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March 3, 2010

TO: Lester Snow,
Secretary of the Natural Resources Agency

FROM: Paul D. Thayer,
Executive Officer

SUBJECT: Review of the Systems of Internal Control

In accordance with the Financial Integrity and State Managers Accountability Act of 1983, Government Code Sections 13400 through 13407, I am submitting the enclosed report describing the review of our systems of internal control for the biennial period ended December 31, 2009.

As statutorily required, the California State Lands Commission is in compliance with Government Code Section 12439.

Please contact David Brown at (916) 574-1870 if you have any questions

Enclosure(s)

cc: Governor Arnold Schwarzenegger
Joint Legislative Budget Committee
Bureau of State Audits
State Library

AGENCY: Natural Resources

DEPARTMENT: State Lands Commission

ORGANIZATION CODE: 3560

INTRODUCTION:

In accordance with the Financial Integrity and State Managers Accountability (FISMA) Act of 1983, the California State Lands Commission submits this report on the review of our systems of internal control for the biennial period ending December 31, 2009.

Should you have any questions please contact:

David W. Brown

Chief, Administrative and Information Services

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BACKGROUND:

Mission and Goals:

The California State Lands Commission (CSLC) was created by the California Legislature in 1938 as an independent body, composed of three members - the Lieutenant Governor and State Controller, both statewide elected officials, and the Director of Finance, an appointee of the Governor. The CSLC was given the authority and responsibility to manage and protect the important natural and cultural resources on public lands within the state and the public's rights to access such lands. The land area under the control of the CSLC is equal to the states of Connecticut and Delaware combined.

The CSLC was created in response to disclosures of corruption and fraudulent practices in the management of oil, gas, and other mineral resources belonging to the state. After extensive investigation, it was determined that the abuse in the management of those resources was so great that there should be greater political accountability. Hence the three-member CSLC was created. Since its inception, the CSLC has managed the resources of the state without a hint of malfeasance or scandal, while generating revenues for the public benefit approaching $9 billion.

The California State Lands Commission's policies for the management of the state's lands and natural resources are based on the highest standards of environmental protection, financial responsibility and the Public Trust Doctrine, which imposes a duty to preserve the public′s lands for the use and enjoyment of future generations, and are designed to perform two functions: (1) generating revenue for the state, and (2) protecting, preserving and restoring the natural values of state lands. The resources managed by the CSLC are diverse and range from commercially valuable minerals such as oil, natural gas, hard rock minerals, sand, gravel, and geothermal steam to unique natural resources such as forests, grazing lands, wetlands, riparian vegetation, and fish and wildlife habitat. Enactment of the Lempert-Keene-Seastrand Oil Spill Prevention and Response Act of 1990 expanded the CSLC′s jurisdiction over marine oil facilities and led to the creation of the Marine Facilities Division. Additional responsibilities were added in 1999 for ballast water management to control introduction of non-indigenous species from foreign waters.

The Commission is responsible for maintaining approximately 5,000 leases that will generate an estimated $250 million in the 2009-10 fiscal year.

The Commission's Strategic Plan includes the following:

Mission Statement

The California State Lands Commission serves the people of California by providing stewardship of the lands, waterways, and resources entrusted to its care through economic development, protection, preservation, and restoration.

Vision Statement

The California State Lands Commission works as a team to set the standard for excellence in public land management and resource protection to ensure the future quality of the environment and balanced use of the lands and resources entrusted to its care.

Values

- We treat our customers and each other with integrity, respect, and professionalism.
- We are all one team - working together toward a common vision.
- We strive for open, clear, and honest internal and external communication.
- We are committed to personal and organizational accountability and responsibility.
- We are sensitive to the long-term impacts of our decisions.
- We recognize staff as our greatest asset and encourage personal and professional growth.

- We continuously improve our processes.
- We provide quality customer service.
- We strive for a balance among competing uses and long-term protection of natural resources.
- We respect the trust responsibilities which govern the land and resources entrusted to our care.

ORGANIZATIONAL GOALS

Goal #1: Protect, restore, enhance, and preserve resources on State lands.
Goal #2: Manage State lands to generate revenues, enhance the economy, and ensure ongoing viability of the resource while protecting the environment.
Goal #3: Expand public use and access to and along the State′s inland and coastal waters.
Goal #4: Achieve excellence and improve efficiency and effectiveness of Commission operations.
Goal #5: Create better public understanding of the Commission′s responsibilities and programs.
Goal #6: Obtain funding for Commission Policy priorities.

The Commission's staff operates at the direction of an Executive Officer who is appointed by the Commission. Staff is organized into six divisions per the attached organization chart. Each division is managed by a Career Executive Appointment with subordinate managers and supervisors. Current staffing totals 208 authorized positions with a budget of $30,218,000.

Control Environment:

Integrity and Ethical Values: The Commission has established policies designed to encourage ethical behavior by all employees. These include policies on Sexual Harassment, Equal Employment Opportunity, Information Security, Incompatible Activities, Workplace Violence Prevention, Privacy, and Reasonable Accommodations as well as a Conflict of Interest Code. All designated employees are required to complete an annual Statement of Economic Interests Form (FPPC form 700). All employees are required to take ethics training, sexual harassment training, and privacy training as prescribed by law. Employees are reminded at login to the computer systems that information technology systems are to be used for business purposes only and are subject to monitoring. Internet access is monitored and objectionable sites are blocked from access. The Commission has a current Disaster Recovery Plan and is preparing a Risk Management Plan. Other policy reminders, programs, and events are regularly announced to employees through their respective managers or by the Executive Officer through All Employee emails. Policy and procedure violations are dealt with on a progressive disciplinary basis.

Commitment to Competence: All positions are required to have duty statements/job descriptions prepared by supervisors on file with the Human Resources section. Classification and job analyses are performed and maintained to determine the knowledge and skills needed to perform particular jobs. No hiring or promotions are allowed without a current duty statement. All hires and promotions are reviewed by Human Resources, Fiscal, Chief Administrative Officer and Executive Officer to ensure compliance, funding availability and organizational consistency.

Commission staff receive on-the-job training for their various assignments and are mentored by experienced staff. Training resources are made readily available and supervisors are encouraged to develop training plans for their subordinate staff.

Management Philosophy and Operating Style: Managers at every level are expected to maintain contact with and consistently emphasize appropriate behavior to all staff. Management carefully considers how their own actions and priorities are perceived by employees and stakeholders. The Executive Officer, all Division Chiefs, and deputies meet on a weekly basis to discuss program priorities, fiscal realities, and policy issues.

Turnover, particularly in senior positions has become a concern to management due to the impact on productivity and competency. Most managers and supervisors are eligible for retirement.

Organization Structure: The Commission staff is organized into six divisions that report to an Executive Officer appointed by the Commission. These include three line programs in Land Management, Marine Facilities Management, and Mineral Resources Management and three support programs in Legal Services, Environmental Planning, and Administrative Services. The Commission functions as a matrix organization with involvement of multiple division staff supporting projects and initiatives. This structure facilitates the flow of information at all levels and across all business activities. Managers have the required knowledge and expertise to perform their duties and establish reporting relationships to ensure effective communication between employees, supervisors, and managers. All communications with any Commissioner is the sole purview of the Executive Officer and Chief Counsel.

Assignment of Authority and Responsibility: The Commission delegates certain ministerial duties to the Executive Officer. These are documented through formal action at a public meeting of the Commission. The Executive Officer is allowed to further delegate these authorities to designated staff. All authorities are clearly delineated in written delegations from the Executive Officer to specific classifications, predominately subordinate managers, and include specific types of transactions and documents that can be executed. Job descriptions contain references to control related responsibilities.

Human Resource Policies and Practices: Policies and procedures are in place to ensure appropriate hiring, training, and promoting of employees. All administrative policies and procedures are readily available to all staff on the Commission intranet. Employee awareness is confirmed by the completion of a new employee checklist by Human Resources staff and the required submission of acknowledgement forms for many administrative policies.

VACANT POSITIONS:

The Commission exercises adequate controls of positions and is in compliance with Government Code Section 12439.

RISK ASSESSMENT:

Internal Controls: Commission management, specifically in the Administrative and Information Services Division, conducted a deep dive review of all internal processes regarding control of assets. As a model, the Guidance for the Evaluation of Internal Control, 2006 edition was used to conduct this comprehensive review of controls. Staff involved were interviewed and processes documented to ensure proper controls were in place. This review encompassed all procurement, contracting, budgeting, accounting, and personnel transaction processes.

Program Risks: Discussion with Executive Management and a review of recent budgetary requests were made to determine where risks lie. The top issues facing the Commission were recently compiled for a Commissioner's Briefing Book. Those risks to the Commission and its programs have been incorporated here.

EVALUATION OF RISKS AND CONTROLS:

INTERNAL CONTROLS

#1 Revolving Fund Reconciliation Not Current

During this review, a deficiency was indentified in the reconciliation of the Revolving Fund to the General Checking account. No other material deficiencies or significant risks were found in controls. There were minor adjustments made during the review to certain processes to ensure separation of duties and appropriate level of transaction review.

Corrective Action: Staff have been assigned to bring reconciliations current by the 2009-10 financial statements deadline.

#2 Delinquent Accounts Receivable notification are not timely

All amounts due the State resulting from surface leases, oil, gas and mineral royalties and reimbursements for staff costs are all being properly billed and recorded. Limited available staffing is inhibiting the ability to send past due notices at 30-day intervals as required. Notices are sent and debts are pursued as time is available however staffing reductions and the resultant available resources have required emphasis on the billing of new revenues.

Corrective Action: Management will evaluate the availability of existing workloads and redirect existing resources to assist accounts receivable desk.

PROGRAM RISKS

#3 Continued Erosion of General Fund Positions

As a result of recent budget actions, the Commission's General Fund budget has been reduced by over 30% from the baseline presented in the 2002-03 Governor's Budget. These reductions reflect across-the-board actions caused by severe General Fund revenue shortfalls. These reductions come on top of a 50% reduction in the early 1990's. General Fund positions in 1990 totaled 242 and as of the beginning of the 2009-10 FY there were 67.2. Additional positions are expected to be lost during the current budget cycle.

The Commission is a revenue generating enterprise. General Fund positions perform the core program responsibilities such as land stewardship, ownership determination, and revenue generation. Most significant are direct revenue producing activities. Billing and collection costs as well as audits are General Fund functions and are responsible for over $250 million in annual General Fund revenues. Currently, emphasis is on the billing, collection and remittance of revenues.

Another example with significant economic impact is the Granted Lands program. This is a General Fund program that is responsible for oversight of local jurisdiction's management of lands granted to them by the Legislature. These include all of the major ports in California such as San Francisco, Oakland, LA/Long Beach, San Diego, and Eureka. Economic development projects within these grants can often result in significant impacts on local economies and often involve difficult Public Trust use issues that must be resolved by the Commission before development can occur.

Total Commission positions have benefited from the addition of new oil spill prevention programs such as the Marine Facilities Management as well as the Invasive Species Control program and an increase in reimbursable positions resulting from full cost recovery policies for permit and lease application processing. These activities are funded through fees. These “special fund” sources restrict management’s ability to respond to issues concerning the Commission as they arise. Positions allocated to special funds must be dedicated to those programs and tasks. To redirect to other activities will cause budget deficiencies.

The ability of staff to respond to Commission and constituent needs is being severely impacted by continued across-the-board cuts. The negative impacts are manifested in missed revenue opportunities to the State as well as deferral of large scale economic benefits, including state and local revenues receipts from development projects dependent on Commission trust use or ownership determinations. Such short staffing is also inhibiting the Commission’s ability to adequately pursue delinquent past-due accounts receivables. Management is extremely concerned about staff’s continued ability to respond to Commission fiduciary responsibilities and project needs.

Corrective Action: Commission will continue to pursue budgetary solution for staffing**.**

#4 Revenue Audit Program

Commission revenues in the current year will total more than $250 million. These revenues are predominately from oil and gas and other mineral leases. State lessees are entitled under the terms of their leases to deduct certain processing and transportation costs from the State’s current income stream. Due to the amounts involved, the complexity of the deductions and the limited language addressing these deductions in the leases themselves, the possibility for excessive deductions, both intentional and merely erroneous, is great.

The Commission’s audit staff has suffered from a dramatic reduction in size from 7 to 3 positions in recent years resulting from across-the-board General Fund reductions and vacancy sweeps. As a result, the Commission is unable to conduct an audit program at a reasonable frequency given the revenues at stake. At the current level of staffing, only the Long Beach tidelands and the 14 highest revenue producing oil fields can reasonably be audited, and even then, no more frequently than every seven years. A prudent frequency is at least every four years. The remaining leases, with annual revenues of over $15 million, may never be audited.

Experience has shown that those paying the State royalties for oil, gas, and minerals should not be allowed to manage themselves. Audit recoveries over the past five years have totaled over $20million or nearly $1.4 million per auditor. Over that same period, oil prices have more than tripled from $20-25 per barrel to the current level of $75 per barrel, resulting in a windfall of new revenue but also increasing revenues at risk. With more revenues at stake, the importance of comprehensive oversight of State leases is all the more critical.

The Attorney General's Office recently settled a lawsuit seeking recovery of underreported royalties from State dredging leases in Northern California in response to a third party complaint. The settlement resulted in a recovery of $14 million to the General Fund. The State's inability to audit these dredging leases led to the State's failure to uncover this loss and that failure exacerbated the extent of the loss. In addition, the State is spending millions of dollars to pursue litigation. We estimate that up to $2 million each year was lost as a result of underreporting of dredging lease royalties alone.

Corrective Action: Commission will continue to pursue budgetary solution for staffing

CONCLUSION:

Based upon the internal risk assessment in support of the 2009 FISMA, it was determined that the Commission does have appropriate control systems and processes in place to support the accomplishment of its mission, safeguard its reputation, and protect its fiscal integrity.

The two program risks identified in this report are beyond the direct control of the Commission. However, it shall continue to pursue potential solutions. These will include continuing to pursue operational efficiencies as well as working with the Department of Finance and the Legislature during the development of the 2010-11 Budget and beyond. Budget Change Proposals will be prepared to address these risks but without augmentation to staffing, the risks will persist and will increase with any forthcoming across-the-board reductions in response to the overall fiscal crisis.