# CALIFORNIA STATE WATER RESOURCES CONTROL BOARD

Review Report

## PAYROLL PROCESS REVIEW

*July 1, 2010, through June 30, 2013*

BETTY T. YEE

California State Controller

August 2016

# BETTY T. YEE
## California State Controller

August 26, 2016

State Water Resources Control Board
1001 I Street
Sacramento, CA 95814
Attn: Felicia Marcus, Chair

Dear Board Members:

The State Controller's Office has reviewed the California State Water Resources Control Board's (Water Board) payroll process for the period of July 1, 2010, through June 30, 2013. The Water Board'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 Water Board payroll process that leave the Water Board at risk of improper payments if not mitigated. We found that the Water Board 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, the Water Board 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 Water Board payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the Water Board inappropriately granted employees keying access to the State's payroll system. In one instance, a payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. In another instance, a payroll transactions unit staff member's keying access should have been immediately removed after leaving state service; instead, the access remained for 105 days after the employee left. Furthermore, two other employees had keying access without the required written justification.

Our review also found that the Water Board lacked sufficient controls over the processing of specific payroll-related payments to ensure that the Water Board complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. We believe that the control deficiencies contributed to the Water Board employees' excessive vacation and annual leave balances, costing at least $3,279,593 as of June 30, 2013; overpayments in attorney pay differential totaling $105,086; improper holiday credits costing an estimated $23,626; and overpayments of approximately $12,565 and underpayments of approximately $4,597 in separation lump-sum pay. Considering that our review was performed only on a limited number of transactions, we believe that a more extensive review could determine that the amount of improper payments may be even higher than what we found

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

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

Attachment

cc: Tom Howard, Executive Director
State Water Resources Control Board
John Russell, Deputy Director, Administrative Services
State Water Resources Control Board
Bill Damian, Assistant Deputy Director, Administrative Services
State Water Resources Control Board
Chris Fernandez, Chief, Human Resources Branch
State Water Resources Control Board
Terri Shaffer, Personnel Officer, Administrative Services
State Water Resources Control Board
Melissa Harpster, Staff Services Manager II, HR Branch, Administrative Services
State Water Resources Control Board
Mark Rodriguez, Chief, Administrative Services
California Department of Human Resources

# Contents

**Review Report**

**Summary** ..... 1

**Background** ..... 3

**Objectives, Scope, and Methodology** ..... 3

**Conclusion** ..... 4

**Views of Responsible Officials** ..... 6

**Restricted Use** ..... 6

**Findings and Recommendations** ..... 7

**Attachment—State Water Resources Control Board's Response to Draft Review Report**

# Review Report

## Summary

The State Controller's Office (SCO) reviewed the California State Water Resources Control Board's (Water Board) payroll process for the period of July 1, 2010, through June 30, 2013. The Water Board 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 Water Board payroll process that leave the Water Board at risk of improper payments if not mitigated. We found that the Water Board 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, the Water Board lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The payroll transactions unit staff processes 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. In addition, the payroll transactions manager had keying access to the payroll system while responsible for approving payroll transactions entered in the system. This control deficiency was aggravated by the lack of compensating controls, such as involving management oversight and review, to mitigate the risks associated with such a deficiency. The lack of segregation of duties without appropriate compensating controls has a pervasive effect on the Water Board payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the Water Board inappropriately granted employees keying access to the State's payroll system. In one instance, a payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. In another instance, a payroll transactions unit staff member's keying access should have been immediately removed after leaving state service; instead, the access remained for 105 days after the employee left.

Our review also found that the Water Board lacked sufficient controls over the processing of specific payroll-related transactions to ensure that the Water Board complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. As summarized in the table on the following page, the control deficiencies contributed to the Water Board employees' excessive vacation and annual leave balances, costing at least $3,279,593 as of June 30, 2013, and improper payments during the review period costing an estimated net total $136,680. Considering that our review was performed only on a limited number of transactions, we believe that a more extensive review could determine that the amount of improper payments may be even higher than what we found.

The following table summarizes our review results:

| | | Selections Reviewed | | | Selections with Issues | | | |
|---|---|---|---|---|---|---|---|---|
| Finding Number | Issues | Number of Selections Reviewed | Selection Unit | Dollar Amount of Selections Reviewed | Number of Selections with Issues | Issues as a Percentage of Selections Reviewed [a] | Approximate Dollar Amount | Dollar Amount of Issues as a Percentage of Dollar Amount of Selections Reviewed [a] |
| 1 | Inadequate segregation of duties and compensating controls | See below | See below | See below | See below | See below | See below | See below |
| 2 | Inappropriate keying access to the State's payroll system | 15 | Employee | – | 4 | 27% | – | – |
| 3 | Inadequate controls over annual and vacation leave credit, costing the State liability for excessive balances | 252 | Employee | $3,279,593 | 252 | 100% | $3,279,593 | 100% |
| 4 | Inadequate controls over attorney pay differential, resulting in overpayments | 4 | Employee | 105,086 | 4 | 100% | 105,086 | 100% |
| 5 | Inadequate controls over holiday credits, resulting in improper accruals | 69 | Holiday Credit Transactions | 23,626 | 69 | 100% | 23,626 | 100% |
| 6 | Inadequate controls over employee separation lump-sum pay, resulting in improper payments: | | | | | | | |
| | Overpayments [b] | 12 | Employee | 1,151,329 | 3 | 25% | 12,565 | 1% |
| | Underpayments [b] | 12 | Employee | 1,151,329 | 4 | 33% | (4,597) | – |
| | Total | 352 | | $4,559,634 | 336 | 95% | $3,416,273 | 75% |

[a] All percentages are rounded to the nearest full percentage point.
[b] These issues were based on the review of the same set of selections.

## 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 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 California State 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 the 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

Our review objectives were to determine whether:

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

- The Water Board maintained accurate records of leave balances.
- Salary advances were properly administered and recorded in accordance with state laws, regulations, policies, and procedures.

We reviewed the Water Board payroll process and transactions for the period of July 1, 2010, through June 30, 2013.

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

- Reviewed state and Water Board policies and procedures related to the payroll process to understand the practice of processing various payroll and payroll-related transactions.
- Interviewed Water Board payroll personnel to understand the practice of processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to the payroll transaction processing, and obtain or confirm our understanding of existing internal control over the payroll process and systems.
- Selected transactions recorded in the State's payroll database based on risk factors and other criteria for review.
- Analyzed and tested transactions recorded in the State's payroll database and reviewed relevant files and records to determine the accuracy of payroll and payroll-related payments, accuracy of leave transactions, proper review and approval of transactions, adequacy of internal control over the payroll process and systems, and compliance with collective bargaining agreements and state laws, regulations, policies, and procedures. Errors found were not projected to the intended population.
- 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 Water Board payroll process that leave the Water Board at risk of additional improper payments if not mitigated.

An evaluation of an entity's payroll process may identify deficiencies in its internal control over such a process. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements in financial information, impairments of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts on a timely basis.

Control deficiencies, either individually or in combination with other control deficiencies, may be evaluated as significant deficiencies or material weaknesses. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those

charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement in financial information; impairment of effectiveness or efficiency of operations; or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

Based on our review, the Water Board 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, the Water Board lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The payroll transactions unit staff processes 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 Water Board payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

In addition, the Water Board inappropriately granted employees keying access to the State's payroll system. Two of the 15 employees (13%) who had keying access at some point during the review period did not have their keying access immediately removed or modified subsequent to separation from state service or change in classification. A payroll transactions manager should not have been allowed keying access to the system due to the employee's management status. Also, a payroll transactions unit staff member's keying access should have been immediately removed after leaving state service; instead, the access remained for 105 days after the employee left. In addition, two other employees had keying access while they were appointed to classifications other than the two classifications allowed to have keying access; however, the Water Board did not have the required written justification.

Further, the Water Board lacked sufficient controls over the processing of specific payroll-related transactions to ensure that the Water Board complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. We believe that the control deficiencies contributed to the Water Board employees' excessive vacation and annual leave balances and improper payments, costing the State an estimated total of $3,416,273. Specifically, 252 employees exceeded the limit set by collective bargaining agreements and state regulations by more than 69,000 hours in vacation and annual leave, costing at least $3,279,593 as of June 30, 2013. During the review period, the Water Board and its employees did not have any plans in place to reduce leave balances below the limit. We expect the amount of the liability to increase if the Water Board does not take action to address the excessive vacation and annual leave credits. In addition, the Water Board improperly paid a total of $105,086 to four employees (100% of

selections) who did not satisfy the requirements for attorney pay differential. It also improperly granted 578 holiday credit hours, costing approximately $23,626, in 69 transactions we reviewed (100% of selections). Moreover, the Water Board improperly paid seven of the 12 employees (58%) we reviewed for separation lump-sum pay. Of the seven employees, three were overpaid approximately $12,565 and four were underpaid approximately $4,597. Considering that our review was performed only on limited selections, we believe that a more extensive review could determine that the amount of improper payments may be even higher than what we found.

## Views of Responsible Officials

We issued a draft review report on June 8, 2016. Thomas Howard, Executive Director, responded by letter dated June 17, 2016 (Attachment). Mr. Howard agreed with the review results and stated that the Water Board has implemented corrective actions to address the findings in this report.

## Restricted Use

This report is solely for the information and use of the Water Board, 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

August 26, 2016

# Findings and Recommendations

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

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

Government Code (GC) sections 13402 and 13403 mandated state agencies to establish and maintain 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.

Our review found that the Water Board payroll transactions unit staff performed conflicting duties. The staff executes multiple steps in processing payroll transactions, including data entry into the State's payroll system; audits of employee timesheets; reconciliation of payroll, including system output to source documentation; and reporting of payroll exceptions. The Water Board failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. For example, the payroll transactions unit staff keys 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 Water Board 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, 5, and 6 represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that a material misstatement in financial information or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis.

<u>Recommendation</u>

The Water Board 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 record-keeping function, which is accomplished by entering data into a computer system.

- *Authorization to execute.* This duty belongs to individuals with authority and responsibility to initiate and execute transactions.
- *Periodic reviews and reconciliation of actual payments to recorded amounts.* This duty refers to making comparisons at regular intervals and taking action to resolve differences.

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

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

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

The Water Board lacked adequate controls to ensure that only appropriate staff have keying access to the State's payroll system. We found that two employees did not have their access immediately removed or modified. In addition, two other employees had keying access without the required written justification.

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

The Water Board had 15 employees with keying access to the State's payroll system at some point between July 1, 2010, and June 30, 2013. Of the 15 employees, two did not have their keying access immediately removed or modified subsequent to separation from state service or change in classification. In the first case, the payroll transactions manager who was appointed in March 2012 had keying access to the payroll system beyond June 30, 2013. According to the Decentralization Security Program manual, the manager's access should have been removed. This individual was provided keying access before becoming a manager; however, the Water Board did not discontinue the individual's access after the individual became a manager. The manager is an approving official who often approves certain payroll transactions prior to input into the system. The manager also is responsible for reviewing the work of his or her staff. To properly segregate duties, employees charged with approving transactions should not be able to input the transactions that they approve. In the second case, a payroll transactions unit staff member left the Water Board in December 2011; however, the employee continued to have keying access until early April 2012, or 105 days after the employee separated.

In addition, two other employees had keying access while they were appointed to classifications other than the two classifications allowed to have keying access; however, the Water Board did not have the required written justification.

The Decentralization Security Program manual states, in part:

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

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

Recommendation

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

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

The Water Board failed to implement controls to ensure that it adheres to the requirement of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. This deficiency resulted in liability for excessive leave credits that could cost the State at least $3,279,593 as of June 30, 2013. We expect the liability to increase if the Water Board does not take action to address the excessive vacation and annual leave credits.

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

Our review of the leave accounting records found that the Water Board had 1,419 employees with unused vacation or annual leave credits at June 30, 2013. Of the 1,419 employees, 252 (18%) exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 3,821 hours in annual leave, or 3,181 hours beyond the 640-hour limit. Collectively, the 252 employees accumulated more than 69,000 hours in excess vacation and annual leave, costing at least $3,279,593 as of June 30, 2013. This estimated liability does not adjust for salary rate increases and additional leave credits[1]. Accordingly, we expect that the amount needed to pay for the liability would be higher. For example, a Water Board employee separated from state service with 2,363 hours in leave credits, including 2,227 hours in annual leave. After adjusting for additional leave credits, the employee should have been paid for 2,811 hours, or 19% more.

We performed an additional review of nine of the 252 employees to determine whether the Water Board complied with collective bargaining agreements and state regulations. We found that the Water Board could not demonstrate that it allowed the nine employees to carry vacation or annual leave balances beyond the limit based on exceptions specified in agreements and state regulations. The Water Board also did not take action to bring leave balances below the limit. According to the payroll transactions unit management and staff, the Water Board and its employees did not have any plans in place to reduce leave balances below the limit.

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

| As of | Number of employees with vacation or annual leave balance exceeding 640 hours | Year-to-year percentage increase | Total vacation and annual leave hours in excess of the 640-hour limit | Year-to-year percentage increase |
|---|---|---|---|---|
| July 1, 2010 | 177 | – | 50,655 | – |
| June 30, 2011 | 229 | 29% | 62,330 | 23% |
| June 30, 2012 | 234 | 2% | 65,326 | 5% |
| June 30, 2013 | 252 | 8% | 69,410 | 6% |

Source: State's leave accounting system.

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

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

Recommendation

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

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

**FINDING 4—Inadequate controls over attorney pay differential, resulting in overpayments**

The Water Board lacked adequate controls to ensure that the payroll transactions unit processes attorney pay in accordance with state policy. The Water Board improperly granted $105,086 in attorney pay differential to four employees. If not corrected, this control deficiency also leaves the Water Board at risk of additional improper payments to employees who do not meet the requirements to receive the pay.

CalHR's *California State Civil Service Pay Scales*, section 14, Pay Differential 8, sets forth the requirements for various excluded employees to receive attorney pay differential. The requirements include that the employee's duties "involve responsibility for directing and reviewing the work of attorneys within a legal program or a department, which has complex and sensitive areas of law necessitating a staff, which must include attorneys at the Attorney IV level."

Payroll records showed that the Water Board granted a total of $105,086 in attorney pay differential to four excluded employees from July 2010 through June 2013. We selected all of these payments for review to determine whether the Water Board complied with state policy and paid only eligible employees. We requested from the Water Board the documents to support the payments. The Water Board payroll transactions unit management and staff responded that they have no documentation to support such payments. In addition, they indicated that the Water Board previously learned that the employees inappropriately received such payments because they did not meet the requirements to receive the pay. However, the Water Board also could not provide any documentation to support this assertion. Alternatively, we reviewed the Water Board's

organization charts and the four employees' job descriptions. We found that although the employees had responsibilities for directing and reviewing the work of legal staff, the staff members did not include attorneys at the Attorney IV level. We also reviewed the job descriptions of the Water Board employees at the Attorney IV level and found that they were not under the responsibilities of the four employees. Accordingly, the Water Board improperly paid a total of $105,086 to four employees for attorney pay differential.

Pursuant to GC sections 13402 and 13403, the Water Board has a duty to maintain a system of internal control, including ensuring that the controls are functioning as prescribed, to ensure that the employees satisfied the requirements to receive the payments for attorney pay differential. According to the Water Board's procedures for attorney pay differential transactions, the classification and pay analyst determines the employee's eligibility to receive the pay. The Water Board could not demonstrate the implementation of this control due to the lack of supporting documentation. We also found no evidence that the Water Board performs regular reviews of these payments to ensure they were proper and in accordance with state policy.

Recommendation

The Water Board should recover overpayments in accordance with GC section 19838 and State Administrative Manual (SAM) section 8776.7. If an overpayment is made to a separated employee, then the Water Board should recover the amount in accordance with SAM section 8776.6.

To prevent improper compensation for attorney pay differential from recurring, the Water Board should:

- Conduct ongoing monitoring of controls to ensure they are consistently implemented and operating effectively;
- Provide adequate supervisory review to ensure that the payroll transactions unit staff process only valid attorney pay differential that complies with state policies; and
- Provide training to managers, supervisors, and staff involved in attorney pay differential transactions to ensure that they understand the requirements under the state policy.

**FINDING 5—Inadequate controls over holiday credits, resulting in improper accruals**

The Water Board lacked adequate controls over the accrual of its employees' holiday credits. The Water Board improperly granted 578 holiday credit hours in 69 transactions (100% of selections) reviewed, costing the State approximately $23,626. The control deficiency also leaves the Water Board at risk of additional improper accruals of holiday credit if not mitigated.

Collective bargaining agreements and GC section 19853 specify the number of hours of holiday credit an employee would receive per qualifying holiday. Leave accounting records showed that the Water Board had 1,559 employees who received holiday credits between July 2010 and June 2013. We reviewed selected holiday credit transactions for

69 of these employees. We found that the 69 employees received a total of 578 holiday credit hours that did not comply with collective bargaining agreements and state law. For example, the Water Board granted a total of 506 holiday credit hours to 64 employees in December 2010 when the leave accounting system automatically credited each employee for a Saturday holiday. Therefore, employees received twice the credits they should have earned. We found no indication that the holiday credit transactions were reviewed by an individual other than the payroll transactions unit staff member responsible for keying these transactions in the system.

The following table summarizes the 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 entered twice in the system | 64 | 64 | 506 | $21,408 |
| Holiday credit did not match supporting documentation | 5 | 5 | 72 | 2,218 |
| Total | 69 | 69 | 578 | $23,626 |

Source: State's leave accounting system and the Water Board's payroll records.

Recommendation

The Water Board should conduct a review of the leave accounting system to ensure that the accrual of holiday credits complies with collective bargaining agreements and state law. The Water Board should correct any improper holiday credits in the leave accounting system.

To prevent recording of improper holiday credits in the leave accounting system from recurring, the Water Board should:

- Provide adequate oversight to ensure that payroll transactions unit staff accurately records leave transactions; and
- 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.

**FINDING 6—Inadequate controls over employee separation lump-sum pay, resulting in improper payments**

The Water Board lacked adequate controls over the processing of employee separation lump sum pay. Seven of 12 employees (58%) we reviewed were improperly paid. The control deficiency also leaves the Water Board at risk of additional improper separation lump sum payments if not mitigated.

Pursuant to collective bargaining agreements and state law, employees are entitled to receive cash for accrued eligible leave credits when separating from state employment. Payroll records indicated that the Water Board processed separation lump sum pay for 206 employees between July 2010 and June 2013. We reviewed 12 selected employees who received lump-

sum payments due to separation from state employment. As shown in the table below, three of the 12 employees (25%) were paid 383 hours more than they should have been paid for accrued leave credits, resulting in a total overpayment of approximately $12,565. In addition, four employees (33%) were paid 99 hours less than they should have been paid for accrued leave credits, resulting in a total underpayment of approximately $4,597. These improper payments resulted from miscalculation of the employees' accrued leave credits by the payroll transactions unit staff. We found no indication that the processing of these lump-sum payments was reviewed by an authorized individual.

The following table summarizes the improper employee separation lump-sum payments:

| | Leave Hours | | | Estimated Dollar Amount of Overpayment (Underpayment) |
|---|---|---|---|---|
| | Paid | Earned | Overpaid (Underpaid) | |
| Overpayment | | | | |
| Employee A | 1,581 | 1,228 | 353 | $10,876 |
| Employee B | 2,855 | 2,845 | 10 | 437 |
| Employee C | 2,282 | 2,262 | 20 | 1,252 |
| Subtotal | 6,718 | 6,335 | 383 | 12,565 |
| Underpayment | | | | |
| Employee D | 2,100 | 2,108 | (8) | (364) |
| Employee E | 1,615 | 1,674 | (59) | (2,229) |
| Employee F | 2,787 | 2,811 | (24) | (1,503) |
| Employee G | 1,855 | 1,863 | (8) | (501) |
| Subtotal | 8,357 | 8,456 | (99) | (4,597) |
| Net total | 15,075 | 14,791 | 284 | $7,968 |

Source: State's payroll system and the Water Board's payroll records.

Recommendation

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

# Attachment—
# State Water Resources Control Board's Response to Draft Review Report

CALIFORNIA
Water Boards

EDMUND G. BROWN JR.
GOVERNOR

MATTHEW RODRIQUEZ
SECRETARY FOR
ENVIRONMENTAL PROTECTION

State Water Resources Control Board

June 17, 2016

Andrew Finlayson, Chief
State Agency Audits Bureau
State Controller's Office, Division of Audits
PO Box 942850
Sacramento CA 92550-5874

Dear Mr. Finlayson,

We have reviewed the Draft Payroll Process Review Report (Review Report) for the State Water Resources Control Board (Water Board), prepared by the State Controller's Office. The draft report covers the period of July 1, 2010 through June 30, 2013. In general we find the Review Report to be a thorough analysis and accurate characterization of the processes that existed during the time period reviewed, from 2010 to 2013. We have also reviewed the recommendations on improving our internal controls to address the deficiencies identified in the Review Report, and find them to be well thought out and constructive.

As we discussed with your review team, we have already implemented additional internal control measures that we believe have addressed most, if not all, of the deficiencies identified in the Review Report that existed in the 2010 to 2013 time period. In January 2014, prior to the State Controller's Office Payroll Process Review, the Water Board created a Special Projects Unit within the Human Resources Branch of the Division of Administrative Services. The Special Projects Unit was established to create and maintain an independent internal audit system for our payroll processes, among other responsibilities, in the Human Resources Branch. Since January 2014, the Special Projects Unit has audited all employment history transactions entered into the State Controller's Office production payroll system. Any and all errors discovered by these internal audits are corrected immediately. Follow-up training is provided as necessary to both individual staff and the Transaction Unit as a whole based on the errors found during the audit to help prevent similar errors from occurring in the future.

The current processes employed by the Special Project Unit have already mitigated most of the findings addressed in the Review Report. Regardless of that, however, the Water Board will review each recommendation in the Review Report against our current practices, to ensure that our current processes adequately address the internal control deficiencies noted. If our internal review indicates the current practices are insufficient to address the noted internal control deficiency, the Water Board will take corrective steps to implement more stringent internal controls as noted in the Review Report.

The following major steps have already been implemented, that address the findings of the Review Report:

**Finding 1 – Inadequate segregation of duties and compensating controls over payroll transactions:**

Remedial measures already implemented include:

- As implemented in January 2014, the Personnel Specialists record and execute transactions; the Special Projects Unit then reviews and reconciles all transactions. Any identified errors are communicated to and corrected by the Personnel Specialists. Any necessary corrected transactions are also reviewed by the Special Projects Unit. This revised process ensures review and compensating control over all payroll transactions.

**Finding 2 – Inappropriate keying access to the State's payroll system:**

Remedial measures already implemented include:

- As implemented in March 2016, the Special Projects Unit supervisor, functioning as the Water Board's security monitor, tracks staff changes within the Human Resources Branch, reviews every staff change to ensure State Controller's Office access is appropriate for assigned duties, and ensures appropriate keying access in to the State Controllers' Office payroll system to protect the confidentiality and integrity of the data.
- Also, as implemented in March 2016, when the State Controller's Office approves keying access to staff in classifications outside of the Personnel Specialist classification series, Special Projects Unit maintains copies of the Decentralization Security Program forms, justifications, and the State Controller's Office approvals.

**Finding 3 – Inadequate controls over vacation and annual leave balances, costing the State liability for excessive credits**

Remedial measures already implemented include:

- As implemented in January 2014, the Human Resources Branch annually reports to Executive Management all staff with excessive leave credits. Employees with excessive leave credits are required to prepare and implement annual leave reduction plans to reduce their leave balances to acceptable levels within a certain timeframe. These leave reduction plans are reviewed and approved by the management of each employee's respective organization within the Water Board. The 2016 annual report and review of excess leave credits identified that these efforts have decreased the total number of employees with excessive leave credits, despite the Water Board's staffing growth and drought emergency workload in recent years.
- The Water Board participated in the 2014, 2015, and 2016 leave cash-out and buy-back programs as authorized by the Department of Human Resources, allowing staff to cash-out the maximum allowed under the programs.

**Finding 4 – Inadequate controls over attorney pay differential, resulting in overpayments**

Remedial measures already implemented include:

- As implemented in January 2014, the Special Projects Unit prepares quarterly Management Information Retrieval Systems reports to review all pay differentials in employment history to ensure that pay differentials are being applied correctly.

- All current Assistant Chief Counsels are responsible for directing and reviewing the work of attorneys in complex and sensitive areas of law necessitating subordinate staff at the Attorney IV level; therefore the pay differential is applied appropriately.

**Finding 5 – Inadequate controls over holiday credits, resulting in improper accruals**

Remedial measures already implemented include:

- As implemented in February 2015, all timesheets are audited twice, once by the Personnel Specialist and again by the Special Projects Unit. All errors are identified and corrected within 30 days of the original audit; this includes holiday credits, as well as all other leave types.
- Timesheet audit training has been provided to Transaction Unit staff. As necessary, additional training is provided during weekly staff meetings and by on-the-job training.

**Finding 6 – Inadequate controls over employee separation lump-sum pay, resulting in improper payments**

Remedial measures already implemented include:

- As implemented in July 2015, all separations are calculated by a Personnel Specialist, and an alternate Personnel Specialist or Transaction Unit supervisor calculates for a second level of review. After the transaction is keyed, the Special Projects Unit audits each separation in its entirety. Any errors noted in the separation calculations are corrected.

All deficiencies in our internal controls and processes noted in the Review Report have been corrected. In the future, we will continue to monitor our internal controls and processes, and make any necessary changes if additional deficiencies are discovered. The Water Board's Human Resources Branch is committed to processing all payroll and leave transactions accurately and in accordance with laws, regulations and applicable collective bargaining agreements. Our goal is to have no deficiencies in our payroll processes. We will continue to train our staff, and review our processes, to reach our goal of a 100 percent error-free rate.

If you have any questions or would like to discuss this further please contact the Chief of our Human Resources Branch, Chris Fernandez at 916-341-5126.

Sincerely,

Thomas Howard

Thomas Howard
Executive Director

cc: John Russell, Deputy Director, Administrative Services
Bill Damian, Assistant Deputy Director, Administrative Services
Chris Fernandez, Chief, Human Resources Branch

**State Controller's Office**
**Division of Audits**
**Post Office Box 942850**
**Sacramento, CA 94250-5874**

**http://www.sco.ca.gov**

S15-PAR-9013