DEPARTMENT OF FINANCE

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March 30, 2017

Honorable Holly J. Mitchell, Chair
Joint Legislative Budget Committee
Senate Budget and Fiscal Review Committee
State Capitol, Room 5080
Sacramento, CA 95814

Honorable Phil Ting, Chair
Assembly Budget Committee
State Capitol, Room 6026
Sacramento, CA 95814

Dear Honorable Mitchell and Honorable Ting:

Final Report—California State Board of Equalization Evaluation

The California Department of Finance, Office of State Audits and Evaluations, has completed its evaluation of the California State Board of Equalization (BOE) pursuant to the Fiscal Year 2016-17 Budget Act. This evaluation was considered a non-audit service and does not constitute an audit conducted in accordance with generally accepted government auditing standards.

The enclosed report is for your information and use. BOE's response and our evaluation of the response are incorporated into this final report. Overall, BOE agreed with our results and we appreciate its willingness to improve its practices. This report will be placed on our website.

We appreciate the assistance and cooperation of BOE's staff. If you have any questions regarding this report, please contact Diana Antony, Manager, at (916) 322-2985.

Sincerely,

Original signed by:

Jennifer Whitaker, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Daniel Alvarez, Secretary of the Senate, Office of the Secretary of the Senate
Ms. Diane F. Boyer-Vine, Legislative Counsel, Office of Legislative Counsel
Mr. E. Dotson Wilson, Chief Clerk, California State Assembly, Office of the Chief Clerk
Mr. David Gau, Executive Director, California State Board of Equalization
Mr. Justyn Howard, Program Budget Manager, California Department of Finance
Ms. Kristin Shelton, Program Budget Manager, California Department of Finance

Evaluation

California State Board of Equalization
Sales and Use Tax Reporting
Retail Sales Tax Fund Adjustment

California State Board of Equalization Building
Source: BOE website

Prepared By:
Office of State Audits and Evaluations
California Department of Finance

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March 2017

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EXECUTIVE SUMMARY

In accordance with the 2016-17 Budget Act, the California Department of Finance, Office of State Audits and Evaluations (Finance), performed an evaluation of the California State Board of Equalization's (BOE) sales and use tax resource utilization, outreach activities, sales and use tax reporting, and the November 2015 California State Controller's Office's *Internal Accounting and Administrative Controls Review* (SCO Review) corrective actions pertaining to Findings 1 through 6, including the proposed Retail Sales Tax Fund allocation adjustment.

BOE administers over 30 tax and fee programs, which generated $60.5 billion in revenue during fiscal year 2014-15. BOE is governed by a five-member Board (Board) and executive management team. The Board, acting as a whole, establishes BOE's overarching policies and delegates authority to the Executive Director and the executive team to manage the day-to-day operations. As such, the Board and the executive management team are jointly responsible for establishing and implementing a fair, effective, and efficient tax administration program.

In performing this evaluation, we noted BOE's operational culture impacts its ability to report accurate and reliable information to decision makers including, the Legislature, Finance, and the Board. Specifically, certain board member practices have intervened in administrative activities and created inconsistencies in operations, breakdowns in centralized processes, and in certain instances result in activities contrary to state law and budgetary and legislative directives.

During our evaluation, BOE had difficulty providing complete and accurate documentation in response to our evaluation inquiries and in some instances various levels of management were not aware of and could not speak to certain district activities for which they held oversight responsibilities. Specific examples include the informal establishment of a call center, creating an unofficial office location, and inconsistent use of community liaisons.

In addition, staff resource utilization practices have negatively impacted personnel and accounting records. These records do not accurately depict current operational activities. Despite having dedicated staff and operating budgets of $1.5 million, some board members routinely supplement their staff by redirecting revenue generating staff to perform non-revenue generating board member activities, including outreach activities. These redirections violate Provision 1 of the Budget Act. Additionally, BOE is unable to accurately reflect revenue and cost impacts in its accounting records and Annual Report on Sales and Use Tax Audit and Collection Activities, Statewide Compliance and Outreach Program and Audit Selection Improvements (supplemental annual report).

Further, the External Affairs Department (External Affairs) coordinates numerous aspects of the education and outreach program and the general policy is for board member offices to request certain outreach services through External Affairs. However, this policy is not consistently followed. Instead operational administration of these activities have shifted to board member offices and staff in Field Operations. These outreach activities have a limited nexus with BOE's administered tax programs and have increased in recent years. Additionally, BOE has not implemented budgets and cost tracking measures for these outreach activities, and has hired staff for these activities using practices that bypass the budgetary and legislative processes.

Moreover, BOE's supplemental annual reports submitted to the Legislature do not comply with the Budget Act reporting requirements. Due to staff resource utilization practices noted above, the audit and collection's revenue and personnel costs are incorrect, which further skews the reported cost benefit ratios. The supplemental annual reports are intended to be used by the Legislature as a tool to assess the effectiveness of BOE's existing sales and use tax audit and compliance efforts, and as a means to measure whether the level and design of BOE's current efforts are appropriate. As a result of BOE's staff resource practices, the supplemental annual reports' usefulness is diminished.

Lastly, BOE provided 11 different versions of its proposed sales and use tax allocation adjustment and with each version, Finance continued to find errors and omissions. Since the proposed adjustment continues to change and BOE has not prepared a comprehensive explanation of its assumptions and methodologies, further review of the proposed allocation adjustment is imperative.

BOE has a fiduciary responsibility to promote an operational environment that provides fair, effective, and efficient tax administration over the billions of dollars for which it is responsible. Information included in this report can be used by the Board and BOE executive management to effectuate cultural change of its practices.

BACKGROUND

The California State Board of Equalization (BOE) administers tax and fee programs concentrated in four general areas: sales and use taxes, property taxes, special taxes, and the tax appellate program. BOE has over 30 tax and fee programs, which generated $60.5 billion in revenue and accounted for more than 30 percent of all state revenue for fiscal year 2014-15.[1] Of the $60.5 billion, sales and use tax activities accounted for $52.1 billion. Because a majority of sales and use taxes are self-assessed, BOE has developed an audit and compliance program to verify businesses remit the correct amounts and to provide related education.

Budgetary and legislative directives have restricted BOE's resource utilization and required it to report on its audit and compliance efforts. For example, between 1992-93 and 1997-98, the Legislature approved 250 audit positions to augment BOE's audit program. However, in March 1999, the California State Auditor issued a report[2] that found BOE redirected over half (127 of 250) of its new audit positions to perform support activities. As a result, the 1999-00 Budget Act enacted Provision 1, which specifically prohibited BOE from redirecting resources from audit and collection activities without prior approval from Finance and notification to the Joint Legislative Budget Committee.

In addition, in 2002, the Legislative Analyst's Office (LAO) requested BOE to begin reporting information regarding its performance. Specifically, the 2002-03 Budget Act Supplemental Report[3] required BOE to submit an Annual Report on Sales and Use Tax Audit and Collection Activities (supplemental annual report). The report requires BOE to report the revenue and cost impacts associated with any increase or decrease in resources devoted to audit and compliance activities. Subsequently, in 2006, 2010, and 2011, additional reporting requirements[4] were imposed requiring, among other items, BOE to report on audit selection methodologies, cost benefit analysis, and Statewide Compliance and Outreach Program (SCOP) performance. See Appendix A for a listing of the supplemental annual report requirements.

Further, in November 2015, the California State Controller's Office issued its *Internal Accounting and Administrative Controls Review* (SCO Review), which identified numerous internal control weaknesses and errors with the allocation of the Retail Sales Tax Fund. BOE submitted a Corrective Action Plan (CAP) to SCO in May 2016 and subsequently updated the status in July 2016.

[1] BOE's Annual Report for 2014-15.
[2] California State Auditor Report 98118.1, *State Board of Equalization: Budget Increases for Additional Auditors Have Not Increased Audit Revenues as Much as Expected.*
[3] Supplemental Reports are special requests by the LAO. Specifically, they are statements of legislative intent and requests for studies adopted during budget deliberations.
[4] LAO's Budget Act Supplemental Reports.

In July 2016, in accordance with the 2016-17 Budget Act,[5] Finance was directed to evaluate BOE's Sales and Use Tax Program's activities, including, but not limited to, audits, collections, compliance enforcement, and outreach; BOE's taxpayer outreach and related activities; and BOE's corrective actions related to the SCO Review. Finance, in consultation with the Legislature, further defined the specific objectives of the evaluation to focus on sales and use tax resource utilization, outreach activities, sales and use tax reporting, and the SCO Review corrective actions pertaining to Findings 1 through 6, including the proposed Retail Sales Tax Fund adjustment.

MISSION AND ORGANIZATION

BOE's mission is to serve the public through fair, effective, and efficient tax administration. BOE collects and allocates the state and local sales and use tax for cities, counties, and other districts. The over 30 tax and fee programs administered by BOE provide revenues to support hundreds of state and local government programs and services, including but not limited to, schools and colleges, hospitals and health care services, natural resources, transportation, and housing.

BOE is the nation's only elected tax commission, which consists of four elected board members, each representing an Equalization District (district), and the California State Controller, an ex officio member representing the State at large. The elected board members each represent a district with boundaries that encompass approximately the same population size. Figure 1 on the following page illustrates the district boundaries as of January 2015.[6]

[5] 2016-17 Budget Act section 8860-001-0001, Provision 8.
[6] As of January 5, 2015, BOE's district boundaries were reconfigured as a result of the California Citizens Redistricting Commission.

Figure 1: BOE Equalization Districts

Source: BOE website

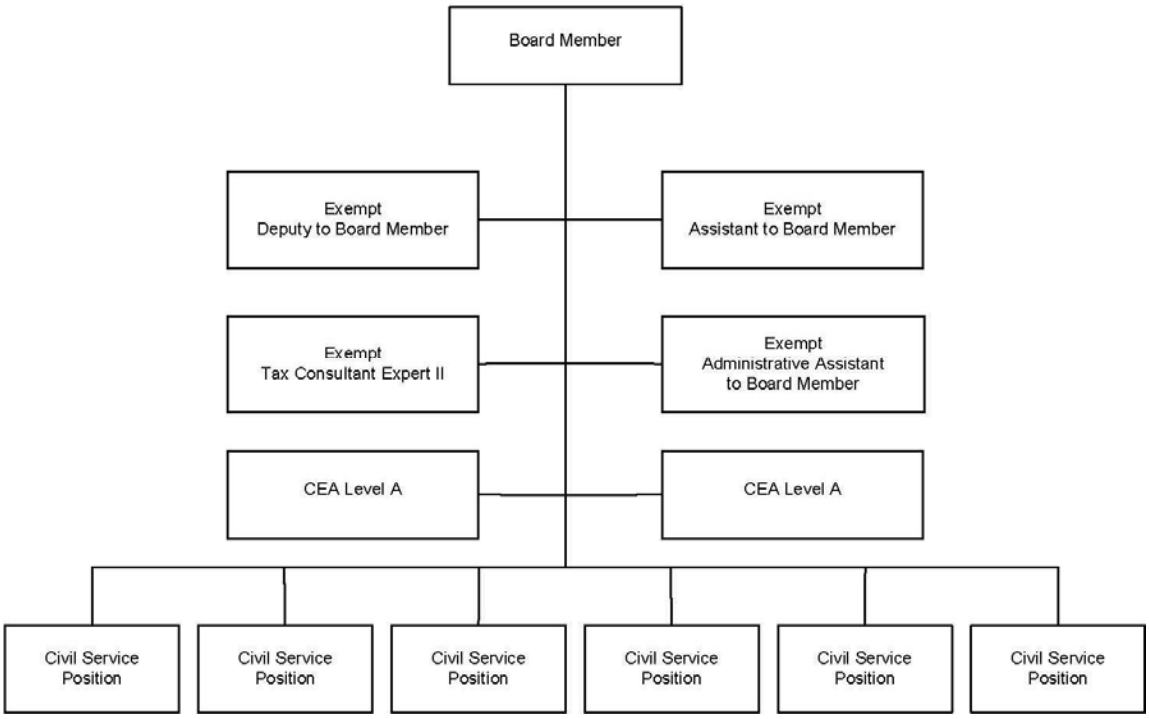
The five member board (Board), as a whole, acts in a quasi-judicial capacity as the appellate body for appeals from various business tax assessments, Franchise Tax Board (FTB) actions, and public utility assessments. In its administrative capacity, the Board issues rules and regulations. Additional Board responsibilities as stated in BOE Publication 545.2 are as follows:

- Establish and adopt BOE policies in monthly public meetings.
- Meet to hear and decide tax appeals, approve regulator changes, annually set property tax values for state assesses, consider reports from various department managers, and receive input from the public.
- Hire the Executive Director and approve the hiring of all executive leaders and Career Executive Assignments (CEA).
- Ensure the agency runs effectively and efficiently by setting policy and guiding executive leadership.
- Supervise policy development through four committees chaired by each of the four board members.

Individual board member's duties include facilitating and resolving constituent concerns, educating taxpayers, influencing public policy, and interacting with the media.

According to BOE's Human Resources Division, each board member's office is comprised of 12 positions, which consist of 2 CEAs, 4 exempt,[7] and 6 civil service positions, as shown in Figure 2. For 2015-16, each board member was allocated a $1.5 million operating budget.

Figure 2: Board Member Office Organizational Chart

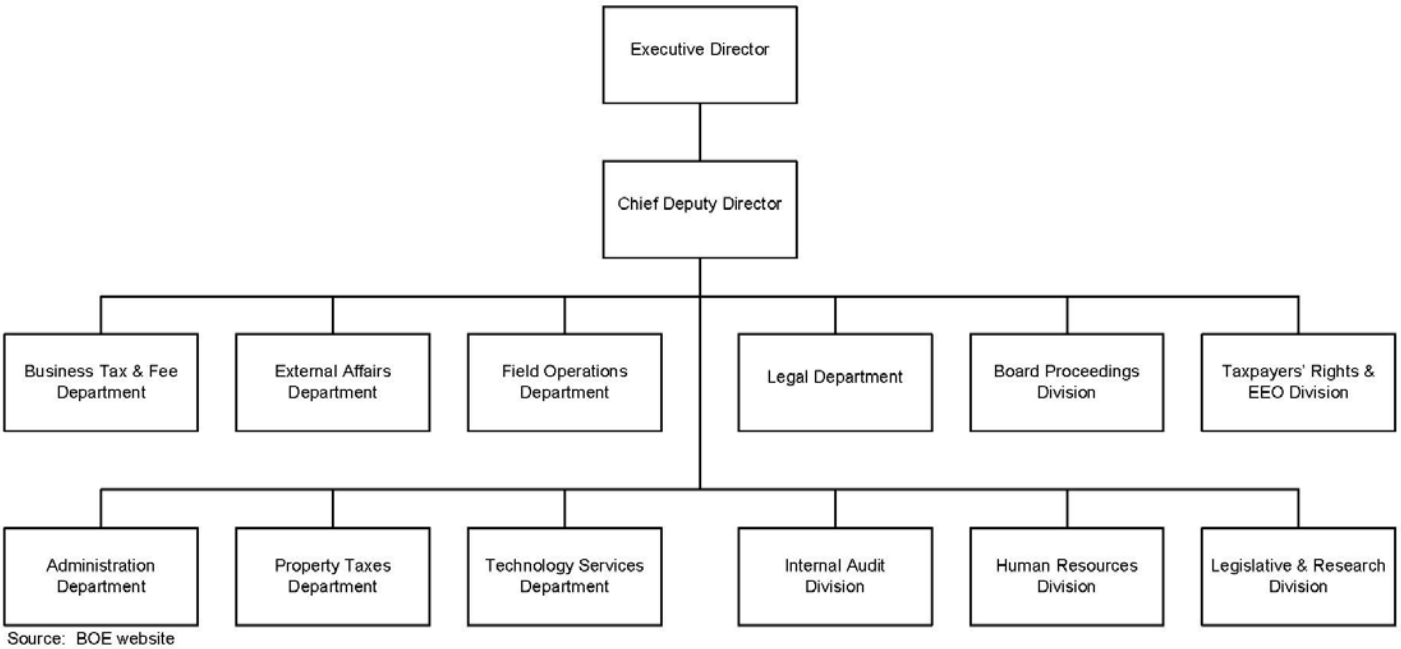


Source: BOE Human Resources Division

[7] Exempt from civil service under section 4, Article VII of the State Constitution. Two of these positions require approval by the Governor.

Under the general direction of the Board and in accordance with established policies, the Board delegates authority to the Executive Director and the executive team to manage the day-to-day operations. As of July 2016, BOE had over 4,800 authorized positions to carry out its daily operations. These positions are organized into programmatic and administrative units within BOE's Sacramento headquarters, 22 field offices, and 4 out-of-state offices. This organizational structure administers the various programs within 12 departments and divisions. See Figure 3.

Figure 3: BOE Organizational Chart



Source: BOE website

Sales and Use Tax Program

In 2015, the Sales and Use Tax Department was reorganized into the Business Tax and Fee Department and the Field Operations Department (Field Operations). These departments are responsible for administering California's state, local, and district sales and use tax programs, which account for more than 80 percent of BOE-collected revenues totaling $52.1 billion during 2014-15.

As described above, BOE is required to submit a supplemental annual report regarding its sales and use tax audit and compliance activities. The report includes data regarding various sales and use tax audit and compliance programs as detailed in the text box.

Sales and Use Tax Audit and Compliance Programs

Audit—Conducts sales and use tax audits to ensure businesses report neither more nor less tax than required by law.

Consumer Use Tax—Works closely with state and federal agencies in administering use tax due on non-dealer sale of vehicles, vessels, aircraft, and mobile homes.

Collection - Collects outstanding sales and use taxes due to BOE.

Return Analysis Unit—Examines sales and use tax returns to investigate discrepancies, create billings, make adjustments to amounts reported, process refunds, or take other actions as warranted.

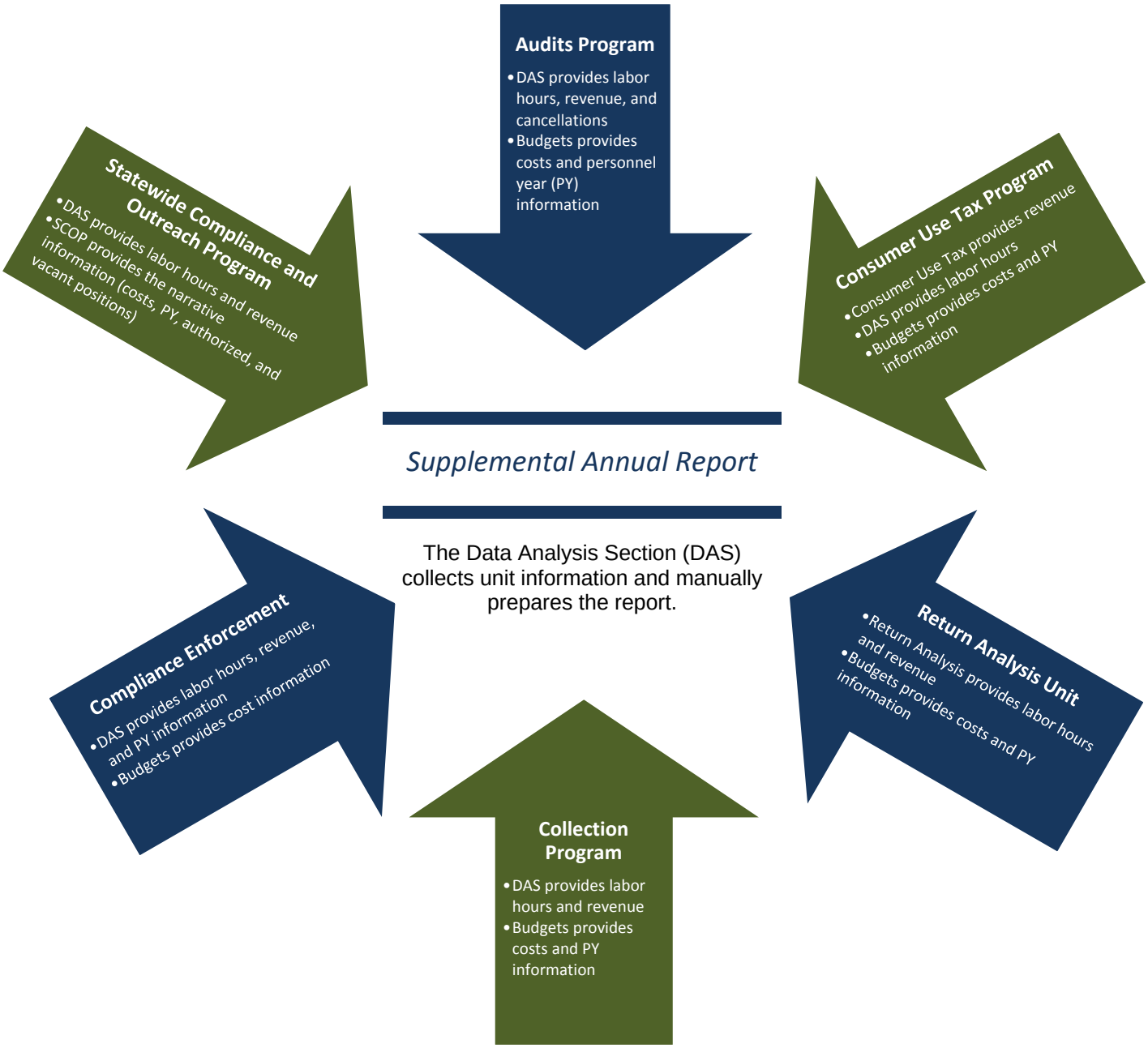
Compliance Enforcement—Uses data from various state and federal agencies to identify non-filers and under-reporters of use tax from imported items, untaxed property brought into the state, and unpermitted business that may owe use tax.

SCOP—Provides outreach, educates business owners on their sales and use tax responsibilities, and increases tax compliance via permit checks, business registration updates and enforcement, and referring leads for audit. SCOP is reported within the Audit and Compliance Enforcement programs in the supplemental annual report.

Source: BOE 2015-16 supplemental annual report

BOE's Data Analysis Section (DAS) is responsible for compiling the supplemental annual report. DAS works closely with numerous units such as the Budget Branch, Consumer Use Tax, Return Analysis, and Field Operations to obtain the required information to compile the report, as shown in Figure 4 on the following page. Currently, the information provided by these units originates from a variety of sources, such as data system queries and manual spreadsheets. DAS manually compiles the information received to prepare the supplemental annual report.

Figure 4: BOE Supplemental Annual Report Process



Source: BOE staff interviews

Education and Outreach

The Harris-Katz California Taxpayers' Bill of Rights (Taxpayers' Bill of Rights) requires BOE to develop and implement a taxpayer education and information program. Accordingly, BOE's education and outreach program is required to be directed at, but is not limited to, the following groups: newly registered taxpayers, recurrent taxpayer noncompliance,[8] and BOE audit and compliance staff. Further, the Taxpayers' Bill of Rights requires the program to include, among other things, mailings or appropriate and effective contact with the above mentioned groups, written communication with newly registered taxpayers, and participation in small business seminars and similar programs organized by federal, state, and local agencies.

Education and Outreach Methods

In-Person—SCOP, Business Consultations, Interested Parties Meetings, Seminars, Workshops, International Fuel Trade Agreement Workshops, Classroom Sessions, Conferences, Speakers Bureaus, and Stakeholder Relations

Web-based—Webinars, Industry Specific Webpages, Videos and Public Service Announcements

Email, Mail, and Telephone—EBlasts, Special Notices, Educational Publications, Newsletters, Written Tax Advice, Telephone Inquiries, Telephone Townhalls, and Proactive Outreach Manager

Other—Social Media and Translations

Source: 2016-17 Education and Outreach Plan, January 2017

BOE's goal is to increase voluntary compliance with the tax and fee programs it administers by maximizing the effectiveness of outreach within its districts in the most efficient and cost-effective manner. Various programs within BOE have responsibilities for organizing and facilitating a variety of outreach activities and events using methods ranging from in-person programs to web-based services and social media, as noted in the text box. External Affairs coordinates numerous aspects of the education and outreach program such as media inquiries, press releases, responding to taxpayer inquiries, and managing the design, printing, and mailing of publications and notices. External Affairs' Outreach Services Division (Outreach Services)[9] is responsible for developing BOE's annual outreach plan and for planning and executing conferences and other events.

At a district level, BOE utilized community/district liaisons (liaisons) within Field Operations to assist with planning and executing education and outreach activities. According to BOE's outreach plan, the liaisons, in coordination with Outreach Services, develops the annual regional outreach plans for each district. The regional outreach plans include the events and activities each district plans to conduct to increase taxpayer awareness and educate individuals on the tax and fee programs BOE administers.

[8] Revenue and Taxation Code, section 7085, requires BOE to perform an annual systematic identification of recurrent taxpayer noncompliance areas.

[9] The Outreach Services Deputy Director position has been vacant since April 2016.

CHAPTER 1

Evaluation of Resource Utilization, Outreach Activities, and Sales and Use Tax Reporting

BOE's operational culture impacts its ability to report accurate and reliable information to decision makers including the Legislature, Finance, the Board, and BOE executive management. Specifically, BOE's operating environment limited our ability to comprehensively evaluate its sales and use tax resource utilization, outreach activities, and sales and use tax reporting.

During our evaluation, we interviewed over 70 employees at BOE's Sacramento headquarters, 8 field offices, and a "non-public" office located in El Segundo, California. We also attended two BOE outreach events including the *Connecting Women to Power Conference* in District 4 and a *Small Business Resource Seminar* in District 3. Further, between January 20, 2017 and January 30, 2017, we met with all five board members individually to provide a summary of our evaluation and obtain their perspective.

As described in the Background section, the Board, acting as a whole, establishes BOE's overarching policies. BOE's Executive Director and executive team are responsible for executing the established policies and directing BOE's daily operations. Board members have dedicated staff and operating budgets to implement their individual board member duties; however, these duties do not include directing the daily operations of BOE.

During interviews, individuals responsible for specific functions within BOE were unable to provide complete and accurate documentation or answer basic questions regarding operations related to our evaluation objectives. Additionally, various levels of management were not aware of and could not speak to certain activities conducted within the districts for which they held oversight responsibilities. Several individuals stated that board members, acting individually, intervene in the daily operations within their respective districts. These individuals also reported a fear of retaliation if staff did not respond or follow the directions of the individual board members. Examples include being informed of potential office relocations or told "one more vote and you're gone" meaning their job appointment could be dismissed by a vote of three board members.

The practice of individual board members intervening in the daily BOE operating activities creates inconsistencies in operations, breakdowns in centralized processes, and in certain instances result in activities contrary to state law and budgetary and legislative directives. Specific examples include, but are not limited to:

> *Culver City Call Center*—District 3's board member was involved in the Culver City call center's (call center) development, including a request to expedite the hiring process and providing direction on the job classifications for some of these positions. The call center was created by hiring over 10 staff into temporary positions and utilizing space in the Culver City field office. Further, Board meeting minutes do not indicate that the call center had been presented, discussed, or approved by the Board during a public meeting.

Establishment of El Segundo Office—BOE established and currently maintains two adjacent offices in El Segundo, California. One suite houses the District 3 board member's office and the adjacent suite houses ten staff from Field Operations and External Affairs. According to BOE's Physical Office Space Report,[1] the El Segundo suite that houses the ten staff is identified as a "non-public" field office. When asked about the El Segundo location, BOE's executive management stated the second suite was initially established to accommodate District 3's Assistant Chief of Field Operations due to a shortage of space within the Culver City field office. However, executive management could not explain why the El Segundo location has been in operation since 2014 and houses ten BOE staff.

Community/District Liaisons—BOE's established community liaisons are inconsistent among the four districts. District 3 uses the Business Taxes Specialist job classification, referred to as District Liaisons. According to the duty statement, liaisons serve as the "Board Member District Liaison" representative and will, among other duties, "advise the Board Member" on complex and difficult audit and compliance issues. Further, the Business Taxes Specialist classification is considered a revenue-generating position. In contrast, all other districts use the Information Officer job classification, referenced as Community Liaisons, and outline their duties as primarily creating and overseeing an outreach and education plan and providing public relations "advice to Field Operations". The Information Officer classification is a non-revenue generating position.
When asked about the inconsistencies, executive management stated that the establishment of community liaisons was at the discretion of districts and individual board members.

San Diego Field Office—District 4 board member staff are currently located in the San Diego field office among the audit and compliance staff. When asked about the seating arrangement, the Executive Director and San Diego field office District Administrator could not provide a clear explanation why board member staff were located in the field office.

Rotational Program—District 3 created a "rotational program" for revenue generating Tax Technicians to work in the District 3 board member's office for up to 1 year to gain broader organizational experience. However, according to BOE's Human Resources Division, this program is only offered at this board member's office.

Outreach Activities—External Affairs indicated that board member offices and community/district liaisons have not consistently communicated with External Affairs regarding the planning and execution of outreach activities conducted within the individual districts. Further, board member driven outreach activities and costs have significantly increased. Additionally, these activities have a limited nexus with BOE's administered tax programs.

STAFF RESOURCE UTILIZATION

BOE's personnel and accounting records do not accurately depict its operational activities. BOE does not have a centralized process for monitoring and recording redirections of revenue generating staff, including sales and use tax audit and compliance personnel. The redirections affect BOE's ability to comply with Provision 1 of the Budget Act and appropriately reflect revenue and cost impacts in its accounting records and supplemental annual reports.

[1] Report on Physical Office Space, as Required by the Supplemental Report of the 2016-17 Budget Act (Item 0860-001-0001, Provision 1), dated February 1, 2017.

Despite having dedicated staff and operating budgets of $1.5 million, some board members routinely supplement their staff by redirecting revenue generating staff to perform non-revenue generating board member activities, including outreach activities. BOE does not have documented policies and procedures governing staff redirections or a centralized process to monitor and record these redirections. Neither BOE's Human Resources Division nor executive management could provide a comprehensive list detailing the nature, frequency, duration, or cost impacts of redirected staff.

In response to this evaluation, BOE provided organizational charts and compiled a list of staff that were redirected or functionally reporting to the board member offices between July 2013 and November 2016. To compile the list, BOE relied on verbal communications from board member offices. As shown in Table 1, BOE reported 47 staff were intermittently redirected to perform board member activities.

Table 1: Redirected Staff for Board Member Activities Between July 2013 and November 2016

	Redirected Positions			
	6 Months or Less	Over 6 Months	Over 1 Year	Total
District 1	2	2	2	6
District 2 *	9	0	2	11
District 3 **	3	3	15	21
District 4 *	1	5	3	9
Total	**15**	**10**	**22**	**47**

* During this time period, a change in the board member occurred.
** Three staff were identified as being part of the District 3 rotational program.

Source: BOE Human Resources Division

Based on interviews with board members, a few of the redirections were to temporarily fill board member office vacancies. However, a majority of the redirections were for extended periods of time. For example, 22 staff (47 percent) were redirected for more than 1 year with 7 staff redirected for over 2 years. In one instance, an individual has been redirected for over 4 years and continues to work in the District 3 board member's office. Further, District 3 created a "rotational program" for revenue generating Tax Technicians to work in the District 3 board member's office for up to 1 year to gain broader organizational experience.

However, the list of 47 staff compiled by BOE did not include information pertaining to staff redirected to perform non-revenue generating activities on a shorter term (i.e., daily) basis. For example, on November 3, 2016, Finance attended the *Connecting Women to Power Conference* in Escondido, California, where 113 field office staff in District 4 were redirected to work at the event, as shown in Table 2 on the following page. The majority of redirected staff (98 staff) were sales and use tax audit and compliance personnel with monthly salaries ranging between $2,384 and $8,450. The redirected staff performed duties including, but not limited to, registration, parking lot duty, and break area facilitation. The redirection was made at the request of District 4 board member's staff. The 98 staff were not included in the compiled list of redirected staff. When asked about the event during an interview on January 6, 2017, BOE's Executive Director and Deputy Director stated they had recently been informed of the staff redirections and were unaware if it was a common practice among all district offices. BOE board members sponsor approximately ten similar large outreach events annually.

Table 2: Connecting Women to Power Conference, November 3, 2016

District 4 Redirected Staff	Number of Staff	Monthly Salary Range	Tasks Assigned During 8-hour Conference
Associate Tax Auditor	25	$4,829-6,350	Parking lot duty, registration, break area facilitation, and other.
Business Taxes Representative	19	3,247-5,029	
Tax Auditor	17	3,247-5,280	
Business Taxes Compliance Specialist	13	4,829-6,048	
Business Taxes Specialist I	8	5,571-6,973	
Business Taxes Administrator I	7	5,307-6,973	
Tax Technician I	6	2,384-3,203	
Tax Technician III	6	3,085-3,864	
Supervising Tax Auditor II	3	5,826-7,660	
Tax Technician II	3	2,758-3,455	
Staff Information Systems Analyst	2	5,295-6,963	
Business Taxes Specialist II	1	5,826-7,660	
Graphic Designer III	1	4,565-5,716	
Office Technician	1	2,758-3,455	
Supervising Tax Auditor III	1	6,428-8,450	
Total	**113**		

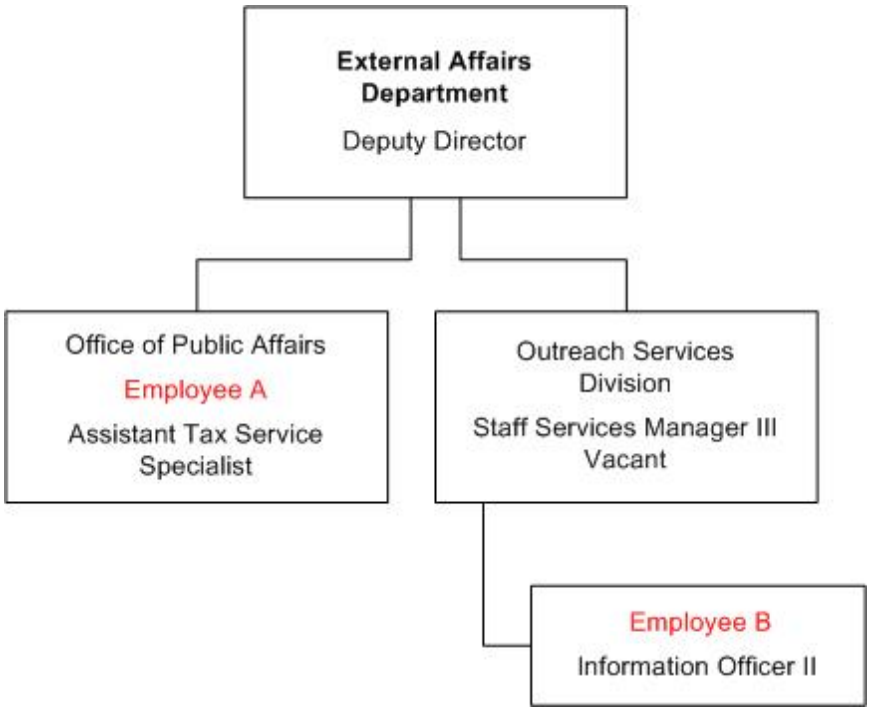
Source: BOE Field Operations Department, San Diego Field Office and 2017-18 Budget Salaries and Wages Supplement

Further, the official organizational charts provided by BOE do not reflect its current operations. Specifically, the long-term redirected staff noted in Table 1 were not accurately reflected in the organizational charts. For example:

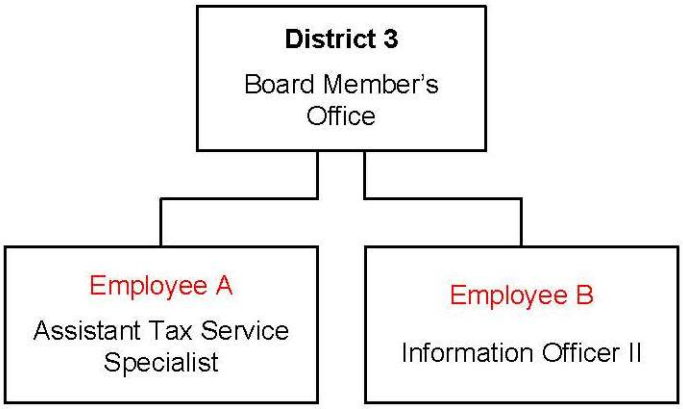
> **Employee A**—BOE's official organizational chart depicts Employee A in External Affairs, Office of Public Affairs, directly reporting to the Deputy Director of External Affairs (External Affairs Deputy). During a Finance on-site interview in October 2016, Employee A stated that although his office was physically located in the District 3 board member's office in El Segundo, he directly reported to the External Affairs Deputy in the Sacramento headquarters office. However, after further inquiry, Employee A confirmed that he had never met nor communicated with the External Affairs Deputy, his supervisor for four months. In November 2016, the External Affairs Deputy and BOE Human Resources Division confirmed Employee A had been redirected to the District 3 board member's office for over four years. Employee A is included in Table 1 above.
>
> **Employee B**—BOE's official organizational chart depicts Employee B in External Affairs, Outreach Services Division, directly reporting to the External Affairs Deputy. During a Finance on-site interview in October 2016, Employee B stated that she reported to the External Affairs Deputy in the Sacramento headquarters office. However, after further inquiry and a subsequent field visit to the El Segundo non-public field office in November 2016, Employee B confirmed that she spent part of her time answering phones at the District 3 board member's office and was scheduled to work on organizing the Volunteer Income Tax Assistance (VITA) efforts. Although Employee B is included as a redirected staff in Table 1, BOE incorrectly reported her redirection as March 2014 through July 2015. However, as noted above, Employee B was still redirected as of November 2016.

The following organizational charts detail the Employee A and B descriptions described above.

BOE's Official Organizational Chart*



BOE's Functional Organizational Chart*



*Source: Interviews with BOE staff and BOE's official organizational chart

Additionally, the organizational charts do not include all BOE field office locations. Specifically, during on-site interviews, Finance identified an office adjacent to the District 3 board member's office in El Segundo, California that was not displayed in any official organizational charts. This office has been operational since 2014 and houses ten Field Operations and External Affairs staff. Executive management could not explain why this office was in operation and not reflected in the organizational charts.

The staff redirections, which include revenue generating classifications, violates Provision 1 of the Budget Act. The provision prohibits BOE from redirecting personnel resources away from direct audit and collection activities without prior approval from Finance and notification to the Joint Legislative Budget Committee. Specifically, 12 of the reported 47 staff (26 percent) in Table 1 and 98 of the 113 staff (87 percent) in Table 2 are classified as revenue generating positions. BOE did not receive prior approval from Finance nor did it notify the Joint Legislative Budget Committee of the redirections.

Provision 1 of the Budget Act

It is the intent of the Legislature that all funds appropriated to BOE for processing tax returns, auditing, and collecting owed tax amounts shall be used in a manner consistent with BOE's authorized budget and with the documents that were presented to the Legislature for its review in support of that budget.

BOE shall not reduce expenditures or redirect funding or personnel resources away from direct auditing and collection activities without prior approval of the Director of Finance. The director shall not approve any such reduction or redirection sooner than 30 days after providing notification to the Joint Legislative Budget Committee.

Such a position shall not be transferred from the organizational unit to which it was assigned in the specific Governor's Budget and the Salaries and Wages Supplement, as revised by legislative actions, without the approval of the Director of Finance. Furthermore, BOE shall expeditiously fill budgeted positions consistent with the funding provided in this act.

Source: 1999-00 to 2016-17 Budget Acts

Moreover, the magnitude of the costs and lost revenue of the redirected staff are unknown. BOE does not track or adjust the hours or cost information for the redirected staff in its accounting records or the supplemental annual reports. Additionally, BOE does not calculate the lost revenue incurred as a result of the redirections. Specifically, according to BOE's Budget Branch, the hours/cost for the redirected staff are charged to the originating unit despite BOE's established timekeeping polices requiring employees to appropriately account for redirected hours.[2] The impacts on the accounting records and supplemental annual report for the identified redirections include:

- *Personnel Costs*—Staff costs and hours for the 12 and 98 redirected revenue generating staff in Tables 1 and 2, respectively, were captured in the originating unit; therefore the reported cost benefit ratios in the supplemental annual report are inaccurate. Further, the supplemental annual report does not reflect the lost revenue.

- *Board Member Costs*—The majority of redirected staff was for board member office activities. Because these redirected staff costs are captured in the originating unit, the reported personnel costs for the board member's office is understated.

- *Outreach Costs*—BOE conducts approximately ten large events annually similar to the *Connecting Women to Power Conference*. Because BOE does not require staff to track their time by outreach event, it is unable to determine the total staff hours for these events. As a result, the actual costs associated with these events is understated.

[2] The BOE-666 Time Reporting Manual provides guidance on timekeeping for loaned staff.

OUTREACH ACTIVITIES

As described in the Background section, External Affairs coordinates numerous aspects of the education and outreach program. The general policy is for board member offices to request certain outreach services through External Affairs. However, this policy is not consistently followed. Instead, operational administration of these activities have shifted to board member offices and staff in Field Operations. BOE's outreach activities that have a limited nexus with BOE's administered tax programs have increased in recent years. These activities concentrate on board member driven events. Additionally, BOE has not implemented budgets and cost tracking measures for these outreach activities, and has hired staff for these activities using practices that bypass the budgetary and legislative processes.

As a result, our evaluation focused on specific outreach activities that are generally driven by board member offices.

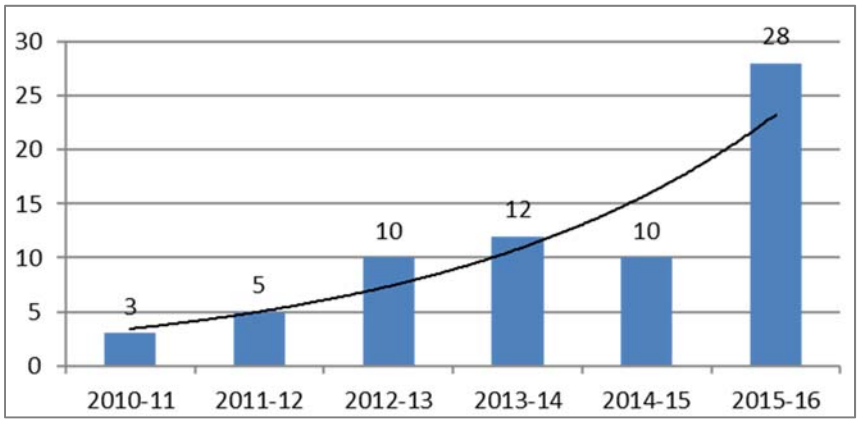
Volunteer Income Tax Assistance

VITA is sponsored by the Internal Revenue Service (IRS) and offers free income tax assistance to individuals and families. Specifically, the program provides IRS-certified volunteers to assist in the preparation of federal and state income tax returns for individuals who generally make $54,000 or less, persons with disabilities, and limited English speaking taxpayers. Although VITA is a volunteer based program, BOE has allowed staff to use state time for training, volunteering, and promoting VITA events; and utilized state funds for associated expenses.

When asked how an income tax program supported BOE's administered tax programs, executive management and the District 3 board member's office stated VITA provided many benefits for BOE such as collecting use tax. Specifically, the District 3 board member claimed BOE's 2016 VITA efforts generated an estimated total use tax revenue of $156,000. However, according to BOE's 2015-16 outreach costs, it spent $124,000 in printing and postage alone for District 3 VITA events.

Further, as shown in Figure 5, between 2010-11 and 2015-16, BOE increased its participation in VITA events from 3 to 28, or over 800 percent. The largest increase occurred between 2014-15 and 2015-16, due to District 3's and District 4's increased participation in VITA.

Figure 5: Number of VITA Events



Source: BOE Annual Reports, Archive of BOE's In-Person Seminars, and BOE's Outreach Services Division

Additionally, between January 2017 and April 2017, District 3 board member's office offers daily VITA services during state business hours at four of the five field offices, as noted in the text box. Records indicate this service has been offered for over the last three tax seasons. However, these events are not included in Figure 5 nor documented in BOE's annual outreach plans.

In contrast, FTB, whose primary mission is to administer personal and corporate income taxes, has a policy that strictly limits staff's VITA participation to a voluntary basis. Although FTB encourages employees to participate in the VITA program, it does not provide state time or resources for its staffs' VITA volunteer activities.

Sample of Daily Field Office VITA Events

Monday, February 6, 2017
Free Income Tax Preparation

Free volunteer tax-filing assistance to help low and moderate-income individuals and families qualify for up to $6,269 in Federal Earned Income Tax Credit (EITC) and up to $2,706 in new State Earned Income Tax Credit (EITC). Volunteer income tax preparation assistance is provided by certified tax preparers.

BOE West Covina District Office
1521 West Cameron Avenue, Suite 300, West Covina, CA 91790

9 a.m. to 4 p.m. (closed noon to 1 p.m.)
Register online or by calling 1-626-480-7200

Tuesday, February 7, 2017
Free Income Tax Preparation

Free volunteer tax-filing assistance to help low and moderate-income individuals and families qualify for up to $6,269 in Federal Earned Income Tax Credit (EITC) and up to $2,706 in new State Earned Income Tax Credit (EITC). Volunteer income tax preparation assistance is provided by certified tax preparers.

BOE Culver City District Office
5901 Green Valley Circle, Suite 200, Culver City, CA 90230

9 a.m. to 4 p.m. (closed noon to 1 p.m.)
Register online or by calling 1-310-342-1000

Source: District 3's board member website

Conferences and Seminars

BOE sponsors conferences and seminars that have a limited nexus with BOE's administered tax programs, including *Connecting Women to Power Conference, Health Wealth Wellness Conference and Resource Fair, Senior and Professional Affordable Housing Symposium,* and various business and nonprofit seminars.

Several of the topics covered at these conferences and seminars are not directly related to BOE administered tax programs. For example, the agenda for the November 3, 2016 full-day *Connecting Women to Power Conference* in Escondido, California, contained a total of 23 breakout sessions. Of the 23 breakout sessions, only 2 were directly related to business tax topics. The remaining time was focused on general business practices, resources, and other topics such as *Desk Yoga, Think Like a Negotiator,* and *No Limit Leadership.*

Additionally, on January 20, 2017, District 3 sponsored the full-day C*alifornia Business International and Domestic Trade Conference*, in Bel Air, California. The conference agenda included opening remarks, key note speakers, and nine breakout sessions. Of the nine breakout sessions, only one session focused on various tax topics. This session was approximately one hour and encompassed information about state and federal tax credits and free government services, as well as tax pitfalls. The session was presented by BOE, IRS, FTB, and Employment Development Department staff. The remaining conference time focused on general business practices, such *as Finding Reputable International Buyers, Getting Paid: Trade Finance and Insurance,* and *Port and Airport Resources—The Ideal Platform for Exports.*

Further, BOE sponsors a variety of business and nonprofit seminars. For example, on October 12, 2016, Finance attended the half-day *Business Resources Seminar and Expo*, in El Monte, California. The seminar agenda included eight topics, of which two were BOE tax subjects. The remaining topics included several subjects not related to BOE's administered tax programs, including *Be Prepared for Your Success* and *Forms of Ownership.*

Sponsorship of these conferences and seminars include printing, venue, postage, and miscellaneous costs such as newspaper advertisements and furnishings. For example, the two 2015-16 *Connecting Women to Power Conference* costs approximated $189,000; this amount does not include costs of staff time for planning, organizing and participating in the event. When asked why BOE sponsors events that have a limited nexus with BOE's administered tax programs, BOE executive management and some board members stated that BOE was required to provide education and outreach in accordance with the Taxpayers' Bill of Rights.

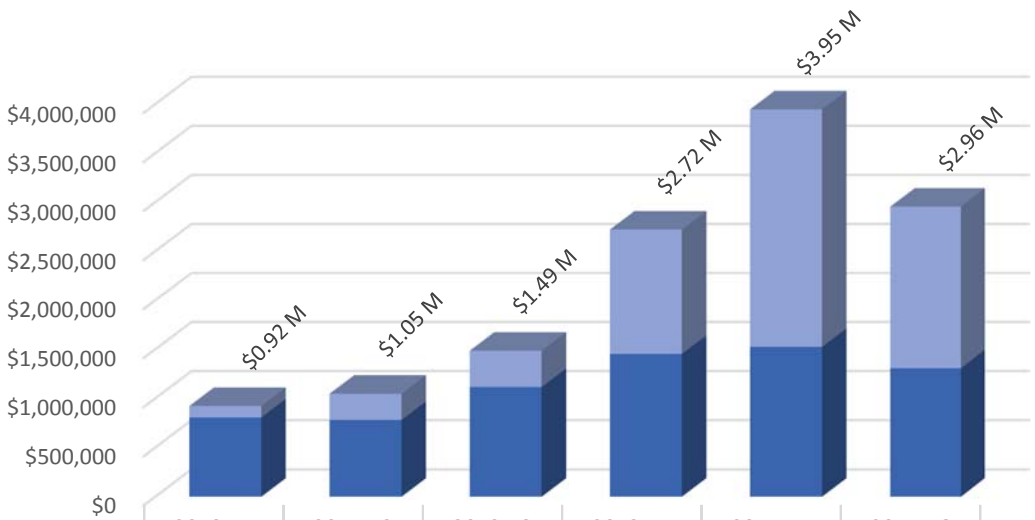
However, other entities have responsibility and funding to provide these types of resources to businesses. For example, Go-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on the issues of business development, private sector investment, economic growth, and export promotion. This program works with local, state, and federal partners to attract, retain, and grow businesses.

Moreover, the Taxpayers' Bill of Rights states that BOE shall participate in small business seminars and similar programs "organized by federal, state, and local agencies". It does not specifically require BOE to sponsor such events. Accordingly, BOE's Speakers Bureau program participates in these events by providing subject matter experts. For example, BOE's 2016-17 Statewide Education and Outreach Plan identified events where BOE subject matter experts would participate, such as the *California Small Business Day*, sponsored by the California Small Business Association, and the *California Public Utilities Commission Small Business Expo*.

Budgets and Costs for Outreach Activities

BOE has not established budgets or cost accounting measures to track the full extent or cost of board member driven outreach activities. In response to our evaluation, External Affairs provided a summary of activities and estimated costs. The information represents costs incurred by External Affairs, which includes Outreach Services. As shown in Figure 6 on the following page, costs for board member driven outreach activities increased over the past six fiscal years. Between 2010-11 and 2015-16, labor and operating costs increased by over $2 million ($2.96 million - $.92 million).

Figure 6: Board Member Directed Outreach Services Costs
Fiscal Years 2010-11 through 2015-16



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Operating	$116,400	$267,480	$370,121	$1,268,857	$2,422,324	$1,647,864
Personal	$806,417	$780,104	$1,116,193	$1,452,524	$1,524,782	$1,307,326

Source: BOE's response to fiscal year 2014-15 Joint Hearing with Budget Subcommittee #4 and Outreach Services costs

Although Figure 6 indicates an increase in outreach costs, the data is inaccurate and understated because not all costs are included. For example, in 2014-15, BOE provided a summary of outreach costs to the Legislature's budget subcommittee. The documentation provided to the Legislature indicated a total of $1.8 million for 2013-14. However, according to the information provided in Figure 6, outreach costs totaled $2.7 million for the same period.

In addition, the cost data is not all inclusive as demonstrated by the following examples:

- *VITA Costs*—BOE does not track all costs incurred for VITA activities, including state time used for training, volunteering, and promoting the program.

- *Redirected* Staff—As noted in the Resource Utilization section, 113 staff were redirected to assist at the November 2016 *Connecting Women to Power Conference*. The salary costs for redirected staff for these types of events are not captured in the cost data above.

Moreover, in addition to the External Affairs staff, BOE has a total of 28 positions within Field Operations where the majority of their duties include outreach and education activities, as shown in Table 3 on the following page. The majority of the positions are classified as Information Officers or Business Taxes Specialists, which BOE refers to as Community or District Liaisons (liaison). However, the costs associated with these Field Operations staff are not captured in Figure 6. Using the mid-range annual salary costs for these 28 positions, the estimated annual cost is $1.9 million. As a result, the total outreach costs for 2015-16 in Figure 6 above would increase from $2.96 million to over $4.86 million.

Table 3: Field Operations Staff Dedicated to Outreach Activities

	Number of Staff	Monthly Salary Range
DISTRICT 1		
Information Officer II	1	$5,553-6,901
Information Officer I	7	4,600-5,758
Business Taxes Specialist I	1	5,571-6,973
DISTRICT 2		
Information Officer II	2	5,553-6,901
Information Officer I	2	4,600-5,758
Business Taxes Specialist II	1	5,826-7,660
DISTRICT 3		
Information Officer I	1	4,600-5,758
Business Taxes Administrator II	1	6,110-7,984
Business Taxes Specialist I	5	5,571-6,973
DISTRICT 4		
Information Officer II	1	5,553-6,901
Information Officer I	5	4,600-5,758
Tax Technician I	1	2,384-3,203
Total	**28**	

Source: BOE's Organization Charts and 2017-18 Budget Salaries and Wages Supplement

During the December 2016 Board meeting, the Executive Director referenced BOE's legal department's memorandum which specifically stated "clear guidelines for implementing the VITA program throughout the equalization districts have not been developed, budgetary limits have not been set, and the recommended annual evaluations of the program's effectiveness and viability have not taken place."

On January, 13, 2017, External Affairs proposed several improvements to BOE's Statewide Education and Outreach Plan, including establishing budgets and parameters for board member driven outreach activities.

Blanket Positions

BOE hired staff for board member driven outreach activities using practices that bypass the budgetary and legislative process. Specifically, during the budgetary process in 2012, BOE requested and was approved for multiple outreach positions. However, during this same time period, BOE hired additional staff to assist with outreach activities using temporary funding, called the temporary help blanket (blanket). These staff remained in blanket positions for extended periods of time while they worked on board member driven outreach activities.

There are several statewide policies related to establishing and adjusting a department's authorized positions. In general, adjustments to permanent authorized positions are required to be approved through the normal budgetary and legislative process. This process includes requesting position adjustments through a Budget Change Proposal (BCP).[3] However, certain administrative tools are available to provide state departments flexibility in managing staffing resources and workload issues. These tools include blanket positions.

[3] A BCP is a proposal to change the level of service or funding sources for activities the Legislature authorized, or to propose new program activities not currently authorized.

As noted in the text box, budgetary requirements restrict the use of blanket positions for temporary, seasonal, or intermittent uses and further requires an employee to be moved into an authorized position as soon as a vacancy becomes available. Further, these tools are intended to quickly allow departments to respond to changes in workload and operational needs outside of the normal budgetary and legislative process. BOE has not complied with these requirements.

BOE submitted two 2012-13 BCPs[4] and was approved to hire 9.5 outreach positions in External Affairs. Four of these positions were to expand the outreach effort for Assembly Bill 155 (AB155).[5] Concurrently, BOE hired additional outreach staff through the blanket bypassing the BCP process.

Blanket Positions

The blanket is a budgetary tool that provides staffing flexibility to meet operational needs and allows departments to hire above the Total Authorized Positions "cap".

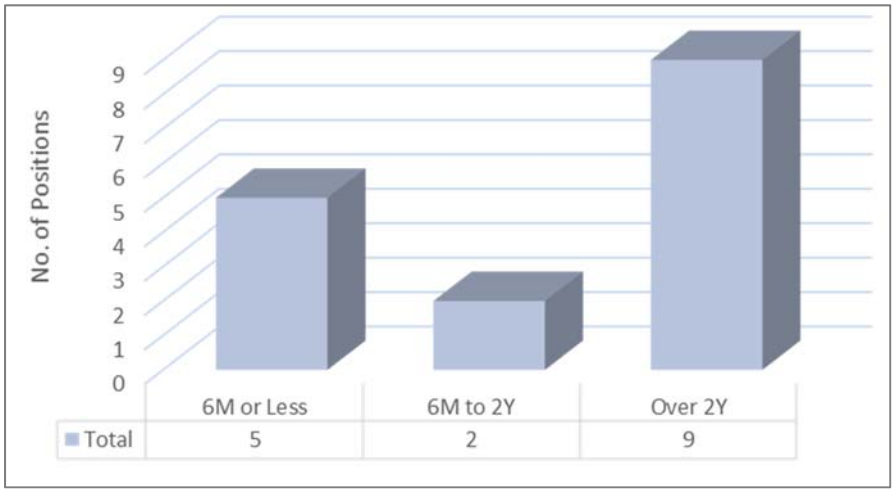
The blanket provides an approved budget that **may be spent for short-term or intermittent uses**; such as:

- Position overlaps
- Special consultant studies
- Student assistants
- Special projects or contracts of a limited nature
- Seasonal workload
- Overtime peak workloads

Source: State Administrative Manual (SAM) section 6518 and Budget Letter 16-30, *Position Control*, October 7, 2016

As of November 2016, BOE had 16 permanent fulltime staff residing in blanket positions. Of the 16 staff, 9 staff (56 percent) have been in blanket positions for over a two year period, as shown in Figure 7.

Figure 7: Permanent Staff in Blanket Positions as of November 2016



Source: BOE's Human Resources Department

Of the 16 staff in blanket positions, 8 staff were hired to work on outreach activities in both Field Operations and External Affairs. Two of these staff were hired into blanket positions in July 2016 and September 2016, which was during the time when BOE was reducing the number of permanent employees in the blanket. Specific examples include:

[4] 2012-13 BCP Number 5, *AB155: Use Tax Nexus*, dated January 4, 2012; 2012-13 BCP Number 2, *Tax Gap II*, dated January 4, 2012.

[5] AB155 enables California to impose a use tax collection obligation on out-of-state retailers without nexus in California, among other things.

Employee A[6]—In May 2012, during the time BOE requested positions through the BCP process, Employee A was hired into a blanket position to work in External Affairs. He was immediately redirected to the District 3s board member's office, where he remains in a blanket position. Employee A continues to work in the board member's office.

Employee C—In December 2014, Employee C was transferred into a blanket position to work in External Affairs, specifically to oversee District 3's AB155 outreach activities. However, Employee C was never reclassified into an authorized AB155 position. Further, in October 2015, Employee C was promoted into another blanket position. His new duty statement designated him as the "CalVITA Service Coordinator" to manage VITA events. However, BOE has never requested nor has BOE been approved for any VITA outreach positions.

BOE has over 600 vacant positions; however, BOE executive management could not explain why it bypassed the budgetary and legislative processes to hire additional outreach staff and why these staff continue to reside in blanket positions.

SALES AND USE TAX REPORTING

BOE's sales and use tax information reported in its supplemental annual report does not comply with Budget Act reporting requirements as described in Appendix A and highlighted in the text box. The report is used by the Legislature as a tool to assess the effectiveness of BOE's existing sales and use tax audit and compliance efforts, and as a means to measure whether the level and design of BOE's current efforts are appropriate.

As shown in the text box under "item d", the supplemental annual report requires BOE to report *data regarding revenue and cost impacts associated with changes in resources devoted to audit and compliance activities*. However, as described within the Staff Resource Utilization section, BOE is not monitoring or recording the redirection of revenue generating staff, and redirected staff's costs are charged against the originating units, including audits and collections. Therefore, the personnel costs included in the supplemental annual reports are incorrect and skew the cost benefit ratios reported.

Supplemental Annual Report Requirements

BOE shall provide to the Chairs of the Joint Legislative Budget Committee and chairs of the fiscal committees of the Legislature by December 1 of each year, beginning December 1, 2002, a report containing the following information:

a) Description of the methodological approach used to conduct its audit and compliance activities, including the work plan relating to these activities

b) The number of hours and costs associated with direct audit and compliance activities, as well as supporting (overhead) activities

c) The revenues associated with its audit and compliance activities

d) <u>Data regarding the revenue and cost impacts associated with any increase or decrease in resources devoted to audit and compliance activities</u>

Items (b), (c), and (d) should include prior-year actual data, current-year estimated data, and budget-year projected data. This information shall also be provided to the Department of Finance, in a format it specifies, with submission of documents used to prepare the Governor's budget as well as when BOE makes a request to alter funding or personnel services for audit or compliance activities. Such information shall also be provided as a part of any budget change proposal submitted to the Legislature regarding resources for auditing or compliance activities.

Subsequently, in 2006, 2010, and 2011, additional reporting requirements were imposed requiring among other items, BOE to report on audit selection methodologies, cost benefit analysis, and Statewide Compliance and Outreach Program performance.

Source: 2002-03 Budget Act Supplement Report

[6] Employee A is the same Employee A previously reported on page 18.

In addition, BOE's supplemental annual report's process contains many manual procedures that use standalone spreadsheets which are prone to errors. Further, there is an absence of standardized, written policies and procedures to ensure the accuracy and consistency of the information reported. The following conditions, both individually and collectively, affect the accuracy and clarity of the supplemental annual report:

- *Errors within the supplemental annual report are not identified and corrected prior to submittal*. For the 2014-15 report, total Audit Program staff hours were overstated by 86 percent due to a formula error within a spreadsheet used to create the supplemental annual report.

- *Significant fluctuations and changes in methodology from prior year reports are not clearly communicated.* For example, the methodology to calculate personnel years (PY) for the Compliance Enforcement program was updated in the supplemental annual report for 2014-15 in an effort to provide a more accurate representation. The change in methodology resulted in reported Compliance Enforcement total PY's to decrease by 19 percent from the prior fiscal year. Additionally, the total reported direct and indirect costs, which are calculated based on the amount of PYs, decreased by 16 percent. However, the report did not include context to clarify that the reason for the decrease was mainly due to a change in the calculation process and not programmatic factors.

- *Methodologies, assumptions, and procedures used to compile the supplemental annual report are not documented and in some instances were unknown.* Staff could not explain differences with certain Excel formulas used to calculate direct and indirect costs for the programs within the supplemental annual report. Finance asked staff to clarify the rationale on why certain cost units and categories were being included and excluded between the different programs. However, the staff could not explain the differences between the formula calculations and stated they utilize the formulas that were developed when the report was first required.

- *Limitations with BOE's data system, Integrated Revenue Information System (IRIS), require manual workarounds and manipulation of data to obtain necessary information for the Supplemental Annual Report*. For example, BOE cannot generate monthly reports of billing adjustments that reduce the amount of total revenue reported for the Consumer Use Tax program using IRIS alone. Instead, each month staff must derive the information by manually accessing individual accounts within IRIS and manually aggregating the information into the detail and format needed for the supplemental annual report.

Similar to BOE, FTB is required to submit a supplemental annual report on its audit and compliance activities. For reference, some of the components used by FTB to address its supplemental annual report requirements are included in Appendix B.

Although BOE submits its supplemental annual reports timely, when performance reports contain errors, the reports' usefulness as a tool for decision makers is diminished. Additionally, without clearly communicating significant fluctuations or methodology changes, the reports may not allow readers to fully assess the effectiveness of BOE's audit and compliance efforts.

Chapter 2

Proposed Retail Sales Tax Fund Allocation Adjustment and Corrective Action Plan

Proposed Allocation Adjustment to Retail Sales Tax Fund

As noted in the Background section, Finance's evaluation includes BOE's CAP related to the 2015 SCO Review. The SCO's Review identified numerous internal control weaknesses, and multiyear misallocations and reporting errors of sales and use tax to the various funds including the State Local Revenue Fund, 2011 Local Revenue Fund, Local Public Safety Fund, Fiscal Recovery Fund, State General Fund, and local, county, and special taxing jurisdictions. A fundamental component of BOE's CAP is the computation of an adjustment to correctly allocate the sales and use tax revenue for 2011-12 through 2015-16.

In July 2016, BOE provided Finance the proposed allocation adjustment, which consisted of a summary spreadsheet and numerous supporting schedules. However, the adjustment provided did not include a comprehensive explanation of the methodologies and assumptions used to calculate the adjustment or management's review process. Additionally, the summary spreadsheet and supporting schedules contained various errors, omissions, and data inconsistencies. In response to inquiries by Finance, BOE revised its proposed allocation adjustment. Specifically, between July 2016 and February 2017, BOE revised its adjustment 11 times for the errors and omissions enumerated in Table 4.

Table 4: Proposed Adjustment–Errors and Omissions

Version	Quarters (Q)	Date Provided	Examples of Errors and Omissions
1	3Q 2011 - 2Q 2015	July 14, 2016	Omits $102 million in journal entries and $30 million in adjustments to the Fiscal Recovery and Local Funds.
2	3Q 2011 - 2Q 2016	November 18, 2016	Omits $51.8 million in corrections related to additional sales tax on diesel fuel.
3	3Q 2011 - 2Q 2016	December 8, 2016	Error of $1.1 billion due to change in rounding of percentage factors. In addition, two day cut-off correction adds $95 million in remittances. Errors from Version 1 are corrected.
4	3Q 2011 - 2Q 2016	December 13, 2016	Formula error results in $360 million overstatement of revenue.
5	3Q 2011 - 2Q 2016	December 19, 2016	Corrects $51.8 million omission to corrections related to additional sales tax on diesel fuel.
6	3Q 2011 - 2Q 2016	December 22, 2016	Corrects $360 million overstatement of revenue.
7	3Q 2011 - 2Q 2016	December 27, 2016	Fiscal year and quarterly analysis schedules are not updated for prior corrections.
8	3Q 2011 - 2Q 2016	January 23, 2017	Omits previous corrections for the $102 million journal entries referred to in Version 1.
9	3Q 2011 - 2Q 2016	January 25, 2017	Increases the correction related to additional sales tax on diesel fuel from $376.7 million to $743.2 million due to a major change in assumptions.
10	3Q 2011 - 2Q 2016	February 17, 2017	Includes $743.2 million adjustment related to additional sales tax on diesel fuel on summary page despite a supporting schedule note stating the adjustment is no longer recommended. Formula error on summary page results in components of adjustment being greater than adjustment.
11a [1]	3Q 2011 - 3Q 2016	February 17, 2017	Adds an additional quarter to the analysis and contains same errors as noted in Version 10.
11b [1]	3Q 2011 - 3Q 2016	February 17, 2017	Includes significant change to presentation and methodology for calculating the proposed adjustment.

[1] *Version 11 includes two separate worksheet tabs summarizing the proposed adjustment using two different methodologies.*

BOE's collection and allocation of over $50 billion in annual revenues has relied on a financial infrastructure involving legacy information systems and multiple standalone databases and manual spreadsheets. Thus, the compilation of financial data, such as the allocation adjustment, requires manual workarounds and estimations that are at high risk of error and misstatement. Therefore, to assure the integrity of the allocation adjustment, it is critical for BOE to exercise due diligence in documenting its methodologies and assumptions used in the compilation including management's review of the adjustment.

In January 2017, in response to the multiple and significant revisions to the proposed allocation adjustment, Finance requested BOE to prepare a comprehensive explanation of all the methodologies and assumptions (both past and present) used to prepare the adjustment. Further, Finance required the final proposed adjustment to be vetted and approved by all responsible units and executive management, including the Executive Director.

On February 17, 2017, BOE submitted its revised allocation adjustments (both Versions 10 and 11), which also included additional information. However, BOE again submitted its proposed allocation adjustment without clearly documenting the significant changes in methodology and assumptions used. Instead, portions of the methodology were buried throughout various documents and spreadsheets. Further, BOE's review process was omitted and the allocation adjustments still reflected errors in the spreadsheets provided.

Since the proposed allocation adjustment continues to change, and BOE has not prepared a comprehensive explanation of its assumptions and methodologies, further review of the adjustment is imperative. The potential fiscal impact to the local agencies and the state continues to be unknown.

Corrective Action Plan

Finance's evaluation of BOE's CAP focused on Findings 1 through 6, which included the Retail Sales Tax Fund proposed allocation adjustment noted above and the inaccurate Retail Sales Tax Fund accounts receivable balance. In general, revenue allocation methodologies and accounting processes reported as implemented on BOE's CAP remain under development and in several instances were inconsistently documented. Further, the Retail Sales Tax Fund accounts receivable write-offs were unsupported and unreconciled.

In addition, full implementation is dependent on key actions remaining in process or planned, including: (1) the development of relevant and reliable information system reports, (2) a control agency approved calculation of misallocations and proposed adjustments, and (3) comprehensive and complete documentation of policies and procedures over the revenue allocation cycle. As a result, the CAP will be reviewed in conjunction with the final allocation adjustment review.

APPENDIX A

The Supplemental Reports of the Budget Act contains statements of legislative intent that are adopted during deliberations of budget packages. Below are requirements specified for BOE regarding its sales and use tax audit and compliance activities.

Board of Equalization's Supplemental Reports of the Budget Act Reporting Requirements
Supplemental Report of the 2002-03 Budget Act Requirements
BOE shall provide to the Chairs of the Joint Legislative Budget Committee (JLBC) and chairs of the fiscal committees of the Legislature by December 1 of each year, beginning December 1, 2002, a report containing the following information: a) Description of the methodological approach used to conduct its audit and compliance activities, including the work plan relating to these activities. b) The number of hours and costs associated with direct audit and compliance activities, as well as supporting (overhead) activities. c) The revenues associated with its audit and compliance activities. d) Data regarding the revenue and cost impacts associated with any increase or decrease in resources devoted to audit and compliance activities. Items (b), (c), and (d) should include prior-year actual data, current-year estimated data, and budget-year projected data. This information shall also be provided to the Department of Finance, in a format it specifies, with submission of documents used to prepare the Governor's budget as well as when BOE makes a request to alter funding or personnel services for audit or compliance activities. Such information shall also be provided as a part of any budget change proposal submitted to the Legislature regarding resources for auditing or compliance activities.
Supplemental Report of the 2006-07 Budget Act Requirements
BOE shall provide to the chairs of the JLBC and the fiscal committees of both houses of the Legislature a report on the outcomes of each of the following audit selection enhancement: • Utilizing new software called Clementine, which will enhance the department's audit selection capabilities by improving data sorting capabilities. • Putting U.S. Customs data into the audit selection database for local district use. • Extending the time allowed for audit selection, in order to facilitate more careful selections. • Sharing information with local districts on the deductions claimed by taxpayers on their returns. • Making greater use of data from the Franchise Tax Board's (FTB's) Integrated Nonfiler Compliance (INC) database to identify taxpayers who may be underreporting sales and use tax liabilities. • Utilizing North American Industry Classification System (NAICS) data to identify tax under reporters. The report shall, in addition to describing the above methods and the outcomes associated with them, also discuss the additional revenues generated and costs incurred through using these methods, and identify other audit selection improvements where additional resources would aid in closing the tax gap further. The report shall be provided annually as part of the department's existing supplemental report requirement regarding audit and collection activities.

Supplemental Report of the 2010-11 Budget Act Requirements
BOE shall provide to the chairs of the JLBC and the fiscal committees of both houses of the Legislature a report on the outcomes of each of the following audit selection enhancement: a) Description of the methodological approach used to conduct its audit and compliance activities, including the work plan relating to these activities. b) The number of hours and costs and costs associated with direct audit and compliance activities, as well as supporting overhead activities. c) The revenues associated with its audit and compliance activities. d) The average and marginal benefit/cost ratios of all its audit and compliance activities. e) Data regarding the revenue and cost impacts associated with any increase or decrease in resources devoted to audit and compliance activities. Increases in resources related to workload growth augmentations devoted to audit and compliance activities will be reported as a component of items (b) and (c). Increases in resources related to specific program enhancements of audit and compliance activities will be reported as a component of item (e). Items (b), (c), (d), and (e) should include prior-year actual data, current-year estimated data, and budget-year projected data. This information shall also be provided as part of any budget change proposal submitted to the Legislature regarding resources for auditing or compliance activities. Included in reporting related to items (b), (c), (d), and (e) should be specific data—directly comparable to that included in the applicable budget change proposal (BCP)—for new and expanded activities approved for 2010-11 concerning sales and use tax collection program enhancement, alcoholic beverage tax audit programs, participation in the High Intensity Financial Crimes Area task force, and the Southern California appeals and settlement unit, including a tally of the number of new positions authorized in that BCP that have been filled to date. In addition to the December 1, 2010 report described above, the board shall submit additional reports with data only for these four new and expanded activities on or before April 1, 2011 and on or before August 1, 2011.
Supplemental Report of the 2011-12 Budget Act Requirements
BOE shall report to the Legislature and the Department of Finance annually, not later than March 1 of each year, on the performance of the Statewide Compliance and Outreach Program (SCOP). The report shall include, but not be limited to, a schedule of authorized positions, vacant positions, expenditures, and revenues attributable to the program.

Source: Legislative Analyst's Office Supplemental Report of the Budget Acts for Fiscal Years 2002-03, 2006-07, 2010-11, and 2011-12

APPENDIX B

The following represents some of the components used by FTB to compile its supplemental annual report.

FTB Supplemental Report Practices	Purpose
Notes for significant one-time fluctuations or changes in methodology	Large one-time fluctuations or changes in reporting methodology are explained in footnotes to provide the readers additional context for significant changes.
Revenue from Budget Change Proposals (BCP) is shown in separate exhibits	This provides an additional tool for readers to assess the performance of changes made through BCPs.
Glossary of Terms	The glossary provides the reader a convenient source to look-up information that is not easily displayed in exhibits.
Discussion of current issues for each program	Provide a description of issues that may significantly impact programmatic functions and how the agency will address them.
A review of the Supplemental Annual Report by Chief Financial Officer prior to publication	Any fluctuations in year-to-year metrics can be noted in the report and management can address issues. The review process allows management to notice errors and to correct them prior to publication.

Source: Interviews with FTB staff and FTB's 2015-16 supplemental report

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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State Controller

DAVID J. GAU
Executive Director

March 24, 2017

Ms. Jennifer Whitaker, Chief
Department of Finance
Office of State Audits and Evaluations
915 L Street
Sacramento, CA 95814-3706

Evaluation
California State Board of Equalization Sales and Use Tax Reporting
Retail Sales Tax Fund Adjustment

Dear Ms. Whitaker,

The Board of Equalization is in receipt of your draft report—California State Board of Equalization (Board) Evaluation. Attached please find the Board's response to the draft report.

If you have any questions, please contact me at (916) 327-4975.

Sincerely,

Original signed by:

David J. Gau
Executive Director
Board of Equalization

DJG:ls
Attachment

cc: Mr. Justyn Howard, Department Of Finance
Ms. Kristin Shelton, Department Of Finance
Ms. Brenda Fleming
Ms. Amy Kelly

DRAFT REPORT
CALIFORNIA STATE BOARD OF EQUALIZATION EVALUATION

BOE's Response

March 24, 2017

The State Board of Equalization (BOE) is responding to the draft report titled "California State Board of Equalization Sales and Use Tax Reporting Retail Sales Tax Fund Adjustment" (the report). Based on the limited time we have had to review and respond to the report, our response is limited to the key points raised.

BOE strongly agrees with the report's observation that it "has a fiduciary responsibility to promote an operational environment that provides fair, effective, and efficient tax administration over the billions of dollars for which it is responsible." The report raises significant concerns, and BOE will use it to continue to effect cultural change and improve its practices.

Clarification Regarding Sales and Use Tax Allocation and Proposed Adjustment

The report states that BOE provided 11 different versions of its Sales and Use Tax (SUT) adjustment, each containing errors and omissions. To clarify, the Department of Finance (DOF) requested multiple changes to the information provided to add additional quarters of data, as they became available. BOE did not produce 11 versions of erroneous information. Throughout the review, DOF acknowledged the complexity inherent to the allocation of more than 35 programs in an obsolete computer system. BOE has exercised due diligence in documenting its methodologies and assumptions used in the computation, including management's review of the adjustment. Contrary to the report's assertion, BOE provided DOF complete, accurate, and comprehensive supporting documentation and explanation of the Sales and Use Tax allocation and proposed adjustment methodologies. We are able to confirm with confidence that Version 11, dated February 17, 2017, correctly reflects the adjustment required for accurate sales and use tax fund allocation components.

Governance Structure

The report identified several areas where BOE can improve its policies and processes, budget controls, and operational culture, and BOE has taken action on a number of items. First, in 2016, BOE employed a formal, documented governance structure comprised of seven action committees whose members are selected from a diverse group of programs across the agency. This new structure encourages cross-departmental communication, transparent decision-making and policy and process improvements central to a strong management structure. Examples of policies considered through this structure are the Board's Voluntary Income Tax Assistance Program (VITA) policy, which was updated at the December 2016 Board meeting, alternatives for the Board's cash acceptance policy, presented to the Board for discussion at the December 2016 Board meeting, and the Physical Office Space Report in Response to Item 0860-001-0001 of the Supplemental Report to the 2016-17 Budget Act.

Policies and Controls

As previously noted, the report observes that BOE does not have sufficient policies and procedures in place. Staff is strengthening and developing a number of policies and controls. For example, the Board approved the 2017 Annual Education and Outreach Plan, which identifies outreach activities scheduled for the remainder of fiscal year (FY) 2016-17 and specifies an allocation of funds amounting to $200,000 for each equalization district to devote to these activities. This plan will be updated every fiscal year, commencing with FY 2017-18, and requires vigilant tracking of outreach event spending. BOE acknowledges that the scope of its outreach events requires greater examination, including a cost-benefit analysis, and management control over the assignment of employees. BOE also is updating the BOE Administrative Manual (BEAM) to provide strict guidelines to all managers and employees regarding attendance and participation in events and conferences. Moreover, as part of outreach event tracking, BOE is developing tighter management controls to ensure appropriate staff assignments and tracking of time.

Additionally, BOE has updated its facilities leasing policy in BEAM sections 5200-5225, and acknowledges the need to ensure Board Member staff is located in offices separate from BOE operations. Further, BOE has reduced its temporary help blanket positions from 157 (as of January 15, 2015) to 8 (as of March 22, 2017), has reduced loaned positions significantly, and is developing a formal loan policy, consistent with Provision 1.

Harassment Policy

The report states several anonymous employees alleged that Board Members intervened in daily BOE operations within their respective districts. It also notes that the employees feared retaliation if they did not cooperate. BOE management is committed to addressing any and all retaliation and/or potential hostile work environment issues.

BOE has a zero tolerance policy prohibiting harassment and discrimination based on protected status categories, which applies even to conduct that may not rise to the level of unlawful discrimination. Under this policy, employees have the right to be treated with courtesy and respect and to work in an environment free from discrimination. Employee rights are specified in BEAM section 1670 et seq.

Retail Sales Tax Fund Allocation Process Controls

BOE also takes seriously the finding of the State Controller's Office (SCO) and the DOF evaluation of the Proposed Retail Sales Tax Fund Allocation Adjustment and Corrective Action Plan. As a result of the SCO finding, BOE made system and process changes. These include modifications to system reports and changes to the statistical factoring process to allocate daily receipts that more closely track current reported sales and use tax allocations. In addition, BOE reconciles daily sales and use taxes collected to reported

amounts every quarter. BOE has worked carefully to ensure adequate controls are in place and documented to verify the accuracy of sales and use taxes collected and deposited into the various fund components.

Data Reports

The report states that BOE's supplemental annual reports process contains many manual procedures that use standalone spreadsheets, which are prone to errors. BOE is implementing the Centralized Revenue Opportunity System (CROS) to replace its outdated computer systems. The CROS solution will increase automation and minimize manual processes to provide accurate and detailed reports. In the interim, BOE continues to develop additional legacy system reports to improve the availability and accuracy of BOE data. This will improve the quality of the Sales and Use Allocation reports and the Supplemental Annual Report.

BOE looks forward to working collaboratively with the legislative budget committees, the Legislative Analyst Office, and the DOF to address the concerns identified in the report. Please contact Mr. David Gau or Ms. Brenda Fleming at (916) 327-4975, if you have questions or need assistance with this response.

EVALUATION OF RESPONSE

BOE's response to the draft report has been reviewed and incorporated into the final report. In evaluating BOE's response, we provide the following comments:

Chapter 1: Resource Utilization, Outreach Activities, and Sales and Use Tax Reporting

BOE stated it strongly agrees that it has a fiduciary responsibility to promote an operational environment that provides fair, effective, and efficient tax administration over the billions of dollars for which it is responsible.

We appreciate BOE's openness to use our report to improve its practices. While BOE's response was limited, we encourage BOE to acknowledge its operational culture impediments and implement immediate compensating controls. Further, because the Board and executive management are jointly responsible for BOE's tax administration, we agree with BOE that it will need to work collaboratively with the Legislature and Finance to effectuate changes.

Chapter 2: Proposed Retail Sales and Use Tax Fund Allocation Adjustment and Corrective Action Plan

BOE disagrees with the reported interim results. BOE states "Finance requested multiple changes to the proposed adjustment to add additional quarters of data as they became available". This statement is incorrect as Finance made one such request. Specifically, on November 3, 2016, Finance requested BOE to incorporate four recently closed quarters. The intent was to mitigate subsequent adjustments.

In addition, BOE states it did not produce 11 versions of erroneous information. However, as noted in Table 4 of the report, BOE revised its proposed allocation adjustment in response to numerous errors, omissions, and inconsistencies noted by Finance.

Lastly, BOE states that Version 11 correctly reflects the adjustment. Because we have not performed an evaluation of Version 11, we cannot comment on the accuracy. As noted in our report, the status of BOE's corrective actions to the SCO Review will be reviewed in conjunction with the evaluation of BOE's February 2017 proposed allocation adjustment.