

CALIFORNIA DEPARTMENT OF STATE HOSPITALS-ATASCADERO

Review Report

PAYROLL PROCESS REVIEW

July 1, 2010 through June 30, 2013



BETTY T. YEE
California State Controller

June 2015



BETTY T. YEE
California State Controller

June 3, 2015

Stirling Price, Executive Director
California Department of
State Hospitals-Atascadero
P.O. Box 7001
1033 El Camino Real
Atascadero, CA 93423-7001

Dear Mr. Price:

The State Controller's Office has reviewed the California Department of State Hospitals-Atascadero (DSH-Atascadero) payroll process for the period of July 1, 2010, through June 30, 2013. DSH-Atascadero 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 laws and regulations regarding payroll and payroll-related expenditures.

Our limited review identified material weaknesses in internal control over the DSH-Atascadero payroll process that leave DSH-Atascadero at risk of additional improper payments if not mitigated. Based on our review, we found that DSH-Atascadero 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, DSH-Atascadero 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 DSH-Atascadero payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

Our review also found that DSH-Atascadero lacked sufficient controls over the processing of specific payroll-related payments to ensure that only valid and authorized payments that comply with collective bargaining agreements and state laws and policies are processed. We believe that the control deficiencies contributed to improper out-of-class compensation, holiday credits, institutional worker supervision pay, award payments, and overtime compensation, costing the State an estimated total of \$129,447. Considering that our review was performed only on limited selections, we are concerned that the amount of improper payments may be even higher than we found.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ljs

Attachment

cc: Pam Ahlin, Director

California Department of State Hospitals
Stephanie Clendenin, Chief Deputy Director
California Department of State of Hospitals
Rob Cook, Chief Operating Officer
California Department of State of Hospitals
Christina Edens, Acting Chief Financial Officer
California Department of State Hospitals
Cindy Woolston, Chief, Office of Audits
California Department of State of Hospitals
Elizabeth Andres, Acting Hospital Administrator
California Department of State Hospitals-Atascadero
Maggie Spurgeon, Acting Human Resources Director
California Department of State Hospitals-Atascadero
Mark Rodriguez, Chief, Administrative Services
California Department of Human Resources

Contents

Review Report

Summary	1
Background	2
Objectives, Scope, and Methodology	3
Conclusion	4
Views of Responsible Officials.....	5
Restricted Use	5
Findings and Recommendations	6
Attachment—California Department of State Hospitals-Atascadero’s Response to Draft Review Report	

Review Report

Summary

The State Controller's Office (SCO) reviewed the California Department of State Hospitals-Atascadero (DSH-Atascadero) payroll process for the period of July 1, 2010, through June 30, 2013. DSH-Atascadero's 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 DSH-Atascadero payroll process that leave DSH-Atascadero at risk of improper payments if not mitigated. Based on our review, we found that DSH-Atascadero 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, DSH-Atascadero lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The payroll transactions unit staff process all payroll transactions, including data entry into the State's payroll system, audits of employee timesheets, reconciliation of payroll including system output to source documentation, and reporting of payroll exceptions. 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 DSH-Atascadero payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

Our review also found that DSH-Atascadero lacked sufficient controls over the processing of specific payroll-related payments to ensure that only valid and authorized payments are processed. The control deficiencies contributed to improper payments from July 2010 through June 2013, costing the State an estimated total of \$129,447. Specifically, DSH-Atascadero improperly paid approximately \$86,849 to 10 of the 15 employees reviewed (67%) for out-of-class assignments that exceeded the limits set by collective bargaining agreements. In addition, DSH-Atascadero improperly granted 462 holiday credit hours, costing approximately \$17,439 in 15 of the 30 transactions reviewed (50%). Moreover, DSH-Atascadero improperly granted \$6,900 in institutional worker supervision pay to 25 employees, or 100% of selections reviewed, even though the employees did not meet the requirements to receive the pay. Furthermore, DSH-Atascadero improperly paid 11 of the 43 employees reviewed (26%) in award and overtime compensation, totaling \$18,259. Considering that our review was performed only on limited selections, we are concerned that the number of improper payments may be even higher than we found.

A summary of our review results is included in Table 1.

Table 1 – Summary of Review Results

Finding No.	Issues	Selections Reviewed		Selections with Issues			Approximate \$ Value	\$ Value of Issues as a Percentage of \$ Value of Selections Reviewed ¹
		Number of Selections Reviewed	Selection Unit	\$ Value of Selections Reviewed	Number of Selections with Issues	Issues as a Percentage of Selections Reviewed ¹		
1	Inadequate segregation of duties and compensating controls	See below.	See below.	See below.	See below.	See below.	See below.	See below.
2	Inadequate controls over out-of-class compensation, resulting in improper payments	15	Employee	\$213,931	10	67%	\$86,849	41%
3	Inadequate controls over holiday credits, resulting in improper accruals	30	Holiday credit transaction	40,128	15	50%	17,439	43%
4	Inadequate controls over institutional worker supervision pay, resulting in improper payments	35	Payment transaction	6,900	35	100%	6,900	100%
5	Inadequate controls over processing of award and overtime payments	43	Employee	314,088	13	30%	18,259	6%
	Total	123		\$575,047	73	59%	\$129,447	23%

¹ All percentages are rounded to the nearest full percentage point.

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 DSH-Atascadero payroll process and transactions for the period of July 1, 2010, through June 30, 2013. We conducted our onsite fieldwork between June 2, 2014, and July 10, 2014.

The objectives of our review were to determine whether:

- Payroll and payroll-related disbursements are accurate and in accordance with collective bargaining agreements and State laws, regulations, policies, and procedures.
- DSH-Atascadero has 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.
- DSH-Atascadero complies with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures.
- DSH-Atascadero maintains accurate records of leave balances.
- Salary advances are 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 DSH-Atascadero policies and procedures related to the payroll process to understand the practice of processing various payroll and payroll-related transactions.
- Interviewed DSH-Atascadero payroll personnel to understand the practice of processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to 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 DSH-Atascadero payroll process that leave DSH-Atascadero 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, we found that DSH-Atascadero 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, DSH-Atascadero 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 DSH-Atascadero payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

Our review also found that DSH-Atascadero lacked sufficient controls over the processing of specific payroll-related payments to ensure that only valid and authorized payments that comply with collective bargaining agreements and state laws and policies are processed. We believe that the control deficiencies contributed to improper out-of-class compensation, holiday credits, institutional worker supervision pay, award payments, and

overtime compensation, costing the State an estimated total of \$129,447. Considering that our review was performed only on limited selections, we are concerned that the number of improper payments may be even higher than we found.

**Views of
Responsible
Officials**

We issued a draft review report on April 28, 2015. On behalf of DSH-Atascadero, Cindy Woolston, Chief, Office of Audits, California Department of State Hospitals (DSH), responded by letter dated May 15, 2015 (Attachment). Our full comments to the DSH's responses to each finding are included in the Findings and Recommendation section.

Restricted Use

This report is solely for the information and use of DSH-Atascadero, 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

June 3, 2015

Findings and Recommendations

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

DSH-Atascadero lacked adequate segregation of duties within its payroll transactions unit. This control deficiency was aggravated by the lack of compensating controls to ensure that the payroll transactions unit processes only valid and authorized transactions that comply with collective bargaining agreements and state laws, regulations, and policies.

California Government Code (GC) sections 13402 and 13403 mandate State agencies to establish and maintain internal accounting and administrative controls, including proper segregation of duties and an effective system of internal review. 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. An individual or small group of individuals should not be in a position to control all aspects of a transaction or business process, such as initiation, authorization, custody, and recording or reporting of transactions. In addition, the same individual responsible for recording or reporting the transaction should not perform control tasks such as review, audit, and reconciliation.

Our review found that DSH-Atascadero's payroll transactions unit staff performed conflicting duties. The staff processes all payroll transactions, including data entry into the State's payroll system, audit of employee timesheets, reconciliation of payroll, including system output to source documentation, and reporting of payroll exceptions. DSH-Atascadero failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. For example, the payroll transactions unit staff enters in regular and overtime pay and reconciles the master payroll, overtime, and other supplemental warrants. We found no indication that these functions were subjected to periodic supervisory review.

The lack of adequate segregation of duties and compensating controls has a pervasive effect on the DSH-Atascadero 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, 4, and 5, 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.

Recommendation

To help address the possibility that a material misstatement in financial information or noncompliance with provisions of laws, regulations, or contracts, including improper payroll-related payments, will not be prevented, or detected and corrected on a timely basis, DSH-Atascadero should separate conflicting payroll function 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 recordkeeping 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 of information 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, DSH-Atascadero should implement compensating controls. For example, if the payroll transactions unit staff member is responsible for recordkeeping but 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 also may include dual authorization requirements and documented reviews of payroll system input and output.

DSH-Atascadero should develop formal written procedures for performing compensating controls. It also should develop a process to formally document the performance of compensating controls.

Summary of DSH's Response

DSH disagreed that DSH-Atascadero lacked adequate segregation of duties and compensating controls within its payroll transactions unit. DSH stated that DSH-Atascadero has compensating controls in place to perform conflicting functions. Specifically, the supervisor performs, on a random basis, review of the work performed by personnel specialist for keying personnel information. See Attachment for DSH's full response.

SCO's Comments

DSH-Atascadero made a similar assertion during the review, stating that the supervisor performed random reviews of transactions processed by the payroll transactions unit staff (i.e., personnel specialist). However, DSH-Atascadero does not have formal written procedures for conducting supervisory review nor does DSH-Atascadero maintain documentation to show that such reviews had taken place. The absence of such formalized processes results in a risk that supervisory reviews will not be performed in a manner consistent with DSH-Atascadero expectations or will not be done at all. In addition, without documentation to show performance of supervisory reviews, DSH-Atascadero could not demonstrate that a compensating control mitigated the effect of the deficiency resulting from inadequate segregation of duties. We included, for clarity, additional

clarification of our recommendations in the recommendation section. The finding remains as stated.

**FINDING 2—
Inadequate
controls over out-
of-class
compensation,
resulting in
improper
payments**

DSH-Atascadero lacked adequate controls to ensure that the payroll transactions unit processes only valid and authorized out-of-class compensation in accordance with collective bargaining agreements and State and DSH-Atascadero policies and procedures. Consequently, DSH-Atascadero improperly granted out-of-class compensation to 10 (67%) of the 15 employees reviewed, costing the State approximately \$86,849. If not corrected, this control deficiency also leaves DSH-Atascadero at risk of additional improper payments to employees who do not meet the requirements to receive the pay.

Payments made for out-of-class assignments that exceeded limits set by collective bargaining agreements, resulting in overpayments

Payroll records showed that DSH-Atascadero paid out-of-class compensation to 358 employees from July 2010 through June 2013. We reviewed selected out-of-class compensation for 15 of these employees to determine whether DSH-Atascadero granted compensation in excess of the number of days allowed by collective bargaining agreements. Of the 15 employees reviewed, 10 exceeded the limits set by collective bargaining agreements. The 10 employees included 1 subject to an agreement that restricts an employee's out-of-class assignment to 120 days; 7 subject to agreements that allow assignment beyond 120 days if approved by CalHR (previously the California Department of Personnel Administration), but DSH-Atascadero did not obtain such approval; and 2 subject to an agreement that restricts assignment to one year.

For the last 2 employees, DSH-Atascadero used a previous grievance settlement agreement between the State and Bargaining Unit 7 to justify the out-of-class assignments beyond one year. We believe that the settlement agreement does not apply to out-of-class assignments or extensions after the period covered by the settlement agreement. Accordingly, DSH-Atascadero paid the 10 employees an estimated total of \$86,849 in compensation for out-of-class assignments, that exceeded the limits set by collective bargaining agreements.

CalHR's Policy Memo #2007-026 reminds departments that there are no exceptions to request extensions of out-of-class assignments for represented employees beyond the provisions of collective bargaining agreements. In addition, DSH-Atascadero's Administrative Directive No. 902.2 only allows out-of-class work for represented employees when an assignment complies with collective bargaining agreements.

The collective bargaining agreement between the State and Bargaining Unit 4 restricts represented employees to up to and including 120 days of out-of-class assignment. The collective bargaining agreements between the State and Bargaining Units 7, 16, and 19 include the following provisions:

Unit	Section	Collective bargaining agreement states, in part...
7	15.2B	...no employee may be compensated for more than one (1) year of out-of-class work for any one (1) assignment. . . . pay shall be limited to out-of-class work performed (a) during the one (1) year calendar period before the employee's grievance was filed; and (b) the time between when the grievance was filed and finally decided by an arbitrator.
16	12.11A	...An employee may be assigned to work out of class for more than 120 consecutive days only with approval of the Department of Personnel Administration (DPA)....
19	15.3A	...An employee may be assigned to work out of class for more than 120 consecutive days only with the approval of the Department of Personnel Administration (DPA)....

Control deficiencies over processing of out-of-class compensation

GC sections 13402 and 13403 mandate State agencies to establish and maintain internal accounting and administrative controls, including a system of authorization and recordkeeping procedures over expenditures, and an effective system of internal review. State agencies also are responsible for ensuring that these controls are functioning as prescribed. However, our review of out-of-class compensation found significant control deficiencies that leave DSH-Atascadero at risk of additional improper payments and practices if not mitigated. Specifically, our review found that:

- DSH-Atascadero failed to implement existing policies and procedures related to out-of-class assignment and compensation consistently. For example, DSH-Atascadero's Administrative Directive 902.2 only allows out-of-class assignments as provided in collective bargaining agreements. However, DSH-Atascadero's payroll transactions unit staff processed compensation for out-of-class assignments even though the assignments exceeded the limits set by collective bargaining agreements or lacked proper approval from CalHR.
- DSH-Atascadero management did not provide adequate oversight to ensure that the processing of out-of-class compensation complies with collective bargaining agreements and State and DSH-Atascadero policies.

Recommendation

DSH-Atascadero should conduct a review of out-of-class compensation during the past three years to ensure that it complies with collective bargaining agreements and State policies. If DSH-Atascadero made overpayments to employees, it should seek reimbursement through an agreed-upon collection method, in accordance with GC section 19838.

To prevent improper out-of-class compensation from recurring, DSH-Atascadero should do the following:

- Implement existing policies and procedures prescribed by Administrative Directive 902.2 regarding out-of-class assignments and compensation. DSH-Atascadero should conduct ongoing monitoring of controls to ensure they are consistently implemented and operating effectively.
- Provide adequate oversight to ensure that the payroll transactions unit staff process only valid and authorized out-of-class compensation that complies with collective bargaining agreements and State and DSH-Atascadero policies.

Summary of DSH's Response

DSH disagreed that DSH-Atascadero improperly granted out-of-class compensation to 10 employees. DSH asserted that the labor contract required DSH-Atascadero to pay compensation to the employees who performed job duties at a higher-level classification. It also stated that DSH implemented an in-house approval process for out-of-class assignments beyond 120 days. See Attachment for DSH's full response.

SCO's Comments

We agree with DSH that the collective bargaining agreements (i.e., labor contracts) require payment of compensation for out-of-class work. However, as indicated in this report, these agreements also set limits on out-of-class assignments and compensation, or require proper approval from CalHR. DSH-Atascadero could not demonstrate that it met these requirements. Also, DSH and DSH-Atascadero did not have delegated authority from CalHR to approve out-of-class assignments and compensation for represented employees beyond the provisions of the collective bargaining agreements. The finding remains as stated.

**FINDING 3—
Inadequate
controls over
holiday credits
resulting in
improper accruals**

DSH-Atascadero lacked adequate controls over the accrual of its employees' holiday credits. Consequently, DSH-Atascadero improperly granted 462 holiday credit hours in 15 of 30 transactions (50%) we reviewed, costing the State approximately \$17,439. If not corrected, the control deficiency also leaves DSH-Atascadero at risk of recording additional improper accruals of holiday credit.

Collective bargaining agreements and GC section 19853 specify the number of hours of holiday credit an employee may receive per qualifying holiday. In our review of 30 selected holiday credit transactions recorded in the State's leave accounting system, we determined 15 involved accruals of 462 holiday credit hours that did not comply with collective bargaining agreements and State law. For instance, DSH-Atascadero granted an employee 219 hours more than the employee was entitled to receive for holiday credit. DSH-Atascadero also granted 6 employees 48 additional hours of holiday credit on holidays that fall on a Saturday, even though the system already had credited eight hours automatically. 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 into the system.

Table 2 – Improper Holiday Credits

Issues	Number of Employees	Number of Holiday Credit Transactions	Number of Hours of Excess Holiday Credits	Estimated Cost to the State as of June 30, 2013
Holiday credit exceeded the limit set by collective bargaining agreements	5	5	248	\$ 10,718
Holiday credit used entered as earned in the system	3	3	158	4,174
Holiday credit entered twice in the system	6	6	48	2,325
Holiday credit on pay periods that had no holidays	1	1	8	222
Total	15	15	462	\$ 17,439
As a percentage of selections reviewed ¹	58%	50%	49%	43%
Selections reviewed	26	30	934	\$ 40,128

Source: State's leave accounting system and DSH-Atascadero's payroll records.

¹ All percentages are rounded to the nearest full percentage point.

Recommendation

DSH-Atascadero 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. DSH-Atascadero should correct any excess holiday credits in the leave accounting system.

To prevent recording of improper holiday credits in the leave accounting system from recurring, DSH-Atascadero 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 DSH's Response

DSH agreed that DSH-Atascadero improperly granted \$17,439 in holiday credits to employees. DSH stated that only \$2,944 of the amount resulted in overpayment.

DSH indicated that it is now using the exception reports provided by the SCO as a tool to identify errors on a timely basis. DSH also cited a report from the California State Auditor (CSA) dated August 26, 2014, regarding the lack of automated controls in the State's leave accounting system. See Attachment for DSH's full response.

SCO's Comments

We could not verify that only \$2,944 resulted in overpayment because DSH did not provide additional source documentation to support its assertion. DSH also did not indicate if DSH-Atascadero implemented actions to address the remaining balance of improper holiday credits.

While we appreciate that DSH-Atascadero will be using the exception reports provided by the SCO as a tool to detect errors, we regret that DSH did not address the control deficiencies in the decentralized payroll process at DSH-Atascadero. As described in its response, DSH cited the CSA's report regarding the lack of automated controls in the State's leave accounting system. However, DSH failed to indicate that the same report stated that unless State agencies implement consistent, comprehensive procedures for reviewing the information entered into the leave accounting system, keying errors are likely to continue to occur. Further, the report emphasized that State agencies retain ownership of their data stored within the leave accounting system and are responsible for the data's accuracy and completeness.

The finding remains as stated.

FINDING 4— Inadequate controls over institutional worker supervision pay (IWSP), resulting in improper payments

DSH-Atascadero lacked adequate controls over the processing of institutional worker supervision pay (IWSP). Consequently, DSH-Atascadero improperly granted a total of \$6,900 in IWSP to 25 employees (100% of selections) whose records we reviewed. If not mitigated, the control deficiency also leaves DSH-Atascadero at risk of making additional improper payments to employees who did not meet the requirements to receive the pay.

Payments did not meet requirements under collective bargaining agreements and State policy, resulting in overpayments

Pursuant to collective bargaining agreements and CalHR's *California State Civil Service Pay Scales*, section 14, Pay Differential 67, employees assigned to supervise resident workers are eligible to receive IWSP if the employees meet certain requirements. The requirements include that the employees have regular, direct responsibility for supervising the work of at least two resident workers who must collectively work 173 hours each month, providing the resident workers with on-the-job training, and evaluating the resident workers' work performance. Pay Differential 67 requires that the employees also have a valid and approved medical clearance on file.

Payroll records showed that DSH-Atascadero paid monthly IWSP to 119 employees from July 2010 through June 2013. We reviewed 35 selected payments to 25 of these employees to determine whether the employees supervised at least two resident workers during the pay period, as required by the collective bargaining agreements and State policy. Of the 35 payments, 16 (46%) were paid to employees who did not work during the pay period; 14 (40%) had no documentation to support that the employee supervised at least two resident workers; and 5 (14%) were paid to an employee whose duties did not involve supervision of resident workers. Accordingly, DSH-Atascadero paid 25 employees a total of \$6,900 for IWSP even though they did meet the requirements to receive the pay. Table 3 summarizes the 35 improper IWSP payments to 25 employees.

Table 3 – Improper IWSP Payments

	Number of Employees	Number of Payments	Amount Paid
Total IWSP payments reviewed	25	35	\$ 6,900
Improper IWSP payments:			
Employee did not supervise any resident worker during the pay period	11 ¹	16	3,080
Employee whose duties did not involve supervision of resident workers	1	5	950
No documentation to support employee supervised at least two resident workers during the pay period	14	14	2,870
Total	25	35	\$ 6,900
As a percentage of total IWSP payments reviewed	100%	100%	100%

Source: State's payroll system and DSH-Atascadero's payroll records.

¹ One employee also received another payment for which there was no documentation to support that the employee supervised at least two resident workers during the pay period.

Inadequate controls over payment of IWSP

DSH-Atascadero had no controls in place over the payment of IWSP, leaving it at risk of additional improper payments if not mitigated. Specifically, DSH-Atascadero had no formal written policies and procedures to ensure that it only granted payments to eligible employees. In addition, DSH-Atascadero did not perform regular reviews to ensure that employees receiving IWSP met the eligibility requirements each pay period. The 35 improper payments described in Table 3 show that control is inadequate. Considering that our review was performed only on limited selections, and that IWSP payments were automatically generated by the payroll system every pay period, we are concerned that the number of improper payments may be even higher than we found.

GC sections 13402 and 13403 mandate State agencies to establish and maintain internal accounting and administrative controls, including a system of authorization and recordkeeping procedures, and internal review over payroll-related payments to its employees.

Recommendation

DSH-Atascadero should conduct a review of payments for IWSP during the past three years to verify that the payments comply with collective bargaining agreements and state policy. If DSH-Atascadero made overpayments to employees, it should seek reimbursement through an agreed-upon collection method in accordance with GC section 19838.

DSH-Atascadero also should establish adequate internal controls to prevent improper IWSP payments from recurring. Specifically, DSH-Atascadero should:

- Establish policies and procedures to ensure that it only grants IWSP to employees who meet the requirements of collective bargaining agreements and State policy. For example, DSH-Atascadero may require the payroll transactions unit staff to obtain from employees copies of the supervised resident workers' time sheets each pay period along with their own time sheets. The payroll transactions unit staff should use these documents to verify each employee's eligibility to receive IWSP.
- Conduct ongoing monitoring of controls to ensure that they are consistently implemented and operating effectively.
- Provide adequate supervisory review to ensure that payroll transactions unit staff processes only valid and authorized payments for IWSP.
- Provide training to managers, supervisors, and staff involved in IWSP transactions to ensure that they understand the requirements under collective bargaining agreements and State policy regarding IWSP.

Summary of DSH's Response

DSH agreed that DSH-Atascadero improperly granted IWSP to employees. See Attachment for DSH's full response.

SCO's Comments

DSH agreed with the finding but did not specifically address the control deficiencies over the processing of IWSP. The finding remains as stated.

**FINDING 5—
Inadequate
controls over
award and
overtime payments,
resulting in
improper
payments**

DSH-Atascadero lacked adequate controls to ensure that the payroll transactions unit staff processes only valid and authorized award and overtime payments that comply with collective bargaining agreements and State laws. Consequently, DSH-Atascadero improperly paid 13 employees a total of \$18,259 in award and overtime compensation. The control deficiencies also leave DSH-Atascadero at risk of making additional improper award and overtime payments if the deficiencies are not mitigated.

Award payments made to employees who did not meet requirements to receive the pay

Payroll records showed that DSH-Atascadero granted eight types of award payments to its employees from July 2010 through June 2013. We reviewed selected transactions in two types of award payments. The selected transactions included 33 payments for Medical Officer of the Day (MOD) to 19 employees, and 5 Psychiatric Technician (PT) educational reimbursements to 4 employees. Some of the employees received more than one of the payments reviewed in our selections.

The collective bargaining agreement between the State and Bargaining Unit 16 allows compensation for MOD work shift of at least eight continuous hours in addition to the employee's regularly scheduled work week. We found that 12 (63%) of the 33 MOD payments reviewed did not meet this requirement because the employees had fewer than eight hours of MOD work shifts. Accordingly, DSH-Atascadero overpaid 8 employees an estimated total of \$13,676.

We also found that two (40%) of the 5 PT educational reimbursements reviewed were improper. One employee received the reimbursement even though the employee had a different job classification that was not eligible to receive the pay. Another employee received the reimbursement twice during a qualifying period. DSH-Atascadero stated that the payroll transactions unit staff might have processed the second payment after the employee resubmitted the required documentation. Accordingly, DSH-Atascadero overpaid the 2 employees a total of \$1,580.

Overtime compensation improperly paid to employees

Payroll records showed that DSH-Atascadero paid overtime compensation to more than 1,700 employees from July 2010 through June 2013. We reviewed 20 overtime payments for 19 of these employees. Of the 20 payments, 3 (16%) were improper. In one case involving 2 employees, DSH-Atascadero counted the leave hours as time worked in calculating overtime. Collective bargaining agreements and State law do not allow leave hours to be counted as time worked in calculating overtime. In another case involving 1 employee, DSH-Atascadero paid twice for the employee's accumulated compensating time off (CTO) hours. DSH-Atascadero stated that the duplicate payment resulted from its failure to reduce the employee's CTO balance during the first cash-out. Consequently, DSH-Atascadero overpaid the 3 employees a total of \$3,003.

Control deficiencies over processing of award and overtime payments

GC sections 13402 and 13403 mandate State agencies to establish and maintain internal accounting and administrative controls, including a system of authorization and recordkeeping procedures over expenditures, and an effective system of internal review. State agencies also are responsible for ensuring that these controls are functioning as prescribed. However, the improper award and overtime payments demonstrated that DSH-Atascadero lacked adequate controls to ensure that the payroll transactions unit staff processes only valid and authorized payments that comply with collective bargaining agreements and state law.

Recommendation

DSH-Atascadero should conduct a review of award and overtime payments during the past three years to ensure that it complies with collective bargaining agreements and State law. If DSH-Atascadero made overpayments to employees, it should seek reimbursement through an agreed-upon collection method in accordance with GC section 19838.

To prevent improper award and overtime payments from recurring, DSH-Atascadero should do the following:

- Establish adequate internal controls to ensure that payments for award and overtime compensation comply with collective bargaining agreements and State law. These controls should require personnel office staff to verify that a payment does not exceed the amount set by collective bargaining agreements and State law.
- Provide adequate oversight to ensure that payroll transactions unit staff process only valid and authorized payments that comply with collective bargaining agreements and State law.

Summary of DSH's Response

DSH agreed that DSH-Atascadero improperly granted award and overtime payments to employees. See Attachment for DSH's full response.

SCO's Comments

DSH agreed with the finding but did not specifically address the control deficiencies over the processing of award and overtime payments. The finding remains as stated.

**Attachment—
California Department of State Hospitals-Atascadero's
Response to Draft Review Report**

OFFICE OF AUDITS1800 Ninth Street
Sacramento, CA 95814

May 15, 2015

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

Dear Mr. Finlayson:

The Department of State Hospitals (DSH) has received the California State Controller Division of Audits (SCO) draft report on payroll controls at DSH Atascadero State Hospital (Atascadero) dated April 28, 2015.

The report identifies internal control weaknesses in the areas of payroll transactions, attendance reporting, and out-of-class compensation. We do not agree with all of the findings contained in the report but agree that \$28,121 is an overpayment from computational errors and the incorrect application of existing rules. DSH will collect, as applicable, all monies overpaid.

Through this report and other payroll process reviews¹ the DSH is aware that improvements are needed in the payroll processing function. As a result, since the exit conference held September 30, 2014, DSH has implemented the following department-wide strategies to correct deficiencies identified:

- Department-wide strategic planning sessions to evaluate strengths and weaknesses in the payroll processing function, risk identification, risk assessments and business objectives for effective and efficient payroll business processing improvements.
- A Department-wide Kaizen session to evaluate workflow and sources of errors. An implementation plan to execute process improvements will be developed as part of the Kaizen session.
- Department-wide follow-up training as applicable, error rate tracking, and auditing of timesheets by management staff/supervisors. This includes the implementation and use of a new DSH Timekeeping Manual.

¹ California State Audit Report #2012-603: High Risk Update: State Agencies Credited Their Employees With Millions of Dollars' Worth of Unearned Leave August 26, 2014. Site last visited 5-4-15.

We anticipate these strategies, when fully implemented, will strengthen the DSH payroll processing function.

The following is a summary of our responses to the specific SCO audit findings:

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

We do not agree with the finding identified by SCO. Atascadero has compensating controls in place to perform conflicting functions as mandated by California Government Code sections 13402 and 13403.

Specifically, the work performed by Personnel Specialist for keying personnel information is subject to supervisor review. The supervisor's review is performed on a random basis. The intent of the supervisor's review is to identify any potential keying discrepancies inadvertently entered by the Personnel Specialist.

In addition, DSH is in the process of developing new audit tools for DSH Personnel Specialists to identify keying problem areas, necessary staff training (based on error rate), and monitoring staff progress/work. These tools will enhance the current process by mandating specific sampling performance measures along with documented supervisor approval. Plans are to have these audit tools available by August of 2015.

RESPONSE FINDING 2: Inadequate controls over out-of-class compensation, resulting in improper payments

We do not agree that improperly granted out-of-class compensation to employees costs the state \$86,849. DSH did not overpay the ten (10) employees by \$86,849 because the labor contract required DSH to pay applicable compensation to employees performing job duties at a higher level classification. The employees performed the job duties. The 10 employees paid beyond 120 days filled positions that, if vacant, would have created licensing and accreditation issues at Atascadero. These positions were mission critical and could not be filled due to various external statewide conditions. DSH was forced during this time frame to implement internal processes necessary to provide 24 hour level(s) of patient care, which included an in-house approval process for out-of-class assignments beyond 120 days. DSH worked with applicable contract labor unions to ensure that all contract labor laws were appropriately followed.

RESPONSE FINDING 3: Inadequate controls over holiday credits resulting in improper accruals

We agree that Atascadero had input errors of about \$17,439 in the California Leave Accounting System (CLAS). However, only \$2,944 of the \$17,439 resulted in an overpayment and will be collected as applicable.

Given the platform and the process to input information into the CLAS², Atascadero has recently instituted the new exception report provided to departments by the SCO (February 2014) that will be used to identify input errors on a timely basis. DSH would appreciate the SCO providing any other available audit tools (exception reports) that will help DSH in the CLAS input process.

RESPONSE FINDING 4: Inadequate controls over institutional worker supervision pay (IWSP), resulting in improper payments

We agree that \$6,900 was improperly granted to employees for IWSP. This will be collected as applicable.

RESPONSE FINDING 5: Inadequate controls over award and overtime payments, resulting in improper payments

We agree that \$13,676 was overpaid to eight (8) DSH staff due to the incorrect application of Medical Officer of the Day rules, \$1,580 was inadvertently paid to an employee twice for educational expenses, and \$3,021 was overpaid in computational errors for overtime compensation. These overpayments will be collected as applicable.

Thank you for the opportunity to respond to your draft report. If you have any questions, please contact me at (916) 651-9984.

Sincerely,



Cindy Woolston, Chief
Office of Audits

cc: Ms. Pam Ahlin, Director :
California Department of State Hospitals
Ms. Stephanie Clendenin, Chief Deputy Director
California Department of State Hospitals
Mr. Stirling Price, Executive Director
California Department of State Hospitals-Atascadero
Ms. Elizabeth Andres, Acting Hospital Administrator
California Department of State Hospitals-Atascadero
Ms. Maggie Spurgeon, Acting Human Resources Director
California Department of State Hospitals- Atascadero
Mr. Rob Cook, Chief Operating Officer
California Department of State Hospitals-Sacramento
Ms. Christina Edens, Acting Chief Financial Officer
California Department of State Hospitals - Sacramento

² See previous footnote. Per the report issued, the California Leave Accounting System lacks sufficient automated controls to prevent state agencies from processing erroneous transactions.

**State Controller's Office
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