

STATE OF CALIFORNIA

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

Fiscal Year 2016-17	Business Unit 1701	Department Business Oversight	Priority No. 3
Budget Request Name 1701-003-BCP-BR-2016-GB		Program Executive	Subprogram

Budget Request Description
Internal Auditing Unit

Budget Request Summary

The Department of Business Oversight (DBO) requests \$334,000 for one permanent Senior Management Auditor and one Associate Management Auditor to establish an internal auditing unit to provide ongoing, independent, objective evaluation and assessment of internal controls of the newly created DBO. The position will be special funded by licensee assessments in State Corporations Fund 0067, Local Agency Deposit Security Fund 0240, Financial Institutions Fund 0298, and Credit Union Fund 0299. No General Fund dollars are being requested.

Requires Legislation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Code Section(s) to be Added/Amended/Repealed	
Does this BCP contain information technology (IT) components? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <i>If yes, departmental Chief Information Officer must sign.</i>	Department CIO	Date
For IT requests, specify the date a Special Project Report (SPR) or Feasibility Study Report (FSR) was approved by the Department of Technology, or previously by the Department of Finance. <input type="checkbox"/> FSR <input type="checkbox"/> SPR Project No. Date:		

If proposal affects another department, does other department concur with proposal? Yes No
Attach comments of affected department, signed and dated by the department director or designee.

Prepared By Betsy Barnhart	Date 10/22/15	Reviewed By Dawne Bortolazzo	Date 10/22/15
Department Director Jan Lynn Owen	Date 10-27-2015	Agency Secretary Anna M. Caballero	Date 10/29/15

Department of Finance Use Only

Additional Review: Capital Outlay ITCU FSCU OSAE CALSTARS Dept. of Technology

BCP Type: Policy Workload Budget per Government Code 13308.05

PPBA

Original signed by
Jeff Carosone

Date submitted to the Legislature

1-7-16

BCP Fiscal Detail Sheet

BCP Title: Management Audit Position Request

DP Name: 1701-003-BCP-DP-2016-GB

Budget Request Summary

	FY16					
	CY	BY	BY+1	BY+2	BY+3	BY+4
Positions - Permanent	0.0	2.0	2.0	2.0	2.0	2.0
Total Positions	0.0	2.0	2.0	2.0	2.0	2.0
Salaries and Wages						
Earnings - Permanent	0	148	148	148	148	148
Total Salaries and Wages	\$0	\$148	\$148	\$148	\$148	\$148
Total Staff Benefits	0	61	61	61	61	61
Total Personal Services	\$0	\$209	\$209	\$209	\$209	\$209
Operating Expenses and Equipment						
5301 - General Expense	0	40	32	32	32	32
5302 - Printing	0	2	2	2	2	2
5304 - Communications	0	4	2	2	2	2
5306 - Postage	0	2	2	2	2	2
5320 - Travel: In-State	0	22	22	22	22	22
5320 - Travel: Out-of-State	0	2	2	2	2	2
5322 - Training	0	6	6	6	6	6
5324 - Facilities Operation	0	28	28	28	28	28
5344 - Consolidated Data Centers	0	2	2	2	2	2
5346 - Information Technology	0	17	14	14	14	14
Total Operating Expenses and Equipment	\$0	\$125	\$112	\$112	\$112	\$112
Total Budget Request	\$0	\$334	\$321	\$321	\$321	\$321

Fund Summary

Fund Source - State Operations						
0067 - State Corporations Fund	0	196	188	188	188	188
0240 - Local Agency Deposit Security Fund	0	2	2	2	2	2
0298 - Financial Institutions Fund	0	106	102	102	102	102
0299 - Credit Union Fund	0	30	29	29	29	29
Total State Operations Expenditures	\$0	\$334	\$321	\$321	\$321	\$321
Total All Funds	\$0	\$334	\$321	\$321	\$321	\$321

Program Summary

Program Funding

1510 - Investment Program	0	196	188	188	188	188
1520 - Licensing and Supervision of Banks and Trust Companies	0	106	102	102	102	102
1545 - Administration of Local Agency Security	0	2	2	2	2	2
1550 - Credit Unions	0	30	29	29	29	29
9900100 - Administration	0	334	321	321	321	321
9900200 - Administration - Distributed	0	-334	-321	-321	-321	-321
Total All Programs	\$0	\$334	\$321	\$321	\$321	\$321

Personal Services Details

Positions	Salary Information			CY	BY	BY+1	BY+2	BY+3	BY+4
	Min	Mid	Max						
4159 - Assoc Mgmt Auditor (Eff. 07-01-2016)				0.0	1.0	1.0	1.0	1.0	1.0
4161 - Sr Mgmt Auditor (Eff. 07-01-2016)				0.0	1.0	1.0	1.0	1.0	1.0
Total Positions				0.0	2.0	2.0	2.0	2.0	2.0
Salaries and Wages	CY	BY	BY+1	BY+2	BY+3	BY+4			
4159 - Assoc Mgmt Auditor (Eff. 07-01-2016)	0	67	67	67	67	67			
4161 - Sr Mgmt Auditor (Eff. 07-01-2016)	0	81	81	81	81	81			
Total Salaries and Wages	\$0	\$148	\$148	\$148	\$148	\$148			\$148
Staff Benefits									
5150350 - Health Insurance	0	13	13	13	13	13			13
5150500 - OASDI	0	9	9	9	9	9			9
5150600 - Retirement - General	0	29	29	29	29	29			29
5150800 - Workers' Compensation	0	1	1	1	1	1			1
5150900 - Staff Benefits - Other	0	9	9	9	9	9			9
Total Staff Benefits	\$0	\$61	\$61	\$61	\$61	\$61			\$61
Total Personal Services	\$0	\$209	\$209	\$209	\$209	\$209			\$209

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

A. Budget Request Summary

The Department of Business Oversight (DBO) requests \$334,000 for one permanent Senior Management Auditor and one Associate Management Auditor to establish an internal auditing unit to provide ongoing, independent, objective evaluation and assessment of internal controls of the newly created DBO. The position will be special funded by licensee assessments in State Corporations Fund 0067, Local Agency Deposit Security Fund 0240, Financial Institutions Fund 0298, and Credit Union Fund, 0299. No General Fund dollars are being requested.

B. Background/History (Provide **relevant** background/history and provide program resource history. Provide workload metrics, if applicable.)

Pursuant to the enactment of Governor Brown's second reorganization plan (GRP2), on July 1, 2013, the Department of Corporations and the Department of Financial Institutions were merged to create the Department of Business Oversight (DBO). The DBO's six divisions oversee 23 financial services industries and licenses.

The stated mission of the DBO is "to regulate state-licensed financial institutions, products and professionals in order to provide accessibility to a fair and secure financial services marketplace." The DBO serves California by enforcing the state's financial services laws and by providing resources to Californians to make informed financial decisions. The DBO oversees the operations of state-licensed financial institutions, including banks, credit unions, money transmitters, issuers of payment instruments and traveler's checks, and premium finance companies. Additionally, the DBO licenses and regulates a variety of financial businesses, including securities brokers and dealers, investment advisors, and payday lenders.

The Legislature deemed auditing to be so important that it enacted Government Code §1237, requiring that state agencies with aggregate annual spending of fifty million dollars or more consider establishing an ongoing audit function. Recent legislation added Government Code §13885 et seq., to focus attention again on the importance of audit activities, with provisions that ensure the independence of internal auditors. These provisions also recognize that findings of internal auditors must be reported to the appropriate levels of government to safeguard public funds and the public trust.

Because the annual appropriation of the Department of Corporations and the Department of Financial Institutions individually was less than fifty million dollars, neither department considered, maintained, nor were funded for an internal audit unit. However, the newly merged DBO's 2015-16 appropriation is \$89 million, well over the threshold of the legislature's requirement. Following the Legislature's requirement to consider the establishment of an independent internal audit function, the DBO has ascertained that it needs to establish an Internal Audit Office to assist executive management in the effective discharge of responsibility by providing objective audits and reviews of the Department's various operations.

The DBO strategic plan is currently under development by a departmental task force. The strategic plan task force is using Strength Weakness Opportunities Threats (SWOT) analysis to develop goals, objectives, and action steps that will include proposals and recommendations for implementation. Currently, the DBO lacks the ongoing expertise to evaluate process improvements necessary to ensure the objectives of the strategic plan will be successful.

C. State Level Considerations

This proposal will further the goals of the GRP2 and of the Legislature by focusing efforts on an independent audit of internal controls as well as effective resource utilization. The Internal Auditing Unit (IAU) will provide the independence and objectivity necessary to effectively evaluate, assess, and strengthen implementation of the DBO's merger and its strategic plan which will soon be completed.

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

This proposal has no direct or indirect impact on other state departments or agencies.

No fee increases to licensees of any of the funds will be necessary to support this proposal.

D. Justification

As an oversight agency, it is critical that the DBO safeguard its public trust by ensuring that it establishes and follows as closely as possible exemplary business practices, just as it requires of its licensees. To ensure the DBO establishes and maintains appropriate internal controls, an internal audit function is essential.

This proposal will further the goals of the GRP2 by focusing efforts on effective resource utilization, promoting consumer protection, and maximizing technology applications in support of mission-critical activities. As a newly merged department, the DBO has special challenges. Every merger promises to create value from some form of synergy, yet often the benefits that look so good on paper often do not materialize. The DBO is committed to successful implementation of the merger, with improved systems and increased operational efficiencies.

While the DBO staff is very proud of the work accomplished to date, the DBO lacks the resources to make an objective appraisal of its efforts. As the DBO completes its first strategic plan and measures departmental risks for the 2015 SLAA report, the need for the expertise of an independent internal auditor has become apparent. The DBO has identified the need for an IAU to provide needed independent and objective assessment of the DBO operations. The IAU will evaluate and assess the DBO's consolidation efforts by monitoring and evaluating the effectiveness of the DBO's risk management processes.

Due to the nature, complexity, and independence required to evaluate the DBO's operations, the IAU will report to the Commissioner. The IAU will review the DBO's systems documentation and communications to employees regarding the systems. The IAU will independently plan and perform departmental operations audits. The IAU will inspect and verify accounts, records, and reports to determine that transactions are accurate and that internal controls are in place. The IAU will issue findings in the form of written reports to the Commissioner. The reports will include recommendations of controls to put in place to reduce risk to the DBO's operations. Periodic evaluations may result in system modifications as changes in conditions warrant.

Currently the DBO relies on its Executive Management to establish the internal controls within their divisions of the DBO. The DBO is lacking a global departmental view of internal control. Establishing an internal auditing unit will assist executive management in the effective discharge of responsibility by providing objective audits and reviews of the Department's various operations. The IAU will provide management with independent and objective assessments regarding the: responsible and effective use of public resources; achievement of objectives and the mission of the department; improvement of government operations; deterrence and detection of fraud and abuse; and assurance of departmental accountability and integrity. Government Code Section 1237 requires state agencies with an aggregate annual spending of fifty million dollars or more to consider establishing an ongoing audit function. The DBO aggregate annual spending in fiscal year 2015-16 is \$89 million and an internal audit unit will provide a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The IAU will follow the audit standards of the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards to conduct the internal reviews of the DBO.

The IAU will support the DBO's focus on the continuous process improvements necessary to strengthen both the efficiency and effectiveness of internal processes and controls. The IAU will promote an environment that supports the evaluation and monitoring of internal controls while optimizing overall risk mitigation throughout the DBO. The IAU will provide independent, objective

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

feedback on the DBO's developing goals and risk mitigation activities as well as management's proposed solutions to maximize the resources of the DBO. The Senior Management Auditor will evaluate and assess agency operational controls. Effective execution of the initiatives and goals of the strategic plan will result in the DBO becoming a stronger, more effective regulator. Improved consumer protection and optimal resource use related to licensee examinations and supervision will establish a sound financial marketplace for Californians.

The IAU will be a critical resource to management by providing an independent and objective view of the internal controls within the DBO. The IAU will provide reports and findings to management by auditing the following: operations, the reliability of reporting for internal and external use, and compliance with applicable laws and regulations. Without the IAU the DBO will continue to rely on Executive Management to provide review of internal control within their divisions. Division Deputies do not have an objective view of the work performed and may lose sight of internal controls, thereby increasing the risk that the DBO will not meet its regulatory objectives. The IAU will provide reasonable assurance to management that the goals and objectives under the regulatory control of the DBO are being met.

Classification	Activity	Hours Per Occurrence	Occurrences Per Year	Total Hours
Senior Management Auditor	Review operations of DBO's six divisions to evaluate internal control systems and determine specific risks facing the DBO. Creates a work plan to review the internal controls of each division every two years. Reviews completed audit and evaluations to ensure objectives and professional standards are met. Ensures findings and recommendations are clear, concise, complete, and fairly presented. Acts to ensure DBO management stays informed of the progress of the assignments.	130	3	390
	Review the strategic plan to determine whether effective controls have been put in place to attain the planned goals.	45	3	135
	Plan audit programs to evaluate the effective use of public resources, achievement of the objectives and the mission of the department, improvement of operations, deterrence of fraud and abuse, and assurance of departmental accountability and integrity.	30	3	90
	Coordinates the work to inspect and verify accounts, records and reports to determine whether transactions are accurate and that internal controls are in place and working as intended.	277	3	831

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

	Recommend to management controls that should be in place to reduce risk to DBO's operations. Make effective oral presentations of findings and recommendations to executive managements.	55	3	165
	Supervises subordinates' performance and completes administrative functions, such as communicating policies and procedures, monitoring performance, and reviewing and approving the annual Individual Development Plan.	35	3	105
	Complete continuing professional education requirements as required by Governmental Audit Standard, and performs other duties as appropriate.	40	1	40
				1,756

Classification	Activity	Hours Per Occurrence	Occurrences Per Year	Total Hours
Associate Management Auditor	Collects and documents data obtained from program records; ad hoc and formal reports; automated and manual systems; interviews management and staff; document reviews, work papers, and permanent files; observes work in progress.	174	3	522
	Analyzes and interprets data to determine the level of compliance with applicable policies, procedures, laws, and regulations; analyzes and interprets data to determine the adequacy of system of controls, the reliability of system data, and the level of implementation related to DBO's information technology projects.	252	3	756
	Develops audit findings, the causes for the findings, and the effect(s) of the findings on the program being audited; develops alternatives and recommendations for the resolution of findings; prepares written reports of findings that are clear, concise, and complete.	147	3	441

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

	Completes continuing professional education requirements as required by Governmental Audit Standard, and performs other duties as appropriate.	40	1	40
				1759

E. Outcomes and Accountability *(Provide summary of expected outcomes associated with Budget Request and provide the projected workload metrics that reflect how this proposal improves the metrics outlines in the Background/History Section.)*

The Internal Auditing Unit will support the DBO's focus on continuous process improvements necessary to strengthen both the efficiency and effectiveness of the newly created DBO. To ensure independence, the IAU will report directly to the Commissioner. The responsibilities of the unit will be to evaluate and assess 1) the consolidation efforts of the DBO, 2) the implementation of its strategic plan goals; and 3) internal controls of each division within the DBO. The deputies of the programs will use objective feedback from the IAU to develop appropriate internal controls and measures for the monitoring of the work performed within each division. As changes in conditions warrant, periodic evaluations from the IAU may result in system modifications to facilitate ongoing system enhancements throughout the DBO.

F. Analysis of All Feasible Alternatives

Alternative 1 – Hire one permanent Senior Management Auditor and one Associate Management Auditor in fiscal year 2016-2017.

Pros:

- The DBO will have staff positions available to take an unbiased objective view of the DBO's consolidation efforts and provide constructive feedback for improvements.
- Provides the DBO with ongoing expertise and evaluation of the strategic plan.
- Provides Executive Management with an objective and independent assessment of the internal controls in place within their division.
- Promotes efficient utilization of resources.
- Improves the DBO operations
- Deters fraud and abuse within the DBO.
- Provides assurance of DBO accountability and integrity.

Cons:

- Costs to the DBO will increase

Alternative 2 -- Hire one two-year limited-term Senior Management Auditor and one two-year limited term Associate Management Auditor in fiscal year 2016-17.

Pros:

- The DBO will have internal control assessment for two years.

Cons:

- This solution does not provide ongoing evaluation and assessment of internal controls after 2 years.
- Limited term applicants may not be of the highest caliber.
- Retaining a Senior Management Auditor and Associate Management Auditor may be difficult; incumbents in limited term positions often seek permanent employment. A sudden vacancy would leave the DBO without the evaluation and assessment of internal controls expertise needed.

Budget Change Proposal - Cover Sheet

DF-46 (REV 08/15)

- * Staff turnover in a limited term position would leave the DBO executive staff with a steep learning curve to overcome.

Alternative 3 – Hire external contractor in fiscal year 2016-17

Pros:

- The DBO will have the resource needed to provide auditing for internal control service.
- An external contractor would remain independent and objective during audit reviews.

Cons:

- Contracting for an internal control auditor may cost hundreds of thousands of dollars, much more than the cost of hiring a permanent staff position.
- This solution does not provide ongoing evaluation and assessment of DBO operations necessary to comply with Government Code Section 1237.
- This alternative will not promote the expertise of State employees.

G. Implementation Plan

Upon approval of this request, the DBO will advertise and hire the for the Senior Management Auditor and Associate Management Auditor positions. The IAU will report directly to the Commissioner. Initially, the IAU will complete a baseline review of existing internal controls, including a review of the strategic plan analytics and related documentation.

H. Supplemental Information (*Describe special resources and provide details to support costs including appropriate back up.*)

No special resources are anticipated to support this position. The Senior Management Auditor and Associate Management Auditor will be accommodated by existing facilities.

I. Recommendation

Appropriate \$334,000 to hire one permanent Senior Management Auditor and one Associate Management Auditor in fiscal year 2016-2017 to provide ongoing, independent, objective evaluation and assessment of internal controls of the newly created DBO. The position will be funded by licensee assessments collected by the DBO Special Funds, State Corporations Fund 0067, the Local Agency Deposit Security Fund 0240, the Financial Institutions Fund 0298, and the Credit Union Fund, 0299. No General Fund dollars are being requested.