-to-date and to be able to interface effectively with newer systems and technologies. To mitigate these risks, FTB is:

- Replacing the aging Vehicle Registration Collections system via the VRC Modification project. As such, the VRC Modification project team will ensure the VRC Modification milestones and approvals remain on track so decommissioning of this legacy system can occur as planned.
- Monitoring enterprise impacts to the Court-Ordered Debt Collection system to ensure operations remain unaffected.

Control: Aging Administrative Systems

Several of FTB's essential aging administrative systems have struggled to accommodate critical mandated business changes as well as new security requirements in a timely and efficient manner. Additional effort is required to keep these systems up-to-date and able to interface effectively with newer systems and technologies. To mitigate these risks, FTB is:

- Replacing the aging TimePortal system (FTB's leave accounting system) via the eTime project under the Administrative Systems Modernization effort.
- Replacing spreadsheets and manual processes for hiring processes via the eRPA project under the Administrative Systems Modernization effort.
- Migrate the FTBNet2 (FTB's intranet) from a databased solution to a SharePoint solution.
- Upgrade the aging Dishonored Checks system via the Dishonored Payment Application Rewrite (DPAR) project.

Control: Aging and Decentralized System Tools

FTB relies on a range of specialized IT tools and services to carry out its mission. FTB has been asked to implement many legislatively mandated solutions in support of critical state services that have added additional complexity to our IT portfolio. Although FTB has been implementing changes to our IT operations to improve service delivery, as FTB's portfolio of services continues to grow we require tools that allow us to solve a variety of business problems using standard

services, improve compliance with evolving security policies and standards, and enhance operational insight. The following mitigation steps will be taken:

- Pursue new enterprise class tools enabling FTB to rapidly develop scalable solutions in support of emerging business needs, streamline operations and programs, improve compliance with security policy standards and best practices, improve service delivery, and improve operational insight for an increasingly complex array of critical state IT Services we provide.
- Pursue security services that have been identified as enterprise solutions that will enable FTB to meet strategic objectives as well as improved compliance with security policies and standards including IRS Publication 1075 and NIST 800-53.

Control: Aging Infrastructure

Portions of FTB's critical IT infrastructure is at a point that it needs to be replaced to continue to effectively provide the online services relied upon by Californians. If these infrastructure components fail it could result in a loss of critical revenue for the state. The following mitigation steps will be taken:

- Updating FTB's data center via the Data Center Modernization project to build and migrate the data center into a consolidated raised-floor facility with Tier 3 equivalency complying with all energy efficiency mandates from Governor, DGS and Building Codes while enhancing the security, monitoring and control for all systems that are part of the new facility. As such, the Data Center Modernization project team will ensure the Data Center Modernization milestones and approvals remain on track so decommissioning of this legacy system can occur as planned.
- Refresh the aging equipment and software that is reaching End-of-Life (EOL) and approaching End-of-Service (EOS), such as high-speed printers, which are used to print all of FTB's outbound notices.

Risk: Data Security and Privacy

FTB's security program focuses on the confidentiality, integrity, and privacy of taxpayer data. FTB will continue identifying threats and preventing unauthorized accesses to FTB's data through sophisticated, state of the art technology and security analysis.

Control: Data Security and Privacy

While all of our previously identified Data Security and Privacy risks have been mitigated, we will continue to mitigate any arising risks through the 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: Budgetary Constraints

FTB's budget flexibility continues to decline as a result of several factors outside the department's control, including: significant externally driven initiatives, rising operational costs and the ongoing budget reduction as a result of BL 20-11.

- FTB has taken on significant work to meet legislative changes and mandates. While FTB is at times augmented for these new workloads, pre-work is often needed to prepare for the changes, prior to augmentation of funding and resources.
- Cost to support IT infrastructure and services continue to increase, especially costs associated with software, where vendors are moving the licensing structures from perpetual licenses to subscription-based services. In addition, FTB's central campus rent cost has also increased.
- FTB's budget was reduced by $4M annually as a result of BL 20-11.

Failure to adequately staff and fund critical workloads will impact the FTB's ability to carry out its mission to help taxpayers file timely and accurate tax returns, and pay the correct amount to fund services important to Californians.

Control: Balance FTB's Budget and Create Financial Flexibility

Balance FTB's budget and create financial flexibility by:

- Prioritizing workloads within the existing budget, seek efficiencies and redirect savings, or seek additional resources as appropriate.
- Accurately forecasting funding needs for fiscal year to avoid unplanned funding needs or unanticipated year end surpluses.
- Managing spending to fund critical needs in labor and OE&E as they arise.

Risk: Customer Service Levels

Customer service staffing levels do not meet taxpayer and practitioner demand for assistance through phone, electronic mail, chat, and correspondence resulting in their inability to timely file and pay taxes. Depending on the disparity between the demand and ability to staff the workloads noted, the impact could be major or minor and will impact numerous areas, including: reduced levels of customer service, increased backlogs, and duplicate contacts that would result in delayed and loss of revenue, inappropriately escalated involuntary collections, and a negative FTB image.

Control: Customer Service Levels

The following mitigation steps will be taken:

- Monitor customer service level of access and response time across all service channels.
- Utilize a planning process to estimate contacts expected and allocate and shift resources accordingly.
- Pursue new resources to right-size contact center service channels.
- When service channels are in need of assistance, offer eligible staff overtime.
- Implement related business continuity plans as necessary.

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