CALIFORNIA AIR RESOURCES BOARD

Review Report

PAYROLL PROCESS REVIEW

July 1, 2010, through June 30, 2013

JOHN CHIANG
California State Controller

December 2014

JOHN CHIANG
California State Controller

December 3, 2014

Mary D. Nichols, Chairman
California Air Resources Board
Office of the Chair
P.O. Box 2815
Sacramento, CA 95812

Dear Ms. Nichols:

The State Controller's Office has reviewed the California Air Resources Board (ARB) payroll process for the period of July 1, 2010, through June 30, 2013. The ARB'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.

An evaluation of an entity's payroll process may identify deficiencies in its internal control over the process. Control deficiencies, either individually or in combination with other control deficiencies, may be evaluated as significant deficiencies or material weaknesses. As discussed below, our limited review identified significant deficiencies in internal control over the ARB payroll process. The combination of these significant deficiencies represents a material weakness.

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 or noncompliance with provisions of laws, regulations, or contracts 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 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 or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis.

Our review noted inadequate segregation of duties and lack of compensating controls over the ARB's processing of payroll transactions. The payroll transactions unit staff processes all payroll transactions, including data entry into the State's payroll system, maintenance of attendance records, certification of overtime and pay differential, and reconciliation of payroll including system output to source documentation. This lack of segregation of duties was aggravated by an absence of compensating controls to mitigate such deficiency. For example, we found no indication of

sufficient oversight of payroll transactions unit staff. During our review, as a result of these internal control deficiencies, we found instances of overpayments and underpayments of employee separation pay and overstatements of leave balances. Of the 20 selected employees we reviewed for separation pay, 2 (or 10%) were overpaid by approximately $9,930 and 2 (or 10%) were underpaid by approximately $696 due to incorrect leave balances. Of the 19 selected employees we reviewed for leave balances, 5 (or 26%) had misstated credits that resulted in total overstatement by approximately $5,187.

We also noted inadequate controls over the earning of compensating time off (CTO) and Furlough 32nd-40th Hour Pay (Furlough). Supervisors granted informal CTO and Furlough to employees without upper-level management's awareness and authorization. Of the 14 selected employees we reviewed, 5 (or 36%) received a total of $11,135 in exchange for 370 hours of informal CTO and Furlough. The payments were made more than one year after the employees accumulated the additional work hours. We also noted that the informal CTO hours were not recorded in the State's leave accounting system, and some were granted to employees when the State implemented a moratorium on overtime. Such practices leave the ARB at risk of additional unauthorized work hours and liability for violation of the timely payment requirements of federal and state laws and collective bargaining agreements.

Additionally, we noted that the ARB lacked adequate controls over salary advances to ensure that it complies with state law and policies. At June 30, 2013, the ARB had approximately $39,537 in outstanding salary advances. Of this amount, $10,234 (or 26%) has been outstanding for between 4 and 11 years. These salary advances were owed by 12 individuals, including 11 who had already separated from ARB. The other individual who still works for the ARB received a salary advance in January 2007. At June 30, 2013, more than six years later, the salary advance has still not been fully collected. These advances could have been collected pursuant to California Government Code section 19838 and State Administrative Manual sections 8776.6 and 8776.7. We also found that the ARB did not perform periodic reconciliation of salary advances in the official accounting system to the schedule maintained by the Human Resources Branch. The lack of periodic reconciliation resulted in long-outstanding differences that may require adjustments in the accounting system or the schedule, as appropriate.

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/sk

cc: Richard Corey, Executive Officer
California Air Resources Board
Edie Chang, Deputy Executive Officer
California Air Resources Board
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Review Report

Summary

The State Controller's Office (SCO) reviewed the California Air Resources Board (ARB) payroll process for the period of July 1, 2010, through June 30, 2013. The ARB'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 significant deficiencies in internal control over the ARB payroll process. We determined that the combination of these significant deficiencies represents a material weakness 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.

We noted inadequate segregation of duties and lack of compensating controls over the ARB's processing of payroll transactions. Adequate segregation of duties reduces the likelihood that error or fraud will not be prevented or detected on a timely basis. During our review, as a result of these internal control deficiencies, we found approximately $9,930 in overpayments and $696 in underpayments of employee separation pay, and $5,187 in overstatements of leave balances.

We also noted inadequate controls over the earning of compensating time off (CTO) and Furlough 32nd-40th Hour Pay (Furlough) that leave the ARB at risk of additional unauthorized work hours and liability for violation of federal and state laws and collective bargaining agreements. Our review found that five employees received $11,135 in exchange for 370 hours of informal CTO and Furlough that were granted without upper-level management's awareness and authorization. Also, these informal CTO hours were not recorded in the State's leave accounting system, and some were granted to employees when the State implemented a moratorium on overtime.

Further, we noted inadequate controls over the collection and recordkeeping of salary advances to ensure that the ARB complies with state law and policies. At June 30, 2013, approximately $10,234 (or 26%) of outstanding salary advances to current and former employees has been uncollected for between 4 and 11 years. These advances could have been collected pursuant to state law and policies. Additionally, the ARB's lack of periodic reconciliation of salary advance balances resulted in long-outstanding differences that may require adjustments in the accounting system or the schedule maintained by the Human Resources Branch, as appropriate.

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

Table 1 – Summary of Review Results

		Selections Reviewed			Selections with Issues			
Finding Number	Issues	Number of Selections Reviewed	Selection Unit	$ Amount of Selections Reviewed	Number of Selections with Issues	Issues as a Percentage of Selections Reviewed [a]	Approximate $ Amount	$ Amount of Issues as a Percentage of $ Amount of Selections Reviewed [a]
1	Inadequate segregation of duties and compensating controls over processing of payroll transactions							
	Overpayment of employee separation pay [b]	20	Employee	$1,257,004	2	10%	$9,930	1%
	Underpayment of employee separation pay [b]	20	Employee	1,257,004	2	10%	(696)	-
	Overstatement in leave balances	19	Employee	89,102	5	26%	5,187	6%
2	Inadequate controls over the earning of CTO and Furlough hours; records not complete and accurate	14	Employee	60,944	5	36%	11,135	18%
3	Inadequate controls over salary advances							
	Salary advance balances not reconciled; transactions not promptly and accurately recorded	23	Reconciling item	(18,042)	23	100%	(18,042)	100%
	Failure to comply with state policies to recover salary advances	12	Employee	10,234	12	100%	10,234	100%

[a] All percentages are rounded to the nearest full 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 SCO's Personnel and Payroll Services Division (PPSD) as PPSD was the State's centralized payroll processing center for all payroll-related transactions. As such, PPSD decentralized the processing of payroll which allowed state agencies and departments to process their own payroll-related transactions. In addition, the SCO's Division of Audits was authorized a limited number of new positions to conduct periodic reviews of this now decentralized payroll processing at state agencies and departments. Due to the budget constraints in the late 1980s, these positions were eliminated and these periodic reviews were discontinued.

In March and May of 2012, an internal audit of the California Department of Parks and Recreation (DPR), as well as an investigation by the California Attorney General's Office, disclosed a vacation buy-back program that was instituted at DPR without management's

authorization or the approval of the California Department of Human Resources (CalHR), as required by state law. This event renewed interest in reinstituting state agency and department payroll reviews by the SCO.

In 2013, the Legislature reinstated these payroll reviews to gain assurance that state agencies and departments were maintaining an adequate internal control structure over their payroll function; providing proper oversight over their 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, and related records of state agencies within the uniform state pay roll system, in such manner as the Controller may determine." In addition, GC section 12410 stipulates that "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment."

Objectives, Scope, and Methodology

The SCO reviewed the ARB payroll process for the period of July 1, 2010, through June 30, 2013. We conducted our onsite fieldwork from November 14, 2013, through January 9, 2014.

The objectives of this review were to determine whether:

- Payroll and payroll-related disbursements were accurate and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.
- The ARB 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 ARB complied with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures.

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

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

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

Conclusion

An evaluation of an entity's payroll process may identify deficiencies in its internal control over the process. Control deficiencies, either individually or in combination with other control deficiencies, may be evaluated as significant deficiencies or material weaknesses. As discussed below, our limited review identified significant deficiencies in internal control over the ARB payroll process. The combination of these significant deficiencies represents a material weakness.

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 or noncompliance with provisions of laws, regulations, or contracts 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 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 or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis.

Our review noted inadequate segregation of duties and lack of compensating controls over the ARB's processing of payroll transactions. The payroll transactions unit staff processes all payroll transactions, including data entry into the State's payroll system, maintenance of attendance records, certification of overtime and pay differential, and reconciliation of payroll including system output to source documentation. This inadequate segregation of duties was aggravated by an absence of compensating controls to mitigate such a deficiency. For example, we found insufficient oversight of payroll transactions unit staff. During our review, as a result of these internal control deficiencies, we found instances of overpayments and underpayments of employee separation pay and overstatements of leave balances. Of the 20 selected employees we reviewed for separation pay, 2 (or 10%) were overpaid by approximately $9,930 and 2 (or 10%) were underpaid by approximately $696 due to incorrect leave balances. Of the 19 selected employees we reviewed for leave balances, 5 (or 26%) had misstated credits that resulted in total overstatement by approximately $5,187.

We also noted inadequate controls over the earning of CTO and Furlough. Supervisors granted informal CTO and Furlough to employees without upper-level management's awareness and authorization. Of the 14 selected employees we reviewed, 5 (or 36%) received a total of $11,135 in exchange for 370 hours of informal CTO and Furlough. The payments were made more than one year after the employees accumulated the additional work hours. We also noted that the informal CTO hours were not recorded in the State's leave accounting system, and some were granted to employees when the State implemented a moratorium on overtime. Such practices leave the ARB at risk of additional unauthorized work hours and liability for violation of the timely payment requirements of federal and state laws and collective bargaining agreements.

Additionally, we noted that the ARB lacked adequate controls over salary advances to ensure it complies with state law and policies. At June 30, 2013, the ARB had approximately $39,537 in outstanding salary advances. Of this amount, $10,234 (or 26%) has been outstanding for between 4 and 11 years. These salary advances were owed by 12 individuals, including 11 who had already separated from the ARB. The other individual who still works for the ARB received a salary advance in January 2007. At June 30, 2013, more than six years later, the salary advance remains not fully collected. These advances could have been collected pursuant to GC section 19838 and State Administrative Manual sections 8776.6 and 8776.7. We also found that the ARB did not perform periodic reconciliations of salary advances in the official accounting system to the schedule maintained by the Human Resources Branch. The lack of periodic reconciliation resulted in long-outstanding differences that may require adjustments in the accounting system or the schedule, as appropriate.

Views of Responsible Officials

We issued a draft review report on October 7, 2014. Richard Corey, Executive Officer, responded by letter dated October 30, 2014. This final review report includes the ARB's responses as an attachment.

Restricted Use

This report is solely for the information and use of the ARB 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

December 3, 2014

Findings and Recommendations

FINDING 1—Inadequate segregation of duties and lack of compensating controls over the ARB's processing of payroll transactions

The Air Resources Board (ARB) lacked adequate segregation of duties within the payroll transactions unit. This deficiency was aggravated by the lack of compensating controls to mitigate the risks associated with such a deficiency. For example, we found insufficient oversight to ensure that payroll transactions unit staff processes transactions accurately and in compliance with collective bargaining agreements and state laws, regulations, rules, and policies. This significant deficiency, in combination with other control deficiencies as discussed in Findings 2 and 3, represents 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. We also found instances of overpayments and underpayments in separated employees' lump sum pay and misstatements in employees' leave balances. Of the 20 selected employees we reviewed for lump sum payment due to separation from state employment, 2 (or 10%) were overpaid by approximately $9,930 and 2 (or 10%) were underpaid by approximately $696 due to incorrect leave balances. Of the 19 selected employees we reviewed for leave balances, 5 (or 26%) had misstatements in balances that resulted in a net total overstatement by approximately $5,187.

Inadequate segregation of duties and lack of compensating controls

California 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. An individual or small group of individuals should not be in a position to control all aspects of a transaction or business process, such as initiation, authorization, custody, and recording or reporting of transactions. In addition, control tasks such as review, audit, and reconciliation should not be performed by the same individual responsible for recording or reporting the transaction.

Our review revealed that the ARB's payroll transactions unit staff performed conflicting duties. The 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 exceptions of payroll. This was aggravated by inadequate compensating controls to mitigate the risks associated with such 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.

Improper payments in employee separation lump sum pay

Pursuant to collective bargaining agreements and state law, employees are entitled to receive cash for accrued eligible leave credits when separating from state employment. We reviewed 20 selected employees who received lump sum payments due to separation from state employment. As shown in Table 2, of the 20 employees, 2 (or 10%) were paid 192 hours more than they should have been paid for accrued leave credits, resulting in a total overpayment of approximately $9,930. Two other employees were paid 16 hours less than they should have been paid for accrued leave credits, resulting in a total underpayment of approximately $696. 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.

Table 2 – Improper Payments in Employee Separation Lump Sum Pay

	Leave Hours			Estimated $ Amount of Overpayment (Underpayment)
	Paid	Earned	Overpaid (Underpaid)	
Overpayment				
Employee A	1,199	1,019	180	$ 9,300
Employee B	386	374	12	630
Subtotal	1,585	1,393	192	9,930
Underpayment				
Employee C	1,609	1,617	(8)	(454)
Employee D	2,164	2,172	(8)	(242)
Subtotal	3,773	3,789	(16)	(696)
Net total overpayment	5,358	5,182	176	$ 9,234

Source: Our analysis of data obtained from the State's payroll system and review of ARB's payroll records.

Overstatements in employees' leave balances

We reviewed the leave balances reflected in the State's leave accounting system for 19 selected employees and found 5 (or 26%) with misstated credits that resulted in total overstatement by approximately $5,187, as shown in Table 3. Specifically, we found that:

- Two employees were credited with a total of 88 hours of holiday credit more than they earned during the pay period. Another employee was credited 21 hours of holiday credit that could not be verified because the ARB could not provide supporting documentation. The overstatements and unsupported credits in holiday credit cost approximately $4,346.

- One employee incorrectly received 16 hours when the employee elected to change from vacation to annual leave. The overstatement in annual leave costs approximately $729.

- One employee was credited for compensating time off (CTO) at one and one-half time instead of straight time because the payroll transactions unit staff counted CTO used during the work week as time worked for purposes of computing overtime compensation, in

violation of state law and policy. This resulted in overstatement of CTO by four hours costing approximately $112.

Collective bargaining agreements and state law allow departments to buy-back employees' accrued holiday credit, annual leave, and CTO in certain circumstances. Accordingly, overstatement of these leave balances could result in overpayments in the future.

Table 3 – Overstatement in Leave Balances

		Leave Hours			
Employee	Leave Benefit	Per Leave Accounting System	Per Source Documentation	Overstatement	Estimated $ Amount of Overstatement
A	Holiday credit	88	8	80	$ 3,645
B	Annual leave	348	332	16	729
C	Holiday credit	16	8	8	365
D	Holiday credit	21 [a]	—	21	336
E	CTO	12	8	4	112
Total		485	356	129	$ 5,187

Source: Our analysis of data obtained from the State's payroll system and review of the ARB's payroll records.

[a] ARB could not provide documentation to support that the employee earned these holiday credits.

Recommendation

The ARB 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 ARB should recover the amount in accordance with GC section 19838 and State Administrative Manual (SAM) section 8776.6.

The ARB should also conduct a review of the leave accounting system for the past three years to ensure that employees' leave balances are accurate and holiday credits are in compliance with collective bargaining agreements. The ARB should adjust employees' balances in the leave accounting system to correct any misstatements in recording leave transactions.

To help prevent improper payroll payments and misstatements in leave balances from recurring, the ARB should do the following:

- Separate conflicting payroll function duties to the extent possible, considering the limited number of employees involved. The 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 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 fully and appropriately segregate payroll functions due to specific circumstances, the ARB should implement compensating controls. For example, if the payroll transactions unit staff responsible for record-keeping also performs a reconciliation process, a detailed review of the reconciliation could be performed and documented by the supervisor 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.

- Provide adequate oversight to ensure that payroll transactions unit staff processes only authorized payroll transactions that comply with collective bargaining agreements and state laws, regulations, rules, and policies; and records transactions accurately.
- 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 leave credits.

Summary of the ARB's Response

The ARB agreed with the finding and indicated that it is taking necessary steps to correct the deficiencies noted in this report. See Attachment for the ARB's full response.

FINDING 2—Inadequate controls over the earning of CTO and Furlough; records not complete and accurate

The ARB lacked adequate controls over the earning of compensating time off (CTO) and Furlough 32nd-40th Hour Pay (Furlough). Supervisors granted informal CTO and Furlough to employees without upper-level management's awareness and authorization. These additional hours were paid more than one year after the employees accumulated them. Also, the CTO hours were not recorded in the State's leave accounting system, and some hours were granted to employees when the State implemented a moratorium on overtime. Such practices leave the ARB at risk of additional unauthorized work hours and liability for violation of the timely payment requirements of federal and state laws and collective bargaining agreements. This significant deficiency, in combination with control deficiencies discussed in Findings 1 and 3, represents a material weakness in internal control over the payroll process.

We reviewed 14 selected employees who received compensation for additional work hours. Of the 14 employees, 5 (or 36%) received a total of $11,135 in exchange for 370 hours of CTO and Furlough, as shown in Table 4. These additional hours were accumulated in 2005 and 2009,

including periods during the State-implemented moratorium of overtime, based on informal agreements between the supervisors and staff in one section of the ARB's Mobile Source Operations Division (MSOD) that allow CTO credits for attending job-related training after normal business hours.

Table 4 – Informal CTO and Furlough 32nd-40th Hours

Employee	Type of Additional Work Hours Granted	Year Additional Work Hours Were Granted	Additional Work Hours			Amount Paid	Year Payment Issued
			Granted	Used	Paid		
1	CTO	2005, 2006, 2007, 2009	134	35	99	$ 3,893	2011
2	CTO	2009	16	—	16	629	2011
	Furlough	2009	17	—	17	433	2011
3	Furlough	2010	69	—	69	1,809	2010
4	CTO	2008	8	—	8	315	2011
	Furlough	2009	5	—	5	131	2011
5	Furlough	2009	156	—	156	3,925	2010
Total			405	35	370	$11,135	
Subtotal - CTO			158	35	123	$ 4,837	
Subtotal - Furlough			247	—	247	$ 6,298	

Source: Our analysis of data obtained from the State's payroll system and review of ARB's payroll records.

Additional work hours granted without upper-management's awareness and authorization

Our review of the ARB records indicated that MSOD management was not aware that employees were accumulating informal CTO and Furlough. It only came to management's attention because of personnel turnover in MSOD. Management recognized that this was an erroneous practice. Although the supervisors signed the time reports indicating approval for time worked, we found no indication that these additional work hours had authorization from MSOD management. The time report requires only the division chief or designee's approval signature for overtime, compensable by cash, that exceeds 10 hours.

Pursuant to the collective bargaining agreement between the State and unit 11, overtime is earned for all hours worked in excess of 40 hours in a regular workweek and can be compensated by cash or CTO. Overtime requires advance authorization, except in an emergency, by the State or its designated representative. This authorization must also be confirmed in writing not later than 10 days after the end of the pay period during which the overtime was worked.

In 2009, due to the State's budget crisis, the State implemented a furlough program to save payroll expenditures. The program requires reduction of state employees' salaries to reflect furlough days. In its policy memos regarding the furlough program, CalHR urged state departments to manage employees' work schedules to avoid incurring overtime pay. If overtime is absolutely necessary, and employees work more hours than their regular work schedule in a furlough workweek, additional hours worked up to 40 are paid as regular pay using earning identifier "Furlough 32nd-40th Hour Pay." Hours worked over 40 would be paid as overtime. At the ARB, supervisors were encouraged to make

adjustments to employees' schedules to accommodate the needs of the employee and the organization in order to avoid excess hours or overtime.

Recording in the State's leave accounting system

The collective bargaining agreement between the State and unit 11 requires that state agencies maintain complete and accurate records of all compensable overtime worked by its employees. The ARB uses the State's leave accounting system to track and record employees' leave data, including CTO. However, the informal CTO hours for three employees were not recorded in the leave accounting system but were tracked by the employees. The ARB's Human Resources Branch management explained that the CTO hours were not recorded in the leave accounting system because they were not aware that they were granted to employees.

Payment of unused CTO hours

The federal Fair Labor Standards Act (FLSA) requires that all overtime worked by an FLSA-covered employee must be paid whether or not it is authorized. The FLSA and collective bargaining agreement between the State and unit 11 allow the State to provide its employees with CTO in lieu of paying cash for overtime. The agreement requires that if an employee is not allowed CTO within 12 pay periods following the pay period in which the overtime was worked, payment should be made for such overtime on the next payroll. The informal CTO hours for three employees were accumulated between July 2005 and August 2009 and payments were issued in January 2011, in violation of the agreement's timely payment requirements.

Payment of Furlough 32nd-40th Hour Pay

The FLSA requires timely payment of wages to employees who are subject to its minimum wage and overtime compensation provisions; that is, payment of such wages on the regular payday. The SCO Personnel and Payroll Services Division's Payroll Letter #09-007 instructed state agencies that payment for Furlough cannot be requested until after the close of the pay period in which the additional hours were worked. Four of the five employees accumulated Furlough in 2009 but payments were issued in November 2010 and January 2011, in violation of the FLSA's timely payment requirement.

<u>Recommendation</u>

To prevent improper practices regarding the earning of additional work hours from recurring, the ARB should do the following:

- Establish internal controls requiring that additional work hours, including overtime compensable by CTO, are authorized in advance, if feasible, and approved in writing; complete and accurate CTO records are maintained in the State's leave accounting system; and additional work hours, including unused CTO hours, are paid in accordance with federal and state law and collective bargaining

agreements.

- Provide training to managers, supervisors, and staff who might be involved in granting additional work hours, including overtime compensable by CTO, to ensure that they understand the requirements under federal and state law and collective bargaining agreements.

Summary of the ARB's Response

The ARB agreed with the finding and stated that it is taking measures to prevent a reoccurrence of informal CTO in the future. See Attachment for the ARB's full response.

FINDING 3—Inadequate controls over salary advances

The ARB lacked adequate controls over salary advances to ensure it complies with state law and policies. Our review of its records revealed that at June 30, 2013, the ARB has approximately $39,537 in outstanding salary advances, including $10,234 (or 26%) that has been outstanding for between 4 and 11 years. We also found that the ARB did not perform periodic reconciliation of salary advances in the official accounting system to the schedule maintained by the Human Resources Branch. The lack of periodic reconciliation resulted in long-outstanding differences that may require adjustments in the accounting system or the schedule, as appropriate.

Failure to comply with state policies to recover overpayments

California Government Code (GC) section 19838 and State Administrative Manual (SAM) section 8776.7 allow the ARB to collect salary advances in a timely manner. Our review found that at June 30, 2013, the ARB had approximately $39,537 in uncollected salary advances, including $10,234 (or 26%) that has been outstanding for more than four years. The longest outstanding salary advance was 11 years. 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.

The long-outstanding salary advances of $10,234 were owed by 12 individuals. Payroll records indicate that 11 of them had already separated from the ARB. These advances could have been collected by withholding amounts from the former employees' final separation pay pursuant to GC section 19838, had proper verification been performed that these advances were paid. Also, if the former employees left with unpaid salary advances, the ARB has the responsibility to pursue collections as described in SAM section 8776.6. In our review of 3 of the 11 former employees, the ARB could not demonstrate its collection efforts, if any, due to lack of supporting documentation. In addition, the employee who did not separate from the ARB received more than $2,000 in salary advances in January 2007. As of June 30, 2013, more than six years later, a remaining balance of $49 is still uncollected, although the employee still works for the ARB.

Salary advance balances not reconciled; transactions not promptly and accurately recorded

Our review noted that the ARB did not reconcile the salary advance balance in the official accounting system to records maintained by its Human Resources Branch. The Accounting Branch maintains the ARB's accounting activities in the California State Accounting and Reporting System (CALSTARS). These activities include the processing of salary advances. The Human Resources Branch also maintains a separate schedule to track and monitor the salary advances issued and to pursue collection efforts.

We reviewed the outstanding balances of salary advances as of June 30, 2013 between CALSTARS and the Human Resources Branch's schedule. Our review found no indication that the ARB performed reconciliation of the salary advance balances between these two records. The lack of periodic reconciliation resulted in outstanding differences that may require adjustments in CALSTARS or the schedule, as appropriate. As summarized in Table 5, our analysis identified 23 items comprising the difference of approximately $18,042 between the two records. In one instance, a salary advance that was fully collected in January 2013 remains outstanding per a CALSTARS aging report. In another instance, a salary advance issued in May 2013 was not reflected in the aging report. Furthermore, several salary advances could not be explained due to lack of supporting documentation, including one that has been outstanding since 2001.

Table 5 – Outstanding Salary Advances as of June 30, 2013

Per CALSTARS aging report	$57,134
Per Human Resources Branch's schedule	39,092
Difference	$18,042
Breakdown of difference:	
Collections not recorded in the aging report	($15,267)
Misstatements resulting in overstatement of aging report's balance	(9,091)
Salary advance entered twice in the spreadsheet	4,235
Salary advances not recorded in the aging report	3,654
Misstatements resulting in understatement of aging report's balance	3,107
Unexplained balances in the aging report due to lack of documentation	(4,680)
Total	($18,042)

Source: Our analysis of data obtained from ARB's salary advance records.

In the absence of detective controls including reconciliation, errors or omissions in salary advances, whether intentional or not, may not be detected in a timely manner. Periodic reconciliation serves as a check on the accuracy of the recordkeeping process and maintains the salary advance on a more timely and accurate basis. It could also help the ARB's ability to collect and clear outstanding salary advances in a timely manner.

SAM section 8776 states, in part:

> Departments must ensure ARs are recorded promptly and accurately into the accounting system. The general guideline for recording ARs promptly is within 30 days after the date that the AR arose. For

> employee payroll ARs, the departments should ensure their human resources unit notifies the accounting office timely to meet the 30-day guideline for recording ARs. . . .
>
> Departments will review and reconcile ARs in the accounting system to ARs recorded by the State Controller's Office (SCO) and/or those ARs maintained in departmental records (e.g., program records, payroll records, etc.). AR reconciliations will be prepared monthly within 30 days of the preceding month. Periodic reviews of the AR reports should be performed monthly to ensure there is ongoing collection activity.
>
> Departments must ensure proper recordkeeping is maintained. All efforts made toward the collection of receivables should be documented to include the dates and types of collection effort (e.g., letters, offset, phone calls, e-mails).
>
> AR source documents (e.g., invoices), documentation of collection efforts, and documentation of payments and any adjustments should be retained for at least four years after the receivable has been paid.

Recommendation

The ARB should implement procedures to ensure salary advance transactions are entered into CALSTARS accurately and promptly. The Accounting Branch, in coordination with the Human Resources Branch, should perform periodic reconciliation of salary advances in CALSTARS to the Human Resources Branch's schedule to ensure the accuracy and reliability of its records. It should review any reconciling item and record adjustments, if necessary.

The ARB should also ensure salary advances are recovered in a timely manner pursuant to GC section 19838 and SAM section 8776.7. If the former employees left owing unpaid salary advance, the ARB should pursue collections as described in SAM section 8776.6. If all reasonable collection procedures do not result in payment from former employees, the ARB may request discharge from accountability of uncollectable amounts. The Accounting Branch should review the outstanding salary advances in CALSTARS with the Human Resources Branch to identify those eligible for discharge.

Summary of the ARB's Response

The ARB asserted that it took immediate action to recoup money from the employee for all salary advances that were identified as being collectible, and documented for write-off those salary advances identified as having no supporting documentation and were beyond the statutes of limitations. See the Attachment for the ARB's full response.

SCO's Comments

Our review results, as described in this finding, indicated that the ARB could not demonstrate its collection efforts and maintenance of supporting documentation. The ARB did not provide additional source documentation to support its assertions. In conclusion, the finding remains.

Attachment—
California Air Resources Board's Response to Draft Review Report

Air Resources Board

Mary D. Nichols, Chairman
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Matthew Rodriquez
Secretary for
Environmental Protection

Edmund G. Brown Jr.
Governor

October 30, 2014

Andrew Finlayson, Chief
State Agency Audits Bureau
State Controller's Office, Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874

Dear Mr. Finlayson:

The Air Resources Board (ARB) is in receipt of the California State Controller's Division of Audits (SCO) draft report on Internal Control over payroll processes within ARB. Thank you for an extension of time to submit our comments regarding these findings.

The report identifies internal control weaknesses in the area of payroll transactions, attendance reporting, and reconciliation of salary advances. ARB agrees more internal control needs to be in place and management is taking necessary steps to correct the deficiencies noted in the draft report.

Response Finding 1: Inadequate segregation of duties and compensating controls over processing of payroll transactions:

ARB has hired a Personnel Supervisor I (PSI) to provide an additional level of review, which will improve the segregation of duties and compensating controls over processing payroll transactions. The PS I directly oversees the day to day operations of the Personnel Specialists and ensure transactions are reviewed and carried out in accordance with applicable laws, rules, and regulations governing personnel transactions. This increased level of review will provide more oversight and minimize the error rate of payroll transactions.

Specifically, all lump sum pay-outs will be reviewed by the either the PSI or Transactions Manager (TM), and more frequent post audits will be conducted by the PSI, TM, and senior staff. These post audits will include: periodic comparison of electronic employee records against original hiring documentation; random audits of miscellaneous payroll transactions, which includes overtime payments and pay differentials; random audits of the California Leave Accounting System (CLAS); as well

as ensuring payroll transactions comply with collective bargaining agreements and State laws, regulations, rules, and policies, and transactions are recorded accurately.

In addition, ARB will be conducting random reviews of employee separation lump sum payments and CLAS for the past three years as recommended by SCO.

Response Finding 2: Inadequate controls over the earning of compensating time off (CTO) and Furlough 32nd – 40th Hour Pay (Furlough); records not complete and accurate:

ARB does not encourage nor permit the accumulation of informal CTO. When it was brought to the attention of ARB management that employees were claiming informal CTO approved by their former supervisor, immediate action was taken to determine the validity of the CTO claim. ARB management requested an investigation and requested justification along with supporting documentation that would prove the CTO hours claimed by each employee involved were valid.

An investigation was conducted and documentation was provided to support the informal CTO hours claimed. The package was reviewed by management and it was confirmed that these employees were entitled to the CTO under the Fair Labor Standards Act (FLSA), and action was taken to pay the employees.

ARB agrees there was improper handling of the CTO cash out and measures are being taken to prevent a reoccurrence of informal CTO in the future. ARB recently revised ARB's policy on Overtime and Travel to address the issue of Informal CTO and developed a new overtime request form, which must be approved in advance for all overtime hours worked. The policy is currently being reviewed by executive management.

Response Finding 3: Inadequate control over salary advances:

In accordance with Executive Order B-5-11 and applicable laws, rules, and regulations, ARB took immediate action to collect on outstanding salary advances (S/A) and developed a process to better manage and reconcile outstanding S/As by creating a spreadsheet for ongoing tracking.

The S/A spreadsheet was initially created using a CalSTARS report, and extensive research was conducted by Transactions staff to determine if the S/As noted on the CalSTARS report had already been satisfied or if collection efforts had been made within the statute of limitation. For all S/As that were identified as being collectable, immediate action was taken to recoup the money from the employee, S/As that were

identified as having no supporting documentation and were beyond the statute of limitations were documented for write-off.

The Transactions and Accounting Sections are still working together to improve the reconciliation process that will utilize the CalSTARS report on a monthly basis.

ARB is committed to maintaining a system of adequate internal controls over the payroll processes within our organization as shown in the above responses. If you have any questions, please contact Shereta Alexander at (916) 324-2813.

Sincerely,

Richard Corey
Executive Officer

cc: Edie Chang, Deputy Executive Officer
Air Resources Board

Alice Stebbins, Chief
Administrative Services Division

Shereta Alexander, Chief
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