CALIFORNIA STATE BOARD OF EQUALIZATION

Review Report

PAYROLL PROCESS REVIEW

July 1, 2010, through June 30, 2013

BETTY T. YEE

California State Controller

January 2016

BETTY T. YEE
California State Controller

January 21, 2016

Cynthia Bridges, Executive Director
California State Board of Equalization
Post Office Box 942879
Sacramento, CA 94279

Dear Ms. Bridges:

The State Controller's Office has reviewed the California State Board of Equalization's (BOE) payroll process for the period of July 1, 2010, through June 30, 2013. BOE management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our limited review identified material weaknesses in internal control over the BOE payroll process that leave the BOE at risk of additional improper payments if not mitigated. Based on our review, the BOE has a combination of deficiencies in internal control over its payroll process such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis. Specifically, the BOE lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The lack of segregation of duties without appropriate compensating controls has a pervasive effect on the BOE payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the BOE inappropriately granted employees keying access to the State's payroll system. In one instance, a payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. In another instance, a payroll transactions unit staff's keying access should have been immediately removed after leaving the BOE; instead, the access remained for two months after the staff left.

Further, the BOE lacked sufficient controls over specific payroll and payroll-related transactions to ensure that the transactions comply with collective bargaining agreements and state laws and policies. We believe that the control deficiencies contributed to the BOE employees' excessive vacation and annual leave balances costing approximately $4,885,731 as of June 30, 2013, overpayments in separation lump sum pay totaling $10,910, and improper holiday credits costing an estimated $1,861. The BOE indicated that an estimated $1,147 in improper holiday credit hours had already been corrected in December 2014, a year and a half after our review period. Considering that our review was performed only on limited selections, we are concerned that the number of improper transactions may be even higher.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau by phone at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/as

Attachment

cc: Jerome E. Horton, Chairman
California State Board of Equalization
Senator George Runner (Ret.), Vice Chair
California State Board of Equalization
Fiona Ma, Board Member
California State Board of Equalization
Diane L. Harkey, Board Member
California State Board of Equalization
Betty T. Yee, California State Controller and Board Member
California State Board of Equalization
Brock Wimberley, Chief, Internal Audit Division
California State Board of Equalization
David J. Gau, Chief Deputy Director
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Edna B. Murphy, Deputy Director, Administration Department
California State Board of Equalization
Sandra Mayorga, Chief, Human Resources Division
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Review Report

Summary

The State Controller's Office (SCO) reviewed the California State Board of Equalization's (BOE) payroll process for the period of July 1, 2010, through June 30, 2013. BOE management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our limited review identified material weaknesses in internal control over the BOE payroll process that leave the BOE at risk of additional improper payments if not mitigated. Based on our review, the BOE has a combination of deficiencies in internal control over its payroll process such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis. Specifically, the BOE lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The payroll transactions unit staff executes multiple steps in processing payroll transactions, including data entry into the State's payroll system, reconciliation of payroll including system output to source documentation, and processing of adjustments or corrections. In addition, the payroll transactions manager had keying access to the payroll system while responsible for approving payroll transactions entered in the system. This control deficiency was aggravated by the lack of compensating controls, such as involving management oversight and review, to mitigate the risks associated with such a deficiency. The lack of segregation of duties without appropriate compensating controls has a pervasive effect on the BOE payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the BOE inappropriately granted employees keying access to the State's payroll system. Of the 35 employees who had keying access at some point during the review period, 6 (17%) did not have their keying access immediately removed or modified subsequent to transfer to another agency, separation from state service, or change in classification. In one instance, a payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. In another instance, a payroll transactions unit staff's keying access should have been immediately removed after leaving the BOE; instead, the access remained for two months after the staff left.

Further, the BOE lacked sufficient controls over specific payroll and payroll-related transactions to ensure that the transactions comply with collective bargaining agreements and state laws and policies. The control deficiencies contributed to the BOE employees' excessive vacation and annual leave balances, overpayments in separation lump sum pay, and improper holiday credits, costing the State an estimated total of $4,898,502. Specifically, 516 employees exceeded the limit set by collective bargaining agreements and state regulations by more than 118,000 hours in vacation and annual leave, costing at least $4,885,731 as

of June 30, 2013. In addition, the BOE overpaid, by approximately $10,910, 2 of the 15 employees reviewed (13%) for separation lump sum pay. It improperly granted 80 holiday credit hours costing approximately $1,861 in 9 of the 15 transactions reviewed (60%). The BOE indicated that an estimated $1,147 in improper holiday credit hours had already been corrected in December 2014, a year and a half after our review period. Considering that our review was performed only on limited selections, we are concerned that the number of improper transactions may be even higher.

A summary of our review results is included in the following table:

		Selections Reviewed			Selections with Issues			
Finding Number	Issues	Number of Selections Reviewed	Selection Unit	$ Amount of Selections Reviewed	Number of Selections with Issues	Issues as a Percentage of Selections Reviewed [a]	Approximate $ Amount	$ Amount of Issues as a Percentage of $ Amount of Selections Reviewed [a]
1	Inadequate segregation of duties and compensating controls	See below.	See below.	See below.	See below.	See below.	See below.	See below.
2	Inappropriate keying access to the State's payroll system	See below.	See below.	See below.	See below.	See below.	See below.	See below.
3	Inadequate controls over vacation and annual leave credit, costing the State liability for excessive balances	516	Employee	$4,885,731	516	100%	$4,885,731	100%
4	Inadequate controls over lump sum separation pay, resulting in overpayments	15	Employee	774,620	2	13%	10,910	1%
4	Inadequate controls over holiday credits, resulting in improper accruals [b]	15	Holiday credit transaction	6,450	9	60%	1,861	29%
	Total	546		$5,666,801	527	97%	$4,898,502	86%

[a] All percentages are rounded to the nearest full percentage point.

[b] The BOE indicated that an estimated $1,147 in improper holiday credit hours had already been corrected in December 2014, a year and a half after our review period.

Background

In 1979, the State of California adopted collective bargaining for state employees. This adoption of collective bargaining created a significant workload increase for the SCO's Personnel and Payroll Services Division (PPSD) as PPSD was the State's centralized payroll processing center for all payroll related-transactions. As such, PPSD decentralized the processing of payroll, which allowed state agencies and departments to process their own payroll-related transactions. Periodic reviews of this now-decentralized payroll processing at state agencies and departments ceased due to budget constraints in the late 1980s.

In 2013, the legislature reinstated these payroll reviews to gain assurance that state agencies and departments were maintaining an adequate internal control structure over the payroll function; providing proper oversight over decentralized payroll processing; and complying with various state laws and regulations regarding payroll processing and related transactions.

Review Authority

Authority for this review is provided by California Government Code (GC) section 12476, which states, "The Controller may audit the uniform state pay roll system, the State Pay Roll Revolving Fund [sic], and related records of state agencies within the uniform state pay roll system, in such manner as the Controller may determine. In addition, GC section 12410 stipulates that "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."

Objectives, Scope, and Methodology

The SCO reviewed the BOE payroll process and transactions for the period of July 1, 2010, through June 30, 2013.

The objectives of this review were to determine whether:

- Payroll and payroll-related disbursements were accurate and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.
- The BOE had established adequate internal control for payroll, to meet the following control objectives:
  - Payroll and payroll-related transactions are properly approved and certified by authorized personnel;
  - Only valid and authorized payroll and payroll-related transactions are processed;
  - Payroll and payroll-related transactions are accurate and properly recorded;
  - Payroll systems, records, and files are adequately safeguarded; and
  - State laws, regulations, policies, and procedures are complied with regarding payroll and payroll-related transactions.
- The BOE complied with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures.
- The BOE maintained accurate records of leave balances.
- Salary advances were properly administered and recorded in accordance with state laws, regulations, policies, and procedures.

To achieve our review objectives, we performed the following procedures:

- Reviewed state and BOE policies and procedures related to the payroll process to understand the practice of processing various payroll and payroll-related transactions.
- Interviewed BOE payroll personnel to understand the practice of processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to the payroll transaction processing, and obtain or confirm our understanding of existing internal control over the payroll process and systems.

- Selected transactions recorded in the State's payroll database based on risk factors and other criteria for review.
- Analyzed and tested transactions recorded in the State's payroll database and reviewed relevant files and records to determine the accuracy of payroll and payroll-related payments, accuracy of leave transactions, proper review and approval of transactions, adequacy of internal control over the payroll process and systems, and compliance with collective bargaining agreements and state laws, regulations, policies, and procedures.
- Reviewed salary advances to determine whether they were properly administered and recorded in accordance with state laws, regulations, policies, and procedures.

Conclusion

Our limited review identified material weaknesses in internal control over the BOE payroll process that leave the BOE at risk of additional improper payments if not mitigated. An evaluation of an entity's payroll process may identify deficiencies in its internal control over such a process. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements in financial information, impairments of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts on a timely basis.

Control deficiencies, either individually or in combination with other control deficiencies, may be evaluated as significant deficiencies or material weaknesses. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis.

Based on our review, the BOE has a combination of deficiencies in internal control over its payroll process such that there is a reasonable possibility that a material misstatement in financial information, impairment of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis. Specifically, the BOE lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The lack of segregation of duties without appropriate compensating controls has a pervasive effect on the BOE payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the BOE inappropriately granted employees keying access to the State's payroll system. In one instance, a payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. In another instance, a payroll transactions unit staff's keying access should have been immediately removed after leaving the BOE; instead, the access remained for two months after the staff left.

Further, the BOE lacked sufficient controls over specific payroll and payroll-related transactions to ensure that the transactions comply with collective bargaining agreements and state laws and policies. We believe that the control deficiencies contributed to the BOE employees' excessive vacation and annual balances costing approximately $4,885,731 as of June 30, 2013, overpayments in separation lump sum pay totaling $10,910, and improper holiday credits costing an estimated $1,861. The BOE indicated that an estimated $1,147 in improper holiday credit hours had already been corrected in December 2014, a year and a half after our review period. Considering that our review was performed only on limited selections, we are concerned that the number of improper transactions may be even higher.

Views of Responsible Officials

We issued a draft review report on October 30, 2015. Cynthia Bridges, Executive Director, responded by letter dated November 9, 2015, agreeing with the review results. This final review report includes the BOE's response as an attachment.

Restricted Use

This report is solely for the information and use of the BOE, the California Department of Human Resources, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

January 21, 2016

Findings and Recommendations

FINDING 1—Inadequate segregation of duties and compensating controls over payroll transactions

The BOE lacked adequate segregation of duties within its payroll transactions unit necessary to ensure that only valid and authorized payroll transactions are processed. The BOE also failed to implement other controls to compensate for this risk.

Government Code (GC) sections 13402 and 13403 mandated state agencies to establish and maintain a system of internal control, including proper segregation of duties. Adequate segregation of duties reduces the likelihood that fraud or error will remain undetected by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of the work performed.

Our review found that the BOE payroll transactions unit staff performed conflicting duties. The staff executes multiple steps in processing payroll transactions, including data entry into the State's payroll system, reconciliation of payroll including system output to source documentation, and processing of adjustments or corrections. The BOE indicated that an individual who is independent of the payroll transactions unit staff reviewed the leave balances generated from the leave accounting system to source documentation. However, the BOE could not provide documentation to support that assertion. In addition, as described in Finding 2, the payroll transactions manager had keying access to the payroll system while responsible for approving payroll transactions entered in the system. The BOE failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. For example, we found no indication that supervisors conduct periodic review of transactions processed by the payroll transactions unit staff.

The lack of adequate segregation of duties and compensating controls has a pervasive effect on the BOE payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively. These control deficiencies, in combination with other deficiencies discussed in Findings 2, 3, and 4, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that a material misstatement in financial information or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis.

<u>Recommendation</u>

The BOE should separate conflicting payroll duties to the extent possible, considering the limited number of employees involved.

Adequate segregation of duties will provide a stronger system of internal control whereby the functions of each employee are subject to the review of another. Good internal control practices require that the following functional duties should be performed by different work units, or at minimum, by different employees within the same unit:

- *Recording transactions.* This duty refers to the record-keeping function, which is accomplished by entering data into a computer system.
- *Authorization to execute.* This duty belongs to individuals with authority and responsibility to initiate and execute transactions.
- *Periodic reviews and reconciliation of actual payments to recorded amounts.* This duty refers to making comparisons at regular intervals and taking action to resolve differences.

If it is not possible to segregate payroll functions fully and appropriately due to specific circumstances, the BOE should implement compensating controls. For example, if the payroll transactions unit staff responsible for recordkeeping also performs a reconciliation process, the supervisor could perform and document a detailed review of the reconciliation to provide additional control over the assignment of conflicting functions. Compensating controls may also include dual authorization requirements and documented reviews of payroll system input and output.

The BOE should develop formal written procedures for performing and documenting compensating controls.

Summary of the BOE's Response

The BOE agreed with the finding and indicated that it has implemented corrective measures to address the deficiencies noted in this finding. See attachment for the BOE's full response.

Auditor's Comments

The SCO will follow up on the BOE's corrective action in a follow-up review.

FINDING 2—Inappropriate keying access to the State's payroll system

The BOE lacked adequate controls to ensure that only appropriate staff have keying access to the State's payroll system. Of the 35 employees who had keying access at some point during the review period, 6 (17%) did not have their access immediately removed or modified. The payroll transactions manager had keying access while responsible for approving payroll transactions entered in the system. Also, a payroll transactions unit staff still had keying access until two months after leaving the BOE.

The SCO maintains the State's payroll information system. The system is decentralized, thereby allowing employees of state agencies to access the system. The SCO's Personnel/Payroll Services Division (PPSD) has established a Decentralization Security Program that all state agencies are required to follow in order to access the payroll systems. The program's objectives are to secure and protect the confidentiality and integrity of the data against misuse, abuse, and unauthorized use.

The BOE had 35 employees with keying access to the State's payroll system at some point between July 1, 2010, and June 30, 2013. Of the 35 employees, 6 (17%) did not have their keying access immediately removed or modified subsequent to transfer to another agency, separation from state service, or change in classification. For example, the payroll transactions manager who was appointed in April 2011 had keying access to the payroll system beyond June 30, 2013. According to the Decentralization Security Program manual, the manager's access should have been removed. This individual was provided keying access before becoming a manager; however, the BOE did not discontinue the individual's access after becoming a manager. The manager is an approving official who often approves certain payroll transactions prior to input into the system. The manager also is responsible for reviewing the work of his or her staff. To properly segregate duties, employees charged with approving transactions should not be able to input the transactions that they approve. In another example, a payroll transactions unit staff left the BOE in January 2013; however, the staff continued to have keying access until early April 2013.

In addition, 6 of the 35 employees had keying access while they were appointed to classifications other than the two classifications allowed to have keying access; however, the BOE could not provide the required written justification. The 6 employees included 5 of those whose keying access was not immediately removed or modified.

The Decentralization Security Program manual states, in part:

> The privilege to access the PPSD database poses a significant risk to the ability for SCO to function. Therefore that privilege is restricted to persons with a demonstrated need for such access. Currently, . . . applications are restricted to Personnel Services Specialists (PSS), or Payroll Technician (PT) classifications because their need is by definition a function of their specific job duties, and any change in those duties requires a reevaluation of the need for access. If the employee's duties change, such that the need for access no longer exists, the access privilege MUST be removed or deleted immediately by a request submitted by the department….A request for an individual in a classification other than in the PSS/PT series to access (the payroll system) requires a written justification from the Personnel/Payroll Officer. The justification must describe the individual's specific job duties that require the need to each type of information…as well as the level of access to that application, in order to perform their Statutory and/or Constitutional duties.

The manual, as revised in January 2015, restricts manager classifications to inquiry access only.

<u>Recommendation</u>

The BOE should ensure that keying access to the payroll system is updated after employees are promoted, change classifications, or leave the BOE. The BOE's designated security monitor should periodically review access to the system to determine that access is in accordance with the Decentralized Security Program.

Summary of the BOE's Response

The BOE has indicated that it implemented the SCO's recommendations after the review period. See attachment for the BOE's full response.

Auditor's Comments

The SCO will confirm the BOE's corrective action in a follow-up review.

FINDING 3—Inadequate controls over vacation and annual leave balances, costing the State liability for excessive credits

The BOE failed to implement controls to ensure that it adheres to the requirement of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits, resulting in liability for excessive leave credits that could cost the State at least $4,885,731 as of June 30, 2013. We expect the amount of the liability to increase if the BOE does not take action to address the excessive vacation and annual leave credits.

Collective bargaining agreements and state regulations limit the amount of vacation and annual leave that most state employees may accumulate to no more than 80 days (640 hours). The limit on leave balance serves as a tool for state agencies to manage leave balances and control the State's liability for accrued leave credits. State agencies may allow employees to carry a higher balance only on limited exceptions. For example, an employee may not be able to reduce accrued vacation or annual leave hours below the limit because of business needs. When an employee's leave accumulation exceeds or is projected to exceed the limit, state agencies should work with the employee to develop a written plan to reduce leave balances below the applicable limit.

Our review of the leave accounting records found that the BOE had 4,321 employees with unused vacation or annual leave credits at June 30, 2013. Of the 4,321 employees, 516 (12%) exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 2,155 hours in annual leave, or 1,515 hours beyond the 640-hour limit. Collectively, the 516 employees accumulated more than 118,000 hours in excess vacation and annual leave, costing at least $4,885,731 as of June 30, 2013. This estimated liability does not adjust for salary rate increases and additional leave credits.[1] Accordingly, we expect that the amount needed to pay for the liability would be higher. For example, a BOE employee separated from state service with 2,494 hours in leave credits, including 2,322 hours in annual leave credit. After adjusting for additional leave credits, the employee should have been paid for 2,972 hours, or 19% more.

We performed additional review of 10 of the 516 employees to determine if the BOE implemented actions to address excessive vacation and annual leave credits in accordance with collective bargaining agreements and state regulations. Our review found no indication among the 10 employees (100% of selections) reviewed that the BOE implemented such actions.

[1] Most state employees receive pay rate increases every year pursuant to state laws or collective bargaining agreements. Also, when projecting accumulated leave balances upon separation, an employee earns additional leave credits equal to the amount that the employee would have earned had the employee taken time off but not separated from state service.

The BOE could not demonstrate that it allowed the 10 employees to carry vacation or annual leave balances beyond the limit based on exceptions specified in agreements and state regulations, or that it implemented actions to bring leave balances below the limit.

The following table shows the annual change during our review period in the number of employees with vacation and annual leave balance exceeding the 640-hour limit and the total vacation and annual leave hours in excess of the 640-hour limit.

As of	Number of employees with vacation or annual leave balance exceeding 640 hours	Year-to-year percentage increase	Total vacation and annual leave hours in excess of the 640-hour limit	Year-to-year percentage increase
July 1, 2010	217	–	46,008	–
June 30, 2011	357	65%	66,496	45%
June 30, 2012	415	16%	89,543	35%
June 30, 2013	516	24%	118,179	32%

If the BOE does not take action to reduce the excessive credits, the liability for accrued vacation and annual leave will most likely increase because most employees will receive salary increases, additional leave credits, or have other non-compensable leave credits that they can use instead of vacation or annual leave, increasing their vacation or annual leave balances. In addition, the state agency responsible for paying these leave balances may also face a cash flow problem if a significant number of employees with excessive vacation or annual leave credits separate from state service. Normally, state agencies are not budgeted to make these lump sum payments. However, the State's current practice dictates that the state agency that last employed an employee pays for that employee's lump sum separation payment, regardless of where the employee accrued the leave balance.

Recommendation

The BOE should implement controls, including existing policies and procedures, to ensure that employees' vacation and annual leave balances are maintained within levels allowed by collective bargaining agreements and state regulations. The BOE should conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively.

If the State offers leave buy-back programs, the BOE should also participate in such programs if funds are available.

Summary of the BOE's Response

The BOE recognized that having an excessive number of employees with vacation or annual leave balances over the limit exposes the BOE and the State to an unfunded liability. The BOE indicated that, as a result, it has implemented actions to address the deficiencies noted in this finding. See attachment for the BOE's full response.

Auditor's Comments

The SCO will follow up on the BOE's corrective action in a follow-up review.

FINDING 4—Inadequate controls over separation lump sum pay and holiday credit accrual

The BOE lacked adequate controls over the processing of employee separation lump sum pay and the accrual of its employees' holiday credits. The BOE overpaid by approximately $10,910, 2 of the 15 employees reviewed (13%) for separation lump sum pay. Also, it improperly granted 80 holiday credit hours costing approximately $1,861 in 9 of the 15 transactions reviewed (60%). The BOE indicated that an estimated $1,147 in improper holiday credit hours had already been corrected in December 2014, a year and a half after our review period. These control deficiencies leave the BOE at risk of additional improper separation lump sum payments and holiday credit accruals.

Overpayments in separation lump sum pay

Pursuant to collective bargaining agreements and state law, employees are entitled to receive cash for accrued eligible leave credits when separating from state employment. Payroll records indicated that the BOE had processed separation lump sum pay for 661 employees between July 1, 2010, and June 30, 2013. We reviewed 15 selected employees and found that 2 were paid 216 hours more than they should have been paid for accrued leave credits, resulting in a total overpayment of approximately $10,910. The overpayments resulted from miscalculation of the employees' accrued leave credits by the payroll transactions unit staff. We found no indication that the processing of these lump sum payments was reviewed by an authorized individual.

Overaccrual of holiday credit

Collective bargaining agreements and GC section 19853 specify the number of hours of holiday credit an employee would receive per qualifying holiday. Leave accounting records indicated that the BOE had 23,222 holiday credit accrual transactions from July 1, 2010, through June 30, 2013. We reviewed 15 selected holiday credit transactions and found that 9 did not comply with collective bargaining agreements and state law. The 9 employees received improper holiday credits totaling 80 hours, costing approximately $1,861. Specifically, the BOE granted 38 hours to seven employees in months that had no holidays; 32 hours to one employee who was not eligible; and 10 hours to one employee who should have been charged for time used. We found no indication that the holiday credit transactions were reviewed by an individual other than the payroll transactions unit staff responsible for keying these transactions in the system. When we presented this issue to the BOE payroll transactions unit management and staff, they indicated that a total of 54 improper holiday credit hours, costing approximately $1,147, had already been corrected in December 2014, a year and a half after our review period.

Recommendation

The BOE should conduct a review of employee separation lump sum payments during the past three years to ensure that the payments are accurate and in compliance with collective bargaining agreements and state law. If an overpayment is made to a separated employee, the BOE should recover the amount in accordance with GC section 19838 and State Administrative Manual 8776.6.

The BOE should conduct a review of the leave accounting system to ensure that the accrual of holiday credits complies with collective bargaining agreements and state law. The BOE should correct any improper holiday credits in the leave accounting system. To prevent improper holiday credits in the leave accounting system from recurring, the BOE should do the following:

- Provide adequate oversight to ensure that payroll transactions unit staff accurately record leave transactions.
- Provide training to payroll transactions unit staff involved in keying transactions into the leave accounting system to ensure that they understand the requirements under collective bargaining agreements and state law regarding holiday credits.

Summary of the BOE's Response

The BOE agreed with the finding and indicated that it has implemented actions to address the deficiencies noted in this finding. See attachment for the BOE's full response.

Auditor's Comment

The SCO will follow up on the BOE's corrective action in a follow-up review.

Attachment —
California State Board of Equalization's Response to Draft Review Report

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

November 9, 2015

Mr. Andrew Finlayson
Chief, State Agency Audits Bureau
Office of State Controller's Office, Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Finlayson:

We appreciate the opportunity to respond to the State Controller's Office (SCO) draft Review Report entitled "California State Board of Equalization (BOE) Review Report Payroll Process Review" for the period of July 1, 2010 through June 30, 2013. We agree with the recommendations set forth in this report.

Over the course of the next six months, it is our intention to monitor and evaluate internal control activities to identify potential issues and take corrective action more timely. The key benefits are that our procedures and performance will be evaluated and measured regularly to address variances from the SCO's findings and recommendations, and will be reviewed for other improvements to be authorized by the Board.

Monitoring and evaluating will include:

- Measuring current practices for internal control activities;
- Monitoring any variables (cost, effort, necessary redundancies, etc.) against management's plan and the SCO baseline to determine future actions; and
- Identifying corrective actions to address issues and risks properly, and proposing and/or implementing Board authorized changes.

BOE is committed to strengthening the control environment, risk assessment practices, control activities, communication, and monitoring of existing processes to reduce the recurrence of issues discussed in the SCO's Review Report.

BOE management remains committed to taking the necessary steps to ensure that control issues regarding payroll processing, segregation of duties and attendance reporting are resolved expeditiously. Further details about specific corrective actions will be provided in the 6-month response.

If you have any questions concerning the enclosed BOE response, please contact me at (916) 327-4975 or Edna Murphy, Deputy Director, Administration Department, at (916) 445-4272.

Sincerely,

Cynthia Bridges
Executive Director

CB:im

cc:

Honorable Jerome E. Horton, Chairman
Senator George Runner (Ret.), Vice Chair
Honorable Fiona Ma, Board Member, Second District
Honorable Diane L. Harkey, Fourth District
Honorable Betty T. Yee, State Controller
David J. Gau, Chief Deputy Director
Edna B. Murphy, Deputy Director, Administration Department
Sandra Mayorga, Chief, Human Resources Division
Brock Wimberley, Chief, Internal Audit Division

Finding 1 - The BOE lacked adequate segregation of duties and compensating controls over payroll transactions.

SCO Recommendation:

The BOE should separate conflicting payroll duties to the extent possible, considering the limited number of employees involved.

BOE Response:

The BOE concurs with the above finding. In response, BOE recognized the need to incorporate additional internal controls in the area of review and audit of all payroll transactions. Corrective measures have been taken to ensure that all work performed by the Personnel Specialist for keying personnel information is subject to supervisory review. The supervisor's review is performed prior to keying to ensure transactions are carried out in accordance with applicable laws, rules, and regulations governing personnel transactions. It should be noted that BOE has also implemented on a daily basis a post-review of personnel transactions entered into the SCO's Personnel Information Management (PIM) system for the monitoring of staffs work. This increased level of review has provided more oversight and has proven to minimize the error rate of payroll transactions.

Finding 2 - Inappropriate keying access to the State's payroll system.

The BOE lacked adequate control to ensure that only appropriate staff has keying access to the State's payroll system.

SCO Recommendation:

The BOE should ensure that keying access to the payroll system is updated after employees are promoted, change classifications, or leave the BOE. The BOE's designated security monitor should periodically review access to the system to determine that access is in accordance with the Decentralized Security Program.

BOE Response:

The BOE security monitor has already implemented all of SCO's recommendations after the internal control review period dates of this audit. Effective January 1, 2014, the former security monitor was reassigned to resume the duties of security monitor. As such, the security monitor has implemented a procedure that provides him with immediate notification when staffing changes are made. Specifically, the security monitor works closely with Human Resources Division (HRD) management and the Personnel Specialist assigned to handle the HRD roster and ensures that the security monitor is notified timely of all appointments, separations, or reclassifications of employees within the HRD. The SCO access is revised accordingly where additions, modifications, or a request to retain and/or remove is processed immediately. The security monitor has also implemented a monitoring process to ensure that the status of employees who currently have access to the system are in accordance with the Decentralized Security Program.

Finding 3 - Inadequate controls over vacation and annual leave balances.

SCO Recommendation:

The BOE should implement controls, including existing policies and procedures to ensure that employees' vacation and annual leave balances are maintained within level balances allowed by collective bargaining agreements and state regulations. The BOE should conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively.

If the State offers leave buy-back programs, the BOE should also participate in such programs.

BOE Response:

The BOE recognizes that having an excessive amount of employees with annual leave or vacation balances over the 640 hour CAP exposes the department and the State to an unfunded liability. As a result, in June of 2014, BOE implemented the use of the BOE-640, Vacation/Annual Leave Agreement form. Subsequently, in May of each year, the division managers receive a MIRS report indicating who within their units have close to or over the 640 hour vacation/annual leave CAP. These documents help the units determine who should have an agreement plan in place.

Employees who exceed or could exceed the 640 hour CAP must submit an agreement form to their managers/supervisors by June 1st each year and indicate in their plan how they intend to reduce their balances. Additionally, each division manager is provided a monthly Leave Accounting Balance (LAB) report to assist them in monitoring their employees leave balances and adherence to their Leave Agreement.

It should also be noted that the BOE has participated in each leave buy-back program that has been offered by the State.

Finding 4 - Inadequate controls over separation lump sum pay and holiday credit accrual.

SCO recommendation:

The BOE should conduct a review of employee separation lump sum payments during the past three years to ensure that the payments are accurate and in compliance with collective bargaining agreements.

The BOE should conduct a review of the leave accounting system to ensure that the accrual of holiday credits complies with collective bargaining agreements and state law.

BOE Response:

The BOE concurs with the above findings and has established the following internal controls:

Lump Sum:

The BOE has implemented a process whereby supervisors and/or senior staff review and sign all lump sum payment calculations both prior to and post keying of transactions and has instituted a random audit of the past separation transactions with lump sum payouts as recommended in the SCO report.

The BOE sends all Personnel Specialists to Lump Sum training at SCO and supplements it with on-the-job training for new staff, as well as refresher training on an as-needed basis performed by the supervisor and/or Personnel Transactions Manager.

Holiday Credit:

In March of 2014, the BOE implemented the pre- and post-audit processes where all leave earning and usage documented on the BOE-634, Attendance Summary, that is keyed into the California Leave Accounting System (CLAS) is reviewed by a second reviewer. The second reviewer compares the BOE-634s to the LAB report, completes the Leave Activity and Correction Certification form, and returns the package to the Personnel Specialist to process any corrections.

The BOE sends all Personnel Specialists to CLAS training at SCO and supplements it with on-the-job training for new staff, as well as refresher training on an as-needed basis performed by the supervisor and/or Personnel Transactions Manager.

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