

NORTH KERN STATE PRISON

Audit Report

PAYROLL AUDIT

August 1, 2015, through July 31, 2018



BETTY T. YEE
California State Controller

May 2020



BETTY T. YEE
California State Controller

May 13, 2020

Kelly Santoro, Warden
North Kern State Prison
2737 West Cecil Avenue
Delano, CA 93215

Dear Ms. Santoro:

The State Controller's Office audited North Kern State Prison's (NKSP) payroll process and transactions for the period of August 1, 2015, through July 31, 2018.

Our audit found material weaknesses in internal control over NKSP's payroll process. These weaknesses contributed to NKSP employees' excessive vacation and annual leave balances; improper and questioned payments for separation lump-sum pay, Fair Labor Standards Act overtime pay, and uniform allowances; and improper holiday credit transactions, costing the State an estimated net total of \$1,794,109.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Luz Lujan, Institutional Parole Officer
North Kern State Prison
Jeff Macomber, Undersecretary
California Department of Corrections and Rehabilitation
Kathleen Allison, Undersecretary
California Department of Corrections and Rehabilitation
Jennifer Osborn, Director
Division of Administrative Services
California Department of Corrections and Rehabilitation
Mai Lee Vang, External Audits Manager
Office of Audits and Court Compliance

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Audit Report

Summary

The State Controller's Office (SCO) audited North Kern State Prison's (NKSP) payroll process and transactions for the period of August 1, 2015, through July 31, 2018. NKSP'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. We completed our audit fieldwork on September 4, 2019.

Our audit determined that administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. However, NKSP:

- Did not maintain adequate and effective internal controls over its payroll process. We found the following deficiencies in internal control over the payroll process that we consider to be material weaknesses:
 - Inadequate segregation of duties and compensating controls over payroll transactions (see Finding 1);
 - Inappropriate keying access to the State's payroll system (see Finding 2);
- Did not process payroll and payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. We found the following instances of noncompliance with the requirements of collective bargaining agreements and state laws, regulations, policies, and procedures:
 - Inadequate controls over vacation and annual leave balances (see Finding 3);
 - Inadequate controls over separation lump-sum pay (see Finding 4);
 - Controls over FLSA overtime pay failed to identify errors (see Finding 5);
 - Inadequate controls over holiday credit transactions (see Finding 6); and
 - Inadequate controls over uniform allowance pay (see Finding 7).

These improper and questioned payments cost the State an estimated net total of \$1,794,109.

Background

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

In 2013, the California State Legislature reinstated these payroll audits to gain assurance that state agencies and departments maintain adequate internal control over the payroll function, provide proper oversight of their decentralized payroll processing, and comply with various state laws and regulations regarding payroll processing and related transactions.

Audit Authority

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

Objectives, Scope, and Methodology

We performed this audit to determine whether NKSP:

- Maintained adequate and effective internal controls over its payroll process;
- Processed payroll and payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures; and
- Administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

The audit covered the period from August 1, 2015, through July 31, 2018.

To achieve our audit objectives, we:

- Reviewed state and NKSP policies and procedures related to the payroll process to understand NKSP’s methodology for processing various payroll and payroll-related transactions;
- Interviewed NKSP payroll personnel to understand NKSP’s methodology for processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to payroll transaction processing, and gain an understanding of existing internal control over the payroll process and systems;
- Selected transactions recorded in the State’s payroll database using statistical sampling, as outlined in the Appendix, and targeted selection based on risk factors and other relevant criteria;
- Analyzed and tested the selected transactions and reviewed relevant files and records to determine the accuracy of payroll and payroll-related payments, accuracy of leave transactions, adequacy and effectiveness of internal control over the payroll process, and compliance with collective bargaining agreements and state laws, regulations, policies, and procedures; and

- Reviewed salary advances to determine whether NKSP administered and recorded them in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Conclusion

Our audit determined that NKSP administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. However, NKSP:

- Did not maintain adequate and effective internal controls over its payroll process¹. We found the following deficiencies in internal control over the payroll process that we consider to be material weaknesses:
 - Inadequate segregation of duties and compensating controls over payroll transactions (see Finding 1);
 - Inappropriate keying access to the State's payroll system (see Finding 2);
- Did not process payroll and payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. We found the following instances of noncompliance with the requirements of collective bargaining agreements and state laws, regulations, policies, and procedures:
 - Inadequate controls over vacation and annual leave balances (see Finding 3);

¹ In planning and performing our audit of compliance, we considered NKSP's internal control over compliance with collective bargaining agreements and state laws, regulations, policies, and procedures to determine the auditing procedures that were appropriate in the circumstances for the purpose of providing a conclusion on compliance, and to test and report on internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this footnote and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. However, as discussed this section, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

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

- Inadequate controls over separation lump-sum pay (see Finding 4);
- Controls over FLSA overtime pay failed to identify errors (see Finding 5);
- Inadequate controls over holiday credit transactions (see Finding 6); and
- Inadequate controls over uniform allowance pay (see Finding 7).

These improper and questioned payments cost the State an estimated net total of \$1,794,109.

Follow-up on Prior Audit Finding

The California Department of Corrections and Rehabilitation, Office of Audits and Court Compliance, conducted a Business Services Review of NKSP from January 4, 2016, through January 7, 2016. The review report, issued February 2016, included a finding related to salary advances. On April 4, 2017, the Office of Audits and Court Compliance concluded that NKSP implemented corrective actions to substantially resolve the finding. Based on the work performed in the current audit, we noted that NKSP has taken appropriate corrective actions in response to the prior finding.

Views of Responsible Officials

We issued a draft audit report on March 11, 2020. Kelly Santoro, Warden, NKSP, responded by letter dated March 18, 2020 (Attachment), agreeing with the findings except for Finding 1, and indicating that the NKSP has taken steps to correct the deficiencies noted. We will follow up during the next payroll audit to verify that these corrective actions were adequate and appropriate.

Restricted Use

This audit report is solely for the information and use of NKSP 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 audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

May 13, 2020

Schedule— Summary of Findings August 1, 2015, through July 31, 2018

Finding Number	Area Tested	Method of Selection	Population	Dollar Population	Number of Selections Examined	Dollar Amount of Selections Tested	Selection Unit	Total Dollar Amount of Known and Likely Issues
1	Inadequate segregation of duties and compensating controls over payroll transactions	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2	Inappropriate keying access to the State's payroll system	Targeted	N/A	N/A	31	N/A	Employee	N/A
3	Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances	Targeted	N/A	N/A	74	\$ 1,701,847	Employee	\$ 1,701,847
4	Inadequate controls over separation lump-sum pay, resulting in improper payments	Statistical	228	\$ 6,191,813	54	3,051,801	Employee	
	– Overpayments					-- See above --		62,561
	– Underpayments					-- See above --		(1,653)
5	Controls over FLSA overtime pay failed to identify errors, resulting in improper payments	Statistical	53,465	31,820,082	105		FLSA Overtime	
						219,032		
	– Overpayments					-- See above --		89,778
	– Underpayments					-- See above --		(69,524)
6	Inadequate controls over holiday credit transactions, resulting in improper credits	Targeted	N/A	N/A	65	51,675	Holiday Credit	7,671
7	Inadequate controls over uniform allowance pay, resulting in overpayments	Targeted	N/A	N/A	104	37,476	Uniform Allowance	3,429
					433	\$ 5,061,831		\$ 1,794,109

Findings and Recommendations

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

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

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including proper segregation of duties and an effective system of internal review. Adequate segregation of duties reduces the likelihood that fraud or error will remain undetected by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of the work performed.

Our audit found that NKSP payroll transactions unit staff performed conflicting duties. Staff members performed multiple steps in processing payroll transactions, including entering data into the State's payroll system; auditing employee timesheets; reconciling payroll, including reconciling system output to source documentation; reporting payroll exceptions; and processing adjustments. For example, staff members keyed in regular and overtime pay, and reconciled the master payroll overtime and other supplemental warrants. NKSP failed to demonstrate that it had implemented compensating controls to mitigate the risks associated with such a deficiency. We found no indication that these functions were subjected to periodic supervisory review after entries were keyed into the system.

The lack of adequate segregation of duties and compensating controls has a pervasive effect on the NKSP payroll process, and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively. These control deficiencies, in combination with other deficiencies discussed in Findings 2 through 8, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that material noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

Good internal control practices require that the following functional duties be performed by different work units, or at minimum by different employees within the same unit:

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

Recommendation

We recommend that NKSP:

- Separate conflicting payroll function duties to the greatest extent possible. Adequate segregation of duties will provide a stronger system of internal control whereby the functions of each employee are subject to the review of another.

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

- Develop formal procedures for performing and documenting compensating controls.

NKSP's Response

The Personnel Specialist duties and responsibilities consist of processing various personnel/payroll transactions, including data entry, reconciliation, and processing of adjustments and corrections. NKSP believes [that] controls are in place [to ensure that] timekeeper duties do not overlap with the personnel transaction staff who key in the payroll system.

SCO Comment

Our finding and recommendation remain unchanged. During the audit, we were not able to verify that compensating controls were in place.

We appreciate NKSP's dedication to effective payroll processes, as described in NKSP's response. We will follow up during the next payroll audit to verify that internal controls are present and functioning.

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

NKSP lacked adequate controls to ensure that only appropriate staff had keying access to the State's payroll system. NKSP inappropriately allowed 12 employees keying access to the State's payroll system. If not mitigated, this control deficiency leaves payroll data at risk of misuse, abuse, and unauthorized use.

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

We audited the records of 31 NKSP employees who had keying access to the State's payroll system at various times from August 2015 through July 2018. Of the 31 NKSP employees, 12 had inappropriate keying access to the State's payroll system. NKSP did not immediately remove or modify the employees' keying access after their separation from state service, transfer to another agency or unit, or change in classification. The keying access of a Personnel Specialist who transferred to another state agency was not removed until March 21, 2018, five days after the transfer.

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

To prevent unauthorized use by a transferred, terminated or resigned employee's user ID, the Security Monitor must IMMEDIATELY submit all pages of the PSD125A to delete the user's system access. Using an old user ID increases the chances of a security breach, which is a serious security violation. Sharing a user ID is strictly prohibited and a serious violation.

Recommendation

We recommend that NKSP:

- Provide adequate controls to ensure that employees with keying access to the State's payroll system do not enter their own data into the system;
- Update keying access to the State's payroll system immediately after employees leave NKSP, transfer to another agency or unit, or change classifications; and
- Periodically review access to the system to verify that access complies with the *Decentralized Security Program Manual*.

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

NKSP failed to implement controls to ensure that it adheres to the collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. The deficiency resulted in a liability for excess leave balances with a value of at least \$1,701,847 as of July 31, 2018². We expect the liability to increase if NKSP does not take action to address the excessive vacation and annual leave balances.

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

²At the time of our audit, we used the most recent and complete vacation and annual leave balances, which were as of July 31, 2018.

Our examination of NKSP's leave accounting records determined that NKSP had 1,327 employees with unused vacation or annual leave credits at July 31, 2018. Of those employees, 74 exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 2,655 hours in annual leave, or 2,015 hours beyond the 640-hour limit. Collectively, the 74 employees accumulated 26,915 hours of excess vacation and annual leave, with a value of at least \$1,701,847 as of July 31, 2018. This estimated liability does not adjust for salary rate increases and additional leave credits³. Accordingly, we expect that the amount needed to pay for this liability will be higher.

We selected 71 employees for examination to determine whether NKSP complied with collective bargaining agreements and state regulations. When we discussed the records of these employees with the personnel office staff, they indicated that NKSP had no plans in place during the review period for reducing leave balances below the limit. NKSP also could not demonstrate that it had complied with collective bargaining agreements and state regulations when allowing these employees to maintain excess vacation or annual leave balances.

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

Recommendation

We recommend that NKSP:

- 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;
- Conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively; and
- Participate in leave buy-back programs if the State offers such programs and funds are available.

³Most state employees receive pay rate increases every year pursuant to state laws and/or collective bargaining agreements until they reach the top of their pay scale, or promote into a higher-paying position. In addition, when an employee's accumulated leave balances upon separation are calculated for lump-sum pay, the employee is credited with additional leave credits equal to the amount that the employee would have earned had the employee taken time off and not separated from state service.

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

NKSP lacked adequate controls over the processing of employee separation lump-sum pay. We identified \$62,561 in overpayments and \$1,653 in underpayments for separation lump-sum pay, likely of \$43,185 in overpayments and \$1,141 in underpayments based on actual transactions audited (“known”); and \$19,376 and \$512 in underpayments based on the results of statistical sampling (“likely”). If not mitigated, these control deficiencies leave NKSP at risk of additional improper separation lump-sum payments.

GC section 19839 allows lump-sum payments for accrued eligible leave credits when employees separate from state employment. Collective bargaining agreements include similar provisions regarding separation lump-sum pay.

Bargaining Unit (BU) 6 Contract, section 10.11 Holidays, (A):

There are holiday pay differences between posted and non-posted positions. When non-posted positions take a day off because of a holiday, they receive eight (8) hours of holiday pay as part of their warrant. When a posted position takes the day off because of a holiday, they must burn leave to receive compensation for that holiday (except where the employee has Holidays off as their normal work schedule.)

Payroll records show that NKSP processed payments for separation lump-sum pay, totaling \$6,191,813, for 228 employees between August 1, 2015, and July 31, 2018, as follows:

Separation Lump-Sum Pay Group	Unit	Amount
Employees under Section 7k of the FLSA (statically sampled)	121	\$4,421,037
Employees not under Section 7k of the FLSA (examined 10 haphazardly)	107	1,770,776
Total Population	<u>228</u>	<u>\$6,191,813</u>

Of the payments for separation lump-sum pay, totaling \$4,421,037, for the 121 employees who were covered by the provisions of Section 7k of the FLSA, we randomly selected a statistical sample of 54 employees who received separation lump-sum pay, totaling \$3,051,801.

Our examination of lump-sum payments made to these 54 employees showed that NKSP overpaid 24 of them by approximately \$43,185, and underpaid seven of them by approximately \$1,141. These payments resulted in an exception totaling \$42,044. As we used a statistical sampling method to select the employees whose payments for separation lump-sum pay we examined, we projected the amount of likely overpayments to be \$19,376 and likely underpayments to be \$512. These payments resulted in a net total exception of \$18,864. Therefore, the known and likely improper payments totaled a net approximate of \$60,908, consisting of \$62,561 in overpayments and \$1,653 in underpayments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	\$ 42,044
Divide by: Samples	3,051,801
Error rate	<u>1.38%</u>
Population that was statistically sampled	4,421,037
Multiply by: Error rate	1.38%
Known and likely improper payments, net	<u>60,908</u>
Less: Known improper payments, net	42,044
Likely improper payments, net	<u>\$ 18,864</u>

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

Recommendation

We recommend that NKSP:

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

**FINDING 5—
Controls over
FLSA overtime pay
failed to identify
errors, resulting in
improper
payments**

NKSP controls over the processing of FLSA overtime pay failed to identify errors. We identified \$89,778 in overpayments and \$69,524 in underpayments for FLSA overtime, consisting of \$617 in overpayments and \$478 in underpayments based on actual transactions audited (“known”); and \$89,161 in overpayments and \$69,046 in underpayments based on the results of statistical sampling (“likely”). If not mitigated, these control deficiencies leave NKSP at risk of additional improper payments for FLSA overtime.

Collective bargaining agreements and state laws and policies contain specific clauses regarding overtime pay. Payroll records show that NKSP processed 53,465 FLSA overtime pay transactions, totaling \$31,820,082, between August 1, 2015, and July 31, 2018. Of the 53,465 FLSA overtime pay transactions, totaling \$31,820,082, we randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling \$219,032. Of the 105 transactions, NKSP overpaid two by approximately \$617 and underpaid two by \$478. We used a statistical sampling method to select the FLSA overtime pay transactions examined, we projected the amount of likely overpayments to be \$89,161 and likely underpayments to be \$69,046. These payments resulted in a net total exception of \$20,115. Therefore, the known and likely improper payments totaled a net of approximately \$20,254, consisting of \$89,778 in overpayments and \$69,524 in underpayments.

The known improper payments were made because the payroll transactions unit staff members miscalculated FLSA overtime hours worked, or incorrectly entered the FLSA overtime hours worked into the payroll system. Furthermore, NKSP lacked adequate supervisory review to ensure accurate processing of FLSA overtime pay.

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

Recommendation

We recommend that NKSP:

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

We further recommend that, to prevent improper and questioned payments for overtime pay from recurring, NKSP:

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

FINDING 6— Inadequate controls over holiday credit transactions, resulting in improper credits

NKSP lacked adequate controls over the processing of holiday credit transactions. We identified approximately \$7,671 in improper holiday credits. If not mitigated, this control deficiency leaves NKSP at risk of additional improper holiday credits.

GC section 19853 specifies the compensation that an eligible employee is entitled to receive when required to work on a qualifying holiday. Collective bargaining agreements between the State and BUs 6, 15, 17, 19 and 20 include similar provisions regarding holiday compensation for represented employees.

Leave accounting records showed that NKSP processed 12,907 accrual transactions of holiday credit. We examined 65 of these transactions, with an estimated value of \$51,675, because they involved unusual credits. Of the 65 transactions, 14 involved improper credits, with an estimated value of \$7,671.

The improper holiday credit transactions occurred because payroll transactions unit staff members granted holiday credits to employees during pay periods with no holidays and improperly calculated holiday credit hours. The NKSP also lacked adequate supervisory review to ensure accurate processing of holiday credits.

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

Recommendation

We recommend that NKSP:

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

FINDING 7— Inadequate controls over uniform allowance pay, resulting in overpayments

NKSP lacked adequate controls over the processing of payments for uniform allowances. We identified \$3,429 in overpayments for uniform allowance. If not mitigated, this control deficiency leave NKSP at risk of additional improper payments.

Pursuant to the collective bargaining agreement between the State and BU 6, certain employees required to wear a uniform and uniform accessories receive a maximum uniform allowance of \$950 per year, to be paid annually. If an employee leaves the classification entitled to the uniform allowance, the employee receives a prorated share of the annual uniform allowance.

Payroll records showed that NKSP processed 2,442 transactions, totaling \$1,817,930, for uniform allowance between August 1, 2015, and July 31, 2018. We judgmentally selected and examined 104 transactions, and found that NKSP overpaid 17 of them, totaling \$3,429. For the 17 transactions, the employees received more than the amount allowed by the collective bargaining agreement. NKSP lacked adequate supervisory review to ensure accurate processing of uniform allowance pay.

Recommendation

We recommend that NKSP:

- Conduct a review of payments for uniform allowance made during the past three years to ensure that the payments complied with collective bargaining agreements; and
- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838.

We further recommend that, to prevent improper payments for uniform allowance from recurring, NKSP:

- Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreements; and

- Provide adequate oversight to ensure that payroll transactions unit staff members process only valid and authorized payments that comply with collective bargaining agreements.

Appendix— Audit Sampling Methodology August 1, 2015, through July 31, 2018

We used attributes sampling for tests of internal control and tests of compliance. The following table outlines our audit sampling application for audit areas that included errors:

Review Area	Type of Test	Population (Unit)	Population (Dollar)	Sampling Unit	Sample Selection Method	Confidence Level	Tolerable Error Rate	Expected Error (Rate) ¹	Sample Size	Results Projected to Intended Population	Finding Number
Separation lump-sum pay	Compliance	228	\$ 6,191,813	Employee	Computer-generated sample random	90%	5%	1.50%	65	Yes	4
Overtime pay	Compliance	53,465	\$ 31,820,082	Employee	Computer-generated sample random	90%	5%	1.50%	105	Yes	5

¹ Pursuant to the AICPA's *Audit Guide: Audit Sampling* (May 1, 2017 edition), pages 131-133, the expected error is the expected number of errors planned for in the sample. It is derived by multiplying the expected error rate by the sample size. The expected number of errors in the sampling tables on pages 135-136 was rounded upward, e.g., 0.2 errors becomes 1.0 error.

**Attachment—
North Kern State Prison’s Response to Draft Audit Report**

DIVISION OF ADULT INSTITUTIONS
NORTH KERN STATE PRISON
2737 West Cecil Avenue
P. O. Box 567
Delano, California 93216



March 18, 2020

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

Dear Mr. Finlayson,

This letter is in response to the draft report issued by the State Controller's Office (SCO) on March 11, 2020 regarding the Payroll Process Review of North Kern State Prison (NKSP).

NKSP takes seriously its responsibilities to ensure effective payroll processes are in place, and is committed to continually improving those processes. NKSP reiterates this commitment by the implementation of enhanced quality controls since the audit period of August 1, 2015 through July 31, 2018. Specifically, we believe significant improvements have taken place by adhering and following established policy and procedural changes, staff training and ongoing process evaluation. NKSP continues to place importance on the quality of work of the Personnel Office and is looking forward to continuing to improve.

The following is in response to each of the findings and recommendations contained in the report:

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

The Personnel Specialist duties and responsibilities consist of processing various personnel/payroll transactions, including data entry, reconciliation, and processing of adjustments and corrections. NKSP believes controls are in place, which ensure timekeeper duties do not overlap with the personnel transactions staff who key in the payroll system.

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

Since the review, NKSP has implemented procedures to remove SCO users immediately when staff has transferred, separated, or on a leave of absence. Institutions now have the ability to e-mail the Decentralized Security Administrator (DSA) any notifications to remove users and submit required documents via secured e-mail. The Institutional Personnel Officer reviews

current user's access to the system periodically to ensure NKSP's compliance with the Decentralized Security Program.

Finding 3 – Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances

Effective June 2019, NKSP implemented the Department's Leave Reduction Plan. All employees in excess of their specific Memorandum of Understanding (MOU) or the California Code of Regulations established leave cap, were required to submit a Leave Reduction Plan (CalHR 138) Form to their supervisor by July 5, 2019 to reduce or keep their leave balance below the cap. The fully implemented Department's Leave Reduction Plan requires all employees to submit a CalHR 138 Form by December of each year.

Finding 4 – Inadequate controls over separation lump-sum pay, resulting in improper payments

NKSP has implemented oversight controls, which require review and signature approval of all lump-sum calculations by both Personnel Supervisor I's and the Personnel Supervisor II. As a result, of the control process, deficiencies identified in the finding have been remedied.

Finding 5 – Controls over FLSA overtime pay failed to identify errors, resulting in improper payments

NKSP has implemented oversight controls to prevent and eliminate improper overtime payments. The Business Information System is utilized to process overtime, which calculates and downloads overtime rates electronically into the SCO System. Personnel Supervisor I's analyze and review a selection of pay timesheets to ensure compliance and provide daily monitoring of pay issued in the SCO system.

Finding 6 – Inadequate controls over holiday credit transactions, resulting in improper credits

Personnel Transactions Staff received additional training on the processing of holiday credits and are required to review all leave credit posted in the California Leave Accounting System on a monthly basis. Personnel Supervisor I's audit these reports on a monthly basis to ensure proper posting of credits.


Finding 7 – Inadequate controls over uniform allowance pay, resulting in overpayments

Personnel Transactions Staff received additional training on the processing of uniform allowance pay. Personnel Supervisor I's review, audit documents and monitor pay issued in the SCO system to ensure accurate processing of uniform allowance pay.

NKSP welcomes insights provided by the auditors and would like to thank SCO for its work on this report.

Should you have any questions, please contact Luz E. Lujan, Staff Services Manager I at (661) 721-2345 extension 6700, or at Luz.Lujan@cdcr.ca.gov.

Sincerely,



KELLY SANTORO
Warden
North Kern State Prison

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

<http://www.sco.ca.gov>