CALIFORNIA MEDICAL FACILITY

Review Report

PAYROLL PROCESS REVIEW

November 1, 2014, through October 31, 2017

BETTY T. YEE
California State Controller

July 2019

BETTY T. YEE
California State Controller

July 26, 2019

Jared D. Lozano, Warden
California Medical Facility
1600 California Drive
Vacaville, CA 95687

Dear Mr. Lozano:

The State Controller's Office reviewed the California Medical Facility (CMF) payroll process and transactions for the period of November 1, 2014, through October 31, 2017. CMF 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 review found material weaknesses in internal control over the CMF payroll process. These weaknesses contributed to CMF employees' excessive vacation, annual leave, and compensating time off balances, improper and questioned payments, and long-outstanding unrecovered salary advances, costing the State an estimated net total of $5,531,871.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Dan Cueva, Chief Deputy Warden
California Medical Facility
Jenny Ruth, Institutional Personnel Officer
California Medical Facility
Ralph Diaz, Secretary
California Department of Corrections and Rehabilitation
Kathleen Allison, Undersecretary of Operations
California Department of Corrections and Rehabilitation
Kenneth Pogue, Undersecretary of Administration & Offender Services
California Department of Corrections and Rehabilitation
Katherine Minnich, Deputy Director of Human Resources
California Department of Corrections and Rehabilitation
Mai Lee Vang, External Audits Manager
Office of Audits and Court Compliance
California Department of Corrections and Rehabilitation
Mark Rodriguez, Chief
Administrative Services Division
California Department of Human Resources
Marissa Revelino, Chief
Personnel and Payroll Services Division
State Controller's Office

Contents

Review Report

Summary

The State Controller's Office (SCO) reviewed the California Medical Facility (CMF) payroll process and transactions for the period of November 1, 2014, through October 31, 2017. CMF 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 CMF payroll process that leave CMF at risk of additional improper payments if not mitigated. We found that CMF 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 or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

Specifically, CMF lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. In addition, CMF inappropriately granted 16 employees keying access to the State's payroll system, leaving payroll data at risk of misuse, abuse, and unauthorized use. These deficiencies have a pervasive effect on the CMF payroll process, and impair the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

We also found that CMF lacked sufficient controls over the processing of specific payroll-related transactions to ensure that CMF complied with collective bargaining agreements and state laws, and that only valid and authorized payments were processed. As quantified in the Schedule, these deficiencies contributed to CMF employees' excessive vacation, annual leave, and compensating time off (CTO) balances; improper and questioned payments for separation lump-sum pay, overtime pay, holiday pay, and leave buy-back; improper holiday credit transactions; and long-outstanding unrecovered salary advances, costing the State an estimated net total of $5,531,871.

Background

In 1979, the State of California adopted collective bargaining for state employees. This 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. PPSD decentralized the processing of payroll, allowing state agencies and departments to process their own payroll-related transactions. Periodic reviews of the decentralized payroll processing at state agencies and departments ceased due to the budget constraints in the late 1980s.

In 2013, the California State Legislature reinstated these payroll reviews to gain assurance that state agencies and departments maintain adequate internal control over payroll, provide proper oversight over their decentralized payroll processing, and comply 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, 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

We performed this review to determine whether CMF:

- Processed payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures;
- Established adequate internal control over 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;
  - State laws, regulations, policies, and procedures are complied with regarding payroll and payroll-related transactions;
- Complied with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures;
- Maintained accurate records of leave balances; and
- Administered and recorded salary advances properly and in accordance with state laws, regulations, policies, and procedures.

We reviewed the CMF payroll process and transactions for the period of November 1, 2014, through October 31, 2017.

To achieve our objectives, we:

- Reviewed state and CMF policies and procedures related to the payroll process to understand CMF's methodology for processing various payroll and payroll-related transactions;
- Interviewed CMF payroll personnel to understand CMF's methodology for processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to payroll transaction processing, and gain an understanding of existing internal control over the payroll process and systems;

- Selected transactions recorded in the State's payroll database using statistical sampling as outlined in the Appendix, random selection, and targeted selection 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, propriety of 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 (errors found in statistically-determined samples were projected to the intended population); and
- Reviewed salary advances to determine whether CMF administered and recorded them in accordance with state laws, regulations, policies, and procedures.

Conclusion

Based on the results of our review, we found that CMF:

- Did not process payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures (see Findings 4 through 8);
- Lacked adequate internal control over payroll and payroll-related transactions (see Findings 1 through 8);
- Did not comply with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures (see Findings 2 and 3);
- Did not maintain accurate records of leave balances (see Findings 4 and 6); and
- Did not administer salary advances in accordance with state laws, regulations, policies, and procedures (see Finding 7).

As quantified in the Schedule and described in the Findings and Recommendations section of this review report, these material weaknesses[1] in internal control over the payroll process contributed to CMF employees' excessive vacation, annual leave, and CTO balances, improper and questioned payments, improper holiday credits, and long-outstanding unrecovered salary advances, costing the State an estimated net total of $5,531,871.

---

[1] An evaluation of an entity's payroll process may identify deficiencies in its internal control over the 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 material weakness is a deficiency, or a 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. 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 from those charged with governance.

Views of Responsible Officials

We issued a draft review report on June 11, 2019. Jared D. Lozano, Warden, responded by letter dated June 19, 2019 (Attachment), indicating CMF's agreement with the findings, and stating that CMF has taken steps since the review period to correct the deficiencies noted in the findings. We will follow up during the next payroll review to verify that these corrective actions were adequate and appropriate. CMF also provided additional information regarding inappropriate keying access granted to managers, as described in Finding 2. Our comments to CMF's response to Finding 2 are included in the Findings and Recommendations section.

Restricted Use

This report is solely for the information and use of CMF 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, and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

July 26, 2019

Schedule— Summary of Findings November 1, 2014, through October 31, 2017

Finding Number	Issues	Number of Selections Reviewed	Method of Selection	Selection Unit	Dollar Amount of Selections Reviewed	Number of Selections with Issues	Issues as a Percentage of Selections Reviewed *	Dollar Amount of Known Issues	Dollar Amount of Likely Issues	Total Dollar Amount of Known and Likely Issues
1	Inadequate segregation of duties and compensating controls over payroll transactions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2	Inappropriate keying access to the State's payroll system	40	Targeted	Employee	$ -	16	40%	$ -	$ -	$ -
3	Inadequate controls over vacation, annual leave, and CTO balances, resulting in liability for excessive balances	227	Targeted	Employee	4,357,091	226	100%	4,351,329	N/A	4,351,329
4	Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments									
	Overpayments (7k employees)	51	Statistical	Employee	2,060,327	36	71%	135,221	163,272	298,493
	Underpayments (7k employees)		-- Same selections above --			7	14%	(8,693)	(10,497)	(19,190)
	Overpayments (non-7k employees)	51	Statistical	Employee	926,846	3	6%	1,836	2,530	4,366
	Underpayments (non-7k employees)		-- Same selections above --			7	14%	(9,476)	(13,061)	(22,537)
	Questioned payments (non-7k employees)		-- Same selections above --			1	2%	2,858	3,940	6,798
5	Inadequate controls over overtime pay, resulting in improper and questioned payments									
	Overpayments	60	Statistical	Payment transaction		5	8%	323	148,474	148,797
	Underpayments		-- Same selections above --			5	8%	(1,891)	(868,318)	(870,209)
	Questioned payments		-- Same selections above --			3	5%	3,434	1,577,036	1,580,470
	Overpayments	9	Targeted	Payment transaction		1	11%	5,126	N/A	5,126
	Underpayments	10	Random selection	Payment transaction		1	10%	(1,126)	N/A	(1,126)
6	Inadequate controls over holiday compensation, resulting in overpayments and improper credits									
	Over-credits	18	Targeted	Holiday credit transaction	4,356	5	28%	2,601	N/A	2,601
	Overpayments	60	Statistical	Payment transaction	20,581	1	2%	246	39,872	40,118
7	Inadequate controls over salary advances, resulting in failure to recover outstanding amounts	12	Targeted	Salary advance transaction	19,287	2	17%	4,265	N/A	4,265
8	Inadequate controls over leave buy-back, resulting in improper payments									
	Overpayments	51	Statistical	Payment transaction	133,662	8	16%	1,344	1,850	3,194
	Underpayments		-- Same selections above --			3	6%	(263)	(361)	(624)
	Total				$ 7,522,150			$ 4,487,134	$ 1,044,737	$ 5,531,871

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

Findings and Recommendations

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

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

GC sections 13400 through 13407 require state agencies to establish and maintain internal 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.

Our review found that CMF payroll transactions unit staff performed conflicting duties. Staff members performed multiple steps in processing payroll transactions, including entering data into the State's payroll system; auditing employee timesheets; reconciling payroll, including reconciling system output to source documentation; reporting payroll exceptions; and processing adjustments. For example, staff members keyed in regular and overtime pay and reconciled the master payroll, overtime, and other supplemental warrants. In addition, as described in Finding 2, two managers had keying access to the State's payroll system while responsible for approving payroll transactions that had been entered into the system. CMF failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. 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 CMF 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 through 8, 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.

Good internal control practices require that the following functional duties 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 review 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.

Recommendation

We recommend that CMF:

- Separate conflicting payroll function duties to the greatest extent possible. 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.

  If it is not possible to segregate payroll functions fully and appropriately, CMF should implement compensating controls. For example, if the payroll transactions unit staff member responsible for recordkeeping also performs a reconciliation process, then the supervisor should 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; and

- Develop formal procedures for performing and documenting compensating controls.

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

CMF lacked adequate controls to ensure that only appropriate staff had keying access to the State's payroll system. CMF inappropriately allowed 16 employees keying access to the State's payroll system. If not mitigated, this control deficiency leaves payroll data at risk of misuse, abuse, and unauthorized use.

The SCO maintains the State's payroll system. The system is decentralized, thereby allowing employees of state agencies to access it. PPSD has established a *Decentralized Security Program Manual* that all state agencies are required to follow in order to access the payroll system. The program's objectives are to secure and protect the confidentiality and integrity of payroll data against misuse, abuse, and unauthorized use.

We reviewed the records of 40 CMF employees who had keying access to the State's payroll system at various times between November 2014 and October 2017. Of the 40 employees, 16 had inappropriate keying access to the State's payroll system. Specifically, CMF did not immediately remove or modify the keying access of 14 employees after their separation from state service, transfer to another agency or unit, or change in classification. Of the 14 employees, we also noted the following:

- One employee continued to have keying access for 142 days after that employee transferred to another state agency;
- Two managers had keying access to the State's payroll system. The managers' duties included approving certain payroll transactions prior to input into the system. The managers also reviewed the work of their staff. To properly segregate duties, employees charged with approving transactions should not be able to enter the transactions that they approve; and
- One employee had keying access while appointed to the Associate Personnel Analyst classification—a position that is not eligible to have keying access to the system without the required justification.

Also, two additional employees had keying access to the payroll system while appointed to Associate Government Program Analyst or Staff Services Analyst classifications. These positions were ineligible to have keying access to the system without the required justification; CMF did not submit the justification letters for these employees.

The *Decentralized Security Program Manual* states, in part:

> The PPSD system contains sensitive and confidential information. Access is restricted to persons with an authorized, legal, and legitimate business requirement to complete their duties. . . .
>
> Currently, PIMS, HIST, KEYM, PIP, LAS, MPC and/or ACAS applications are restricted to Personnel Specialists or Personnel Technician 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/campus. . . .
>
> A request to grant access to an individual in a classification other than in the Personnel Specialist/Payroll Technician series to access PIMS, HIST, KEYM, PIP, LAS, MPC and/or ACAS requires a written justification from the Authorizing Manager. The justification must describe the individual's specific job duties requiring the need to access system information (i.e., PIMS = Employment History, HIST=Payroll History, LAS=Leave Accounting System, etc.) as well as level of access to that application, in order to perform their regular daily duties. **Manager classifications will be granted inquiry access only**. . . .
>
> To prevent unauthorized use by a transferred, terminated or resigned employee's user ID, the Security Monitor must IMMEDIATELY submit all pages of the PSD125A to delete the user's system access. Using an old user ID increases the chances of a security breach which is a serious security violation. Sharing a user ID is strictly prohibited and a serious violation.

<u>Recommendation</u>

We recommend that CMF:

- Update keying access to the State's payroll system immediately after employees leave CMF, transfer to another unit, or change classifications; and
- Periodically review access to the payroll system to verify that access complies with the *Decentralized Security Program Manual*.

<u>CMF's Response</u>

> . . . . In July 2017, as part of the Department of State Hospitals "Lift and Shift", Decentralized Security contacts were transitioned (from "HG") to "MF" using the SCO two character agency identification process. Prior to that transition, it appears that SCO granted temporary keying access for a Staff Services Manager II (SSM II); however, justification

for such access was not provided to CMF as part of the transition. By late 2017, the SSM II's access was changed to "Inquiry Only."

See Attachment for CMF's full response.

SCO Comment

Based on additional information provided by CMF, we modified our statements in Findings 1 and 2 to clarify that two managers had inappropriate keying access.

CMF also referred to SCO granting temporary keying access for an SSM II without providing CMF with the justification letter for such access. Although the SCO processes requests for access, CMF is responsible for authorizing access and compliance with requirements, including providing a written justification and reporting any variances from established procedures to PPSD.

We appreciate CMF's willingness to take action to correct the deficiencies noted in this finding. We will follow up during the next payroll review to verify that these corrective actions were adequate and appropriate.

FINDING 3—Inadequate controls over vacation, annual leave, and CTO balances, resulting in liability for excessive balances

CMF failed to implement controls to ensure that it adheres to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation, annual leave, and CTO credits. This deficiency resulted in liability for excessive leave balances with a value of at least $4,351,329 as of October 31, 2017. We expect the liability to increase if CMF does not take action to address the excessive vacation, annual leave, and CTO balances.

Vacation and Annual Leave

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 balances helps state agencies manage leave balances and control the State's liability for accrued leave credits. State agencies may allow employees to carry a higher leave balance only under limited circumstances. For example, an employee may not be able to reduce accrued vacation or annual leave hours below the limit due to 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 CMF's leave accounting records determined that CMF had 219 employees who exceeded the limit set by collective bargaining agreements and state regulations at October 31, 2017. For example, one employee had an accumulated balance of 2,704 hours of annual leave, or 2,064 hours beyond the 640-hour limit. Collectively, the 219 employees accumulated 94,134 hours of excess vacation and annual leave, with a value of at least $4,221,765 as of October 31, 2017. This estimated liability does not adjust for salary rate increases and additional leave credits.[2] Accordingly, we expect that the amount needed to pay for this liability will be higher. For example, a CMF employee separated from state service with 4,199 hours in leave credits, including 2,251 hours in annual leave. After adjusting for additional leave credits, the employee should have been paid for 4,982 hours, or 19% more.

When we discussed this issue with personnel office staff members, they indicated that CMF did not have plans in place during the review period to address excessive vacation and annual leave balances in accordance with collective bargaining agreements and state regulations. CMF also could not demonstrate that it had complied with collective bargaining agreements and state regulations when allowing these employees to maintain excess vacation or annual leave balances.

Compensating Time Off

Collective bargaining agreements allow employees to accrue up to 240 CTO hours. State agencies should compensate employees in cash for all CTO hours in excess of 240 hours. Leave accounting records showed that seven CMF employees exceeded the 240-hour limit for CTO by 2,424 hours, with an estimated value of at least $129,564 at October 31, 2017. One employee had 1,375 CTO hours, or 1,135 hours beyond the 240-hour limit. This estimated liability does not adjust for salary rate increases.[3] Accordingly, we expect that the amount needed to pay for this liability will be higher than it would have been if the excess CTO balances had been paid for at the time the employees earned them, as required.

If CMF does not take action to reduce the excessive leave balances, the liability for accrued vacation, annual leave, and CTO will likely increase because most employees will receive salary increases or use other non-compensable leave credits instead of vacation, annual leave, or CTO, increasing their vacation or annual leave balances. The state agency responsible for paying these leave balances may face a cash flow problem if a significant number of employees with excessive vacation, annual leave, or CTO balances separate from state service. Normally, state agencies are not budgeted to make these separation 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

We recommend that CMF:

- Implement controls, including existing policies and procedures, to ensure that its employees' vacation, annual leave, and CTO balances

[2] Most state employees receive pay rate increases every year pursuant to state laws and/or collective bargaining agreements until they reach the top of their pay scale, or promote into a higher-paying position. In addition, when an employee's accumulated leave balances upon separation are calculated for lump-sum pay, the employee is credited with additional leave credits equal to the amount that the employee would have earned had the employee taken time off and not separated from state service.

[3] See footnote 2.

are maintained within levels allowed by collective bargaining agreements and state regulations;

- Conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively;
- Compensate employees in cash for CTO hours in excess of the 240-hour limit; and
- Participate in leave buy-back programs if the State offers such programs and funds are available.

FINDING 4— Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments

CMF lacked adequate controls over the processing of employee separation lump-sum pay. We identified $302,859 in overpayments, $41,727 in underpayments, and $6,798 in questioned payments for separation lump-sum pay, consisting of $137,057 in overpayments, $18,169 in underpayments, and $2,858 in questioned payments based on actual transactions reviewed ("known"); and $165,802 in overpayments, $23,558 in underpayments, and $3,940 in questioned payments based on the results of statistical sampling ("likely"). If not mitigated, these control deficiencies leave CMF at risk of additional improper separation lump-sum payments.

GC section 19839 allows lump-sum payment for accrued eligible leave credits when an employee separates from state employment. Collective bargaining agreements include similar provisions regarding separation lump-sum pay.

Payroll records show that CMF processed payments for separation lump-sum pay, totaling $6,752,514, for 253 employees between November 2014 and October 2017, as follows:

Separation Lump-sum Pay Group	Unit	Amount
Section 7(k) employees (statistically sampled)	113	$ 4,548,053
Non-section 7(k) employees (statistically sampled)	140	2,204,461
Total population	253	$ 6,752,514

* Amounts in this table are rounded to the nearest dollar.

Of the payments for separation lump-sum pay, totaling $4,548,053, for 113 employees who were covered by the provisions of Section 7(k) of the Fair Labor Standards Act (FLSA), we randomly selected a statistical sample (as described in the Appendix) of 51 employees who were paid separation lump-sum pay, totaling $2,060,327.

Our review of lump-sum payments made to these 51 employees showed that CMF overpaid 36 of them by approximately $135,221 and underpaid seven of them by approximately $8,693. These payments resulted in a net total improper payments of $126,528. As we used a statistical sampling method to select the employees whose payments for separation lump-sum pay were examined, we projected the amount of likely overpayments to be $163,272 and likely underpayments to be $10,497. Therefore, the known and likely improper payments totaled a net approximate $279,303, consisting of $298,493 in overpayments and $19,190 in underpayments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	$ 126,528
Divide by: Sample	2,060,327
Error rate for projection (differences due to rounding)	6.14%
Population that was statistically sampled	4,548,053
Multiply by: Error rate for projection	6.14%
Known and likely improper payments, net (differences due to rounding)	279,303
Less: Known improper payments, net	126,528
Likely improper payments, net	$ 152,775

* Amounts in this table are rounded to the nearest dollar.

Of the remaining payments for separation lump-sum pay, totaling $2,204,461, for 140 employees who were not covered by the provisions of Section 7(k) of the FLSA, we randomly selected a statistical sample (as described in the Appendix) of 51 employees who were paid separation lump-sum pay, totaling $926,846.

Our review of lump-sum payments made to these 51 employees showed that CMF overpaid three of them by approximately $1,836 and underpaid seven of them by approximately $9,476. Our review of lump-sum payments also showed a lack of supporting documentation for a payment, totaling $2,858, made to one employee. Without the required documentation, there is no record of calculation and approval of payments for separation lump-sum pay. Therefore, we could not determine the validity, accuracy, and propriety of the payment made to the employee. As a result, we questioned this payment. The known improper and questioned payments totaled a net of $4,782. As we used a statistical sampling method to select the employees whose payments for separation lump-sum pay were examined, we projected the amount of likely improper and questioned payments to be a net of approximately $6,591, consisting of $2,530 in overpayments, $13,061 in underpayments, and $3,940 in questioned payments. Therefore, the known and likely improper and questioned payments totaled a net of approximately $11,373, consisting of $4,366 in overpayments, $22,537 in underpayments, and $6,798 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	$ (4,782)
Divide by: Sample	926,846
Error rate for projection (differences due to rounding)	(0.52%)
Population that was statistically sampled	2,204,461
Multiply by: Error rate for projection	(0.52%)
Known and likely improper and questioned payments, net (differences due to rounding)	(11,373)
Less: Known improper and questioned payments, net	(4,782)
Likely improper and questioned payments, net	$ (6,591)

* Amounts in this table are rounded to the nearest dollar.

The known improper payments were made because payroll transactions unit staff members miscalculated leave balances paid, failed to include the leave credits that employees were credited with when their leave balances were calculated for lump-sum pay, and incorrectly entered the leave hours for lump-sum payment into the State's payroll system. CMF also lacked adequate supervisory review to ensure accurate processing of separation lump-sum pay.

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including an effective system of internal review.

Recommendation

We recommend that CMF:

- Establish adequate controls to ensure accurate calculation and payment of separation lump-sum pay;
- Conduct a review of payments for separation lump-sum pay made during the past three years to ensure that the payments were accurate and in compliance with collective bargaining agreements and state law;
- Recover overpayments made to separated employees in accordance with GC section 19838 and *State Administrative Manual* (SAM) section 8776.6, and properly compensate those employees who were underpaid; and
- Maintain documentation supporting the processing of payments for separation lump-sum pay.

FINDING 5— Inadequate controls over overtime pay, resulting in improper and questioned payments

CMF lacked adequate controls over the processing of overtime pay. We identified $153,923 in overpayments, $871,335 in underpayments, and $1,580,470 in questioned payments for overtime pay, consisting of $5,449 in overpayments, $3,017 in underpayments, and $3,434 in questioned payments based on actual transactions reviewed ("known"); and $148,474 in overpayments, $868,318 in underpayments, and $1,577,036 in questioned payments based on the results of statistical sampling ("likely"). If not mitigated, the control deficiencies leave CMF at risk of additional improper payments for overtime pay.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding overtime pay. Payroll records show that CMF processed 25,029 overtime pay transactions, totaling $38,065,108, between November 2014 and October 2017, as follows:

Overtime Payment Type by Group	Unit	Amount
Work Week Group 2 – Paid for less than 300 hours (statistically sampled)	24,721	$ 37,444,519
Work Week Group 2 – Paid for at least 300 hours (items examined 100%)	9	128,711
Work Week Group E (randomly selected items for examination)	299	491,878
Total population	25,029	$ 38,065,108

* Amounts in this table are rounded to the nearest dollar.

Of the 24,721 overtime pay transactions, totaling $37,444,519, for Work Week Group (WWG) 2 employees who were paid for less than 300 hours of overtime per transaction, we randomly selected a statistical sample (as described in the Appendix) of 60 transactions, totaling $81,352. Of the 60 transactions, CMF overpaid five by approximately $323 and underpaid five by approximately $1,891. We also questioned three transactions, totaling $3,434, because CMF could not provide the employees' timesheets to support that the payments were valid and authorized. Without the timesheets, there is no record of hours worked and supervisory review and approval. Therefore, we could not determine the validity and propriety of payments for these three overtime pay transactions. The known improper and questioned payments totaled a net approximate $1,866.

As we used a statistical sampling method to select the overtime pay transactions examined, we projected the amount of likely overpayments to be $148,474 and likely underpayments to be $868,318. We could also estimate that there may have been additional missing timesheets associated with overtime pay, totaling $1,577,036. As timesheets are required documents to authorize pay, we would also question these payments for overtime pay. The likely improper and questioned payments totaled a net approximate $857,192. Therefore, the known and likely improper and questioned payments totaled a net approximate $859,058, consisting of $148,797 in overpayments, $870,209 in underpayments, and $1,580,470 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	$ 1,866
Divide by: Sample	81,352
Error rate for projection (differences due to rounding)	2.29%
Population that was statistically sampled	37,444,519
Multiply by: Error rate for projection	2.29%
Known and likely improper and questioned payments, net (differences due to rounding)	859,058
Less: Known improper and questioned payments, net	1,866
Likely improper and questioned payments, net	$ 857,192

* Amounts in this table are rounded to the nearest dollar.

The known improper payments were made because the payroll transactions unit staff members miscalculated overtime hours worked and paid for overtime hours worked at the straight-time rate instead of the one-and-a-half-time rate, or vice-versa. CMF also lacked adequate supervisory review to ensure accurate processing of overtime pay. CMF could not explain why the system allowed such errors.

We also examined all nine overtime pay transactions, totaling $128,711, for WWG 2 employees who were paid for at least 300 hours of overtime. Of the nine transactions, CMF overpaid one transaction by approximately $5,126 because the overtime hours worked had been miscalculated.

Of the 299 overtime pay transactions, totaling $491,878, for WWG E employees, we randomly selected 10 transactions, totaling $16,187. Of the 10 transactions, CMF underpaid one transaction by $1,126 because the overtime hours were paid for at the straight-time rate instead of the one-and-a-half-time rate.

GC sections 13402 through 13407 require state agencies to establish and maintain internal controls, including a system of policies and procedures adequate to ensure compliance with applicable laws and other requirements, and an effective system of internal review.

Recommendation

We recommend that CMF:

- Conduct a review of payments for overtime pay made during the past three years to ensure that the payments complied with collective bargaining agreements and state laws and policies; and
- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838, and properly compensate those employees who were underpaid.

We further recommend that, to prevent improper payments for overtime pay from recurring, CMF:

- Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreements and state laws and policies; and
- Provide adequate oversight to ensure that payroll transactions unit staff process only valid and authorized payments that comply with collective bargaining agreements and state laws and policies.

FINDING 6—Inadequate controls over holiday compensation, resulting in overpayments and improper credits

CMF lacked adequate controls over the processing of holiday credit transactions. We identified $40,118 in overpayments for holiday compensation, consisting of $246 based on actual transactions reviewed ("known") and $39,872 based on the results of statistical sampling ("likely"). We also identified approximately $2,601 in improper holiday credits. If not mitigated, this control deficiency leaves CMF at risk of additional improper holiday credits.

GC section 19853 specifies the compensation that an eligible employee is entitled to receive when required to work on a qualifying holiday. Collective bargaining agreements between the State and Bargaining Units 6, 15, 17, 18, and 20 include similar provisions regarding holiday compensation for represented employees.

Holiday Pay

Leave accounting records showed that CMF processed 10,700 holiday pay transactions, totaling $3,356,374 between November 2014 and October 2017. Of the 10,700 holiday pay transactions, we randomly selected a statistical sample (as described in the Appendix) of 60 transactions, totaling $20,581.

Our review of these 60 transactions showed that CMF overpaid one of them by $246. A payroll transactions unit staff member incorrectly granted the employee holiday pay at premium rate instead of regular rate. As we used a statistical sampling method to select the transactions examined, we projected the amount of likely overpayments to be $39,872. Therefore, the known and likely overpayments totaled $40,118.

The following table summarizes the results of our statistical sampling:

Known overpayment	$	246
Divide by: Sample		20,581
Error rate for projection (differences due to rounding)		1.20%
Population that was statistically sampled		3,356,374
Multiply by: Error rate for projection		1.20%
Known and likely overpayments (differences due to rounding)		40,118
Less: Known overpayments		246
Likely overpayments	$	39,872

____

* Amounts in this table are rounded to the nearest dollar.

Holiday Credit

We also examined 18 holiday credit transactions, with an estimated value of $4,356. These transactions were selected due to unusual credits. Of the 18 transactions, five involved improper credits, costing an estimated $2,601. The improper holiday credit transactions were made because the payroll transactions unit staff members granted holiday credits to employees during pay periods with no holidays. They also granted holiday credit hours rather than reducing holiday credit balances by the number of credits used. CMF also lacked adequate supervisory review to ensure accurate processing of holiday credits.

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including an effective system of internal review.

<u>Recommendation</u>

We recommend that CMF:

- Conduct a review of holiday credits granted during the past three years to ensure that credits complied with collective bargaining agreements and state law;
- Correct any improper holiday credits in the State's leave accounting system; and
- Establish adequate controls to ensure that holiday credits granted are valid and comply with collective bargaining agreements and state law.

FINDING 7— Inadequate controls over salary advances, resulting in failure to recover outstanding amounts

CMF lacked adequate controls over salary advances to ensure that advances were recovered in accordance with state law and policies. Two salary advances, totaling $4,265, remained outstanding as of October 31, 2017, as a result of CMF's noncompliance with the State's collection policies and procedures. The oldest unrecovered salary advance was outstanding for over one year. This control deficiency leaves CMF at risk of further failures to collect salary advances if not mitigated.

At October 31, 2017, CMF's accounting records showed 35 outstanding salary advances totaling $108,377, including 12 balances totaling $19,287 that had been outstanding for more than 120 days. Generally, the prospect of collection diminishes as an account ages. When an agency is unable to collect after three years, the possibility of collection is remote.

GC section 19838 and SAM sections 8776 and 8776.7 describe the State's collection policies and procedures, which require CMF to collect salary advances in a timely manner and maintain proper records of collection efforts.

In our review of the 12 salary advances that were over 120 days old, we noted that CMF did not comply with the State's collection policies and procedures for two of them, totaling $4,265. CMF did not send collection notices promptly, and in some cases did not send the notices at all. These two salary advances remained outstanding during our review. One salary advance has been outstanding for over one year.

The lack of adequate controls over salary advances reduces the likelihood of collection, increases the amount of resources expended on collection efforts, and negatively impacts cash flow.

Recommendation

We recommend that CMF ensure that it recovers salary advances in a timely manner pursuant to GC section 19838 and SAM sections 8776 and 8776.7.

FINDING 8— Inadequate controls over leave buy-back, resulting in improper payments

CMF lacked adequate controls over the processing of payments for leave buy-back. We identified $3,194 in overpayments and $624 in underpayments for leave buy-back, consisting of $1,344 in overpayments and $263 in underpayments based on actual transactions reviewed ("known"); and $1,850 in overpayments and $361 in underpayments based on the results of statistical sampling ("likely"). If not mitigated, the control deficiencies leave CMF at risk of additional improper leave buy-back payments.

A leave-buy back occurs when an employee receives payment at the regular salary rate in exchange for accrued vacation, annual leave, personal leave, personal holiday, and/or holiday credits. Collective bargaining agreements between the State and Collective Bargaining Units 12 and 13 allow for the annual cash-out of a certain number of hours of accumulated vacation and annual leave if funds are available. Title 2, *California Code of Regulations*, section 599.744 also provides that the California Department of Human Resources may authorize a leave buy-back program for employees excluded from collective bargaining. The California Department of Human Resources authorized leave buy-backs for excluded employees in fiscal year (FY) 2014-15, FY 2015-16, and FY 2016-17. It also provided the State's policies and procedures regarding cash-out of vacation and annual leave.

Payroll records showed that CMF processed 200 leave buy-back transactions, totaling $317,689, between November 2014 and October 2017. Of the 200 transactions, we randomly selected a statistical sample (as described in the Appendix) of 51, totaling $133,662. Our review of 51 transactions determined that CMF overpaid eight transactions by $1,344 underpaid three transactions by $263. These payments resulted in net total overpayments of $1,081. As we used a statistical sampling method to select the leave buy-back transactions examined, we projected the amount of likely net overpayments to be $1,489, consisting of $1,850 in overpayments and $361 in underpayments. Accordingly, the known and likely overpayments totaled a net approximate $2,570, consisting of $3,194 in overpayments and $624 in underpayments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	$ 1,081
Divide by: Sample	133,662
Error rate for projection (differences due to rounding)	0.81%
Population that was statistically sampled	317,689
Multiply by: Error rate for projection	0.81%
Known and likely improper payments, net (differences due to rounding)	2,570
Less: Known improper payments, net	1,081
Likely improper payments, net	$ 1,489

____

* Amounts in this table are rounded to the nearest dollar.

The known improper payments were made because payroll transactions unit staff members miscalculated the salary rate used to pay for the leave buy-back. CMF also lacked adequate supervisory review to ensure accurate processing of payments for leave buy-back.

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including an effective system of internal review.

Recommendation

We recommend that CMF:

- Provide adequate supervisory review to ensure that payroll transactions unit staff members process leave buy-back payments accurately; and
- Recover overpayments made to separated employees in accordance with GC section 19838 and SAM section 8776.6, and properly compensate those employees who were underpaid.

Appendix—
Sampling Methodology
November 1, 2014, through October 31, 2017

We used attributes sampling for test of compliance. The following table outlines our sampling application for review areas that included errors:

Review Area	Type of Test	Population (Unit)	Population (Dollar)	Sampling Unit	Sample Selection Method	Confidence Level	Tolerable Error Rate	Expected Error (Rate) [1]	Sample Size	Results Projected to Intended Population	Finding Number
Separation lump-sum pay (employees under Section 7k of the FLSA)	Compliance	113	$ 4,548,053	Employee	Computer-generated simple random	95%	5%	0 (0%)	51	Yes	4
Separation lump-sum pay (employees not under Section 7k of the FLSA)	Compliance	140	$ 2,204,461	Employee	Computer-generated simple random	95%	5%	0 (0%)	51	Yes	4
Overtime pay (WWG 2 employees who were paid for less than 300 hours)	Compliance	24,721	$ 37,444,519	Payment transactions	Computer-generated simple random	95%	5%	0 (0%)	60	Yes	5
Holiday pay	Compliance	10,700	$ 3,356,374	Payment transactions	Computer-generated simple random	95%	5%	0 (0%)	60	Yes	6
Leave buy-back	Compliance	200	$ 317,689	Payment transactions	Computer-generated simple random	95%	5%	0 (0%)	51	Yes	8

[1] Pursuant to the AICPA's *Audit Guide: Audit Sampling* (May 1, 2017 edition), pages 131-133, the expected error is the expected number of errors planned for in the sample. It is derived by multiplying the expected error rate by the sample size. The expected number of errors in the sampling tables on pages 135-136 was rounded upward, e.g., 0.2 errors becomes 1 error.

Attachment—
California Medical Facility's
Response to Draft Review Report

STATE OF CALIFORNIA — DEPARTMENT OF CORRECTIONS AND REHABILITATION GAVIN NEWSOM, GOVERNOR
DIVISION OF ADULT INSTITUTIONS
CALIFORNIA MEDICAL FACILITY
P.O. Box 2000
Vacaville, CA 95696-2000

June 19, 2019

Mr. Andrew Finlayson, Chief
State Agency Audits Bureau
SCO, Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Mr. Finlayson:

This letter is in response to the draft report issued by the State Controller's Office (SCO) on June 11, 2019 regarding the Payroll Process Review of the California Medical Facility (CMF). CMF takes seriously its responsibility to ensure effective payroll processes are in place, and is committed to continually improving these processes. This commitment is demonstrated by enhanced quality controls implemented since the audit period of 2014 through 2017. Specifically, CMF believes significant improvements have been made via policy and procedural changes, staff training, and ongoing process evaluation. CMF continues to place importance on the quality of work of the Personnel Office and is looking forward to continuing to improve.

CMF welcomes insights provided by the auditors and would like to thank SCO for its work on this report. The following is in response to each of the findings and recommendations contained in this report:

Finding 1 – Inadequate segregation of duties and lack of compensating controls over the processing of payroll transactions. CMF can only segregate duties to the extent allowed by allocated staffing and ensuing vacancies and/or turnover. The Personnel Specialist duties and responsibilities consist of processing various personnel/payroll transactions, including data entry, reconciliation, and the processing of adjustments and corrections. Since training can take up to 18 months, newer Personnel Specialists are under the close supervision of Personnel Supervisors and their work is consistently reviewed. Though it is not feasible to consistently review the work of every Personnel Specialist every day, CMF has implemented periodic reviews of various transactions. In addition, on a monthly basis, Personnel Supervisors review each Personnel Specialist's *Time and Attendance Report* (Form 672), *Employee Time Certification* (Form 966), *Payroll Exceptions Report* (Form 666) and *Absences Without Pay Report* (Form 603), as audit tools to ensure accurate reconciliation of payroll records.

Finding 2 – Inappropriate keying access to the State's payroll system. After the 2017 SCO audit, CMF put into place procedures to timely remove SCO users who are transferring, separating, or taking a leave of absence. Institutions are now allowed to e-mail the Decentralized Security Administrator (DSA) notification of an employee's separation followed by submission of the PSD 125-A form, as well as any required documents. This process has been successful.

In July 2017, as part of the Department of State Hospitals "Lift and Shift", Decentralized Security contacts were transitioned (from "HG") to "MF" using the SCO two character agency identification process. Prior to that transition, it appears that SCO granted temporary keying access for a Staff Services Manager II (SSM II); however, justification for such access was not provided to CMF as part of the transition. By late 2017, the SSM II's access was changed to "Inquiry Only."

Finding 3 – Inadequate controls over vacation, annual leave, and compensating time off (CTO) balances, resulting in liability for excessive balances. As a 24/7 public safety operation, CMF must balance the operational need to cover essential security posts with the fiscal prudence of mitigating liability of excessive leave balances. CMF, therefore, is exploring ways to reduce excessive leave credits through participation in a leave reduction plan process.

Finding 4 – Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments. The largest projected error rate, within this audit, was specific to 7k lump-sum calculations. In September 2018, all Personnel transactions staff participated in mandatory 7k lump sum training. When addressing retirements, resignations, dismissals, and the like, CMF has implemented controls that require review and approval of lump sum calculations by a Personnel Supervisor I, as well as subsequent auditing by a Personnel Supervisor II. As a result of the training and the control processes put in place, any deficiencies identified in this finding have been remedied.

Finding 5 – Inadequate controls over overtime pay, resulting in improper payments. Since the implementation of the Business Information System (BIS), which is responsible for the calculation and electronic downloading of overtime to the SCO system, CMF has seen a decline in overtime errors. In addition, CMF has implemented controls to prevent improper overtime payments. Personnel Supervisors analyze and review a selection of pay unit timesheets to ensure compliance, including, but not limited to, the inclusion of supporting documentation, and they provide regular monitoring of pay issued in the state payroll system.

Finding 6 – Inadequate controls over holiday compensation, resulting in improper payments and credits. CMF has seen a reduction in errors, since the implementation of the BIS TimePay$ California Leave Accounting System interface, in which leave is electronically sent to SCO as it relates to holiday credit accruals. Since the review, CMF has provided training to staff and implemented controls to prevent improper holiday compensation. Personnel Supervisors use various audit tools to ensure accurate reconciliation of attendance records

Finding 7 – Inadequate controls over salary advances, resulting in failure to recover outstanding accounts. All salary advances are downloaded onto the BIS Salary Advance Aging Report system, which is overseen by BIS and Regional Accounting Office (RAO) staff. The report is reviewed, monitored, and sent to the institution to process and return on a monthly basis. CMF Personnel Supervisors monitor the report to ensure that salary advances are cleared in a timely manner. While CMF strives to expeditiously and diligently clear salary advances staffing turnover, periodically impacts the effectiveness of our efforts, causing unplanned delays in notification and/or recovery of outstanding accounts. With regard to the two outstanding salary advances identified within the report: one salary advance, in the approximate amount of $255, was issued July 6, 2016. The employee was noticed April 2018, and the salary advance was cleared in October 2018. The second outstanding salary advance, for the approximate amount of $4,010, was issued on May 15, 2017. An error was made whereby the employee received both the salary advance and final pay warrant. Because of staffing turnover, the separated employee was not immediately notified of the overpayment. After an initial overpayment notification letter, in September 2017, the outstanding salary advance was sent to RAO for collections through the California Franchise Tax Board.

Finding 8 – Inadequate controls over leave buy-back, resulting in improper and questioned payments. Prior to this audit, and under former management, CMF designated the processing of leave buy-back to a Personnel Supervisor II. Subsequent to this review, CMF has provided training to Personnel Specialists to ensure that leave buyback payments are processed to comply with collective bargaining agreements. All leave buyback payments are reviewed by a Personnel Supervisor I, prior to processing, and audited by a Personnel Supervisor II.

Should you have any questions, please contact Jenny Ruth, Institutional Personnel Officer, at (707) 453-7094.

Sincerely,

J. Lozano

JARED D. LOZANO
Warden (A) (4)
California Medical Facility

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250

http://www.sco.ca.gov

S18-PAR-9003