CALIFORNIA DEPARTMENT OF STATE HOSPITALS – NAPA

Review Report

PAYROLL PROCESS REVIEW

January 1, 2012, through December 31, 2014

BETTY T. YEE
California State Controller

May 2017
May 10, 2017

Pam Ahlin, Director
California Department of State Hospitals
1600 9th Street, Room 151
Sacramento, CA  95814

Dear Ms. Ahlin:

The State Controller’s Office has reviewed the California Department of State Hospitals – Napa (DSH-Napa) payroll process for the period of January 1, 2012, through December 31, 2014. DSH-Napa management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our limited review identified material weaknesses in internal control over the DSH-Napa payroll process that leave DSH-Napa at risk of additional improper payments if not mitigated. Specifically, DSH-Napa lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. The lack of segregation of duties and appropriate compensating controls has a pervasive effect on the DSH-Napa payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

DSH-Napa also inappropriately granted four employees keying access to the State’s payroll system. The employees, who were appointed as analysts, were given keying access without the required written justification. DSH-Napa requested the removal of keying access for one of the four employees 49 days after the employee became an analyst. This control deficiency leaves DSH-Napa at risk of misuse, abuse, and unauthorized use of payroll data.

Further, DSH-Napa lacked sufficient controls over the processing of specific payroll-related transactions to ensure that DSH-Napa complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. These control deficiencies contributed to DSH-Napa employees’ excessive vacation and annual leave balances, costing the State at least $2,594,300 as of December 31, 2014; and improper and questioned payments, unrecovered long-outstanding salary advances, and improper holiday credit accruals, costing the State an estimated net total of $74,139. Our review was performed on a limited number of transactions only; a more extensive review may determine that the amount of improper payments is higher than what we found.
If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, by telephone at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

Attachment

cc: Diana S. Dooley, Secretary
California Health and Human Services Agency
Stephanie Clendenin, Chief Deputy Director
California Department of State Hospitals
Lupe Alonzo-Diaz, Deputy Director, Administration
California Department of State Hospitals
Mark Rodriguez, Chief, Administrative Services Division
California Department of Human Resources
Cindy Woolston, Chief, Office of Audits
California Department of State Hospitals
Dolly Matteucci, Executive Director
California Department of State Hospitals – Napa
George Watanabe, Assistant Hospital Administrator
California Department of State Hospitals – Napa
Contents

Review Report

Summary ........................................................................................................................................ 1
Background .................................................................................................................................... 2
Objectives, Scope, and Methodology .......................................................................................... 3
Conclusion .................................................................................................................................... 4
Views of Responsible Officials ..................................................................................................... 5
Restricted Use .............................................................................................................................. 5
Findings and Recommendations .................................................................................................... 6

Attachment—California Department of State Hospitals’ Response to Draft Review Report
Review Report

Summary

The State Controller’s Office (SCO) reviewed the California Department of State Hospitals – Napa (DSH-Napa) payroll process for the period of January 1, 2012, through December 31, 2014. DSH-Napa management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our limited review identified material weaknesses in internal control over the DSH-Napa payroll process that leave DSH-Napa at risk of additional improper payments if not mitigated. We found that DSH-Napa 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, DSH-Napa lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. DSH-Napa payroll transactions unit staff performed conflicting duties. The payroll staff performs multiple steps in processing payroll transactions, including data entry into the State’s payroll system; auditing employee timesheets; reconciling payroll, including system output to source documentation; and reporting payroll exceptions. This control deficiency was aggravated by the lack of compensating controls, such as management oversight and review, to mitigate the risks associated with such a deficiency. The lack of segregation of duties and appropriate compensating controls has a pervasive effect on the DSH-Napa payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

DSH-Napa also inappropriately granted four employees keying access to the State’s payroll system. The employees, who were appointed as analysts, were given keying access without the required written justification. DSH-Napa requested the removal of keying access for one of the four employees 49 days after the employee became an analyst. This control deficiency leaves DSH-Napa at risk of misuse, abuse, and unauthorized use of payroll data.

Further, DSH-Napa lacked sufficient controls over the processing of specific payroll-related transactions to ensure that DSH-Napa complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. As summarized in the following table, the control deficiencies contributed to DSH-Napa employees’ excessive vacation and annual leave balances, costing the State at least $2,594,300 as of December 31, 2014; and improper and questioned payments, unrecovered long-outstanding salary advances, and improper holiday credit accruals, costing the State an estimated net total of $74,139.

Our review was performed on a limited number of transactions only; a more extensive review may determine that the amount of improper payments is higher than what we found.
The following table summarizes our review results:

<table>
<thead>
<tr>
<th>Finding Number</th>
<th>Issues</th>
<th>Number of Selections Reviewed</th>
<th>Selection Unit</th>
<th>Number of Selections with Issues</th>
<th>Dollar Amount of Selections Reviewed</th>
<th>Issues as a Percentage of Selections Reviewed</th>
<th>Approximate Dollar Amount</th>
<th>Dollar Amount of Selections Reviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Inadequate segregation of duties and compensating controls</td>
<td>See below</td>
<td>See below</td>
<td>See below</td>
<td>See below</td>
<td>See below</td>
<td>See below</td>
<td>See below</td>
</tr>
<tr>
<td>2</td>
<td>Inappropriate keying access to the State’s payroll system</td>
<td>21</td>
<td>Employee</td>
<td>4</td>
<td>$2,594,300</td>
<td>19%</td>
<td>$2,594,300</td>
<td>100%</td>
</tr>
<tr>
<td>3</td>
<td>Inadequate controls over vacation and annual leave credit, costing the State liability for excessive credits</td>
<td>185</td>
<td>Employee</td>
<td>185</td>
<td>$2,594,300</td>
<td>100%</td>
<td>$2,594,300</td>
<td>100%</td>
</tr>
<tr>
<td>4</td>
<td>Inadequate controls over holiday credit, resulting in improper accruals</td>
<td>31</td>
<td>Holiday credit transaction</td>
<td>30,647</td>
<td>21</td>
<td>68%</td>
<td>30,125</td>
<td>98%</td>
</tr>
<tr>
<td>5</td>
<td>Inadequate controls over salary advances, resulting in failure to recover outstanding accounts and maintain accurate balances</td>
<td>10</td>
<td>Salary advance transaction</td>
<td>20,654</td>
<td>10</td>
<td>100%</td>
<td>20,654</td>
<td>100%</td>
</tr>
<tr>
<td>6</td>
<td>Inadequate controls over out-of-class compensation, resulting in improper and questioned payments</td>
<td>12</td>
<td>Employee</td>
<td>9</td>
<td>65,394</td>
<td>75%</td>
<td>14,112</td>
<td>22%</td>
</tr>
<tr>
<td>7</td>
<td>Inadequate controls over Medical Officer of the Day, resulting in improper payments</td>
<td>13</td>
<td>Medical Officer of the Day transaction</td>
<td>74,340</td>
<td>7</td>
<td>54%</td>
<td>6,235</td>
<td>8%</td>
</tr>
<tr>
<td>8</td>
<td>Inadequate controls over overtime compensation, resulting in improper payments, net:</td>
<td>21</td>
<td>Overtime payment transaction</td>
<td>108,134</td>
<td>6</td>
<td>29%</td>
<td>3,013</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>293</td>
<td>$2,893,469</td>
<td>242</td>
<td>$2,668,439</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

**Background**

In 1979, the State of California adopted collective bargaining for state employees. This adoption of collective bargaining created a significant workload increase for the 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, allowing 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 maintain an adequate internal control structure over the payroll function, provide proper oversight over decentralized payroll processing, and comply with various state laws and regulations regarding payroll processing and related transactions.
Review Authority

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

Objectives, Scope, and Methodology

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.

- DSH-Napa 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.

- DSH-Napa complied with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures.

- DSH-Napa 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 DSH-Napa payroll process and transactions for the period of January 1, 2012, through December 31, 2014.

To achieve our review objectives, we:

- Reviewed state and DSH-Napa policies and procedures related to payroll process to understand the practice of processing various payroll and payroll-related transactions;

- Interviewed DSH-Napa 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); and

- 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\(^1\) in internal control over the DSH-Napa payroll process that leave DSH-Napa at risk of additional improper payments if not mitigated. DSH-Napa 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, DSH-Napa lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. DSH-Napa payroll transactions unit staff performed conflicting duties. The staff performs multiple steps in processing payroll transactions, including data entry into the State’s payroll system; auditing employee timesheets; reconciling payroll, including system output to source documentation; and reporting payroll exceptions. This control deficiency was aggravated by the lack of compensating controls, such as management oversight and review, to mitigate the risks associated with such a deficiency. The lack of segregation of duties and appropriate compensating controls has a pervasive effect on the DSH-Napa payroll process and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

\(^1\) 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 will not be prevented, or detected and corrected, 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.
DSH-Napa also inappropriately granted four employees keying access to the State’s payroll system. The employees, who were appointed as analysts, were given keying access without the required written justification. DSH-Napa requested the removal of keying access for one of the four employees 49 days after the employee became an analyst. This control deficiency leaves DSH-Napa at risk of misuse, abuse, and unauthorized use of payroll data.

Further, DSH-Napa lacked sufficient controls over the processing of specific payroll-related transactions to ensure that DSH-Napa complies with collective bargaining agreements and state laws, and that only valid and authorized payments are processed. The control deficiencies contributed to DSH-Napa employees’ excessive vacation and annual leave balances, costing the State at least $2,594,300 as of December 31, 2014; improper holiday credit accruals costing an estimated total of $30,125; unrecovered and overstated salary advances totaling $20,654; improper and questioned payments for out-of-class compensation at an estimated total of $14,112; improper payments for Medical Officer of the Day compensation totaling $6,235; and improper payments for overtime compensation at a net total of $3,013. Our review was performed on a limited number of transactions only; a more extensive review may determine that the amount of improper payments is higher than what we found.

**Views of Responsible Officials**

We issued a draft review report on February 21, 2017. Pam Ahlin, Director, DSH, responded by letter dated March 24, 2017 (Attachment). DSH agrees with Findings 2, 4, 5, 7 and 8 and did not dispute Finding 3. DSH indicated that DSH and DSH-Napa have implemented actions to correct the deficiencies noted in those findings. DSH disagrees with Findings 1 and 6. We believe that the basis of DSH’s disagreement with these two findings is incorrect or unsupported. Accordingly, we maintain the conclusions, findings, and recommendations we made regarding this review. Our full comments regarding DSH’s responses to each finding are included in the Findings and Recommendations section.

**Restricted Use**

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

May 10, 2017
Findings and Recommendations

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

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

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

Our review found that DSH-Napa payroll transactions unit staff performed conflicting duties. The staff performs multiple steps in processing payroll transactions, including data entry into the State’s payroll system; auditing employee timesheets; determining eligibility to receive pay; reconciling payroll, including system output to source documentation; and processing adjustments or corrections. For example, the payroll transactions unit staff keys in regular and overtime pay and reconciles the master payroll, overtime, and other supplemental warrants. DSH-Napa failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. For example, we found no indication that supervisors conduct periodic reviews of transactions processed by the payroll transactions unit staff.

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

Recommendation

DSH-Napa should separate conflicting payroll function duties to the 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. Good internal control practices require that the following functional duties should be performed by different work units, or at minimum, by different employees within the same unit:

- **Recording transactions.** This duty refers to the recordkeeping function, which is accomplished by entering data into a computer system.

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

If it is not possible to segregate payroll functions fully and appropriately due to specific circumstances, DSH-Napa should implement compensating controls. For example, if the payroll transactions unit staff 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.

DSH-Napa should develop formal written procedures for performing and documenting compensating controls.

DSH’s Response

DSH does not agree with the finding identified by SCO. DSH-Napa has compensating controls in place to perform conflicting functions as mandated by California Government Code sections 13402 and 13403.

The internal controls have been strengthened by the following actions taken by DSH-Napa:

- In January 2015 a Timekeeping Manual was implemented which changed how timekeeping/attendance records are processed. Specifically, DSH-Napa converted from a manual timekeeping process to a streamlined computer based time reporting process. This new process mandates that the supervisor validate the employees time worked with sign in/out attendance records. In addition, each unit is assigned a timekeeper that will review the timesheet prior to sending the timesheet for processing to Personnel. Thus, there are two levels of review before a timesheet is provided to Personnel which has reduced the amount of errors.

- All supporting documents are submitted with the employee’s timesheet to Personnel which results in better documentation to support pay/leave transactions keyed. Personnel Specialists review these individual attendance records and return them for resolution of discrepancies prior to keying into the SCO system.

- In May 2015, DSH-Napa established a benefits analyst position to process Health/Dental Benefits enrollments/changes and FMLA requests in order to reduce workload on Personnel Specialists so they could have more time to focus on the accuracy of payroll transactions.

- During the SCO audit period of January 1, 2012 to December 31, 2014, the DSH-Napa Personnel office experienced a high vacancy rate and did not have the staff to perform internal audits of payroll transactions. A concerted effort to fill the critical vacancies and provide training has improved the ability of DSH-Napa to provide more separation of duties necessary to mitigate input errors.
The work performed by personnel specialists for keying personnel information is subject to supervisor review. The supervisor’s review is performed on a random basis. The intent of the supervisor’s review is to identify any potential keying discrepancies inadvertently entered by the personnel specialist.

In addition, DSH has developed and implemented audit tools in July of 2016 for DSH personnel specialists to identify keying problem areas, mandate staff training, and monitors staff progress/work.

SCO’s Comment

The finding remains as stated. As discussed in the finding, we found that DSH-Napa lacked adequate segregation of duties and compensating controls within its payroll transactions unit. DSH’s response did not dispute that DSH-Napa payroll transactions unit staff performed conflicting duties. The response asserts, however, the existence of compensating controls to mitigate the risk associated with the lack of adequate segregation of duties. This assertion is incorrect and unsupported. DSH stated that the personnel specialists’ work for keying information is subject to supervisor review, on a random basis. This activity, if operating effectively, provides prudent detective control to ensure personnel specialists key data accurately into the system; however, as discussed in the finding, we found no evidence that such an activity exists. In its response, DSH also did not provide additional documents to support that assertion.

DSH asserted that, subsequent to our review period, DSH and DSH-Napa have implemented measures to strengthen their internal controls. We have not reviewed and cannot comment on the validity of these asserted measures as these were implemented subsequent to the review period. We will follow up at the next payroll review to ensure that such measures (corrective action) were adequate and appropriate.

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

DSH-Napa lacked adequate controls to ensure that only appropriate staff have keying access to the State’s payroll system. Of the 21 employees we reviewed, four (19%) had improper keying access to the system. If not mitigated, this control deficiency leaves DSH-Napa at risk of misuse, abuse, and unauthorized use of payroll data.

The SCO maintains the State’s payroll information system. The system is decentralized, thereby allowing employees of state agencies to access the system. The 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.

DSH-Napa had 21 employees with keying access to the State’s payroll system at various times between January 2012 and December 2014. Our review of the 21 employees found that four did not have their keying access immediately removed or modified subsequent to change in job classification. The four employees had keying access while appointed as Staff Services Analyst or Associate Personnel Analyst—classifications
other than the two classifications authorized to have keying access. The employees were provided keying access before becoming analysts; however, DSH-Napa did not have the required written justification to allow the employees to have continued access as analysts. DSH-Napa requested the removal of keying access for one of the four employees 49 days after the employee became an analyst.

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. . . .

To prevent unauthorized use of a transferred, terminated or resigned employee’s userid, it is required that the Security Monitor IMMEDIATELY submit a PSD125A to delete their system access. DO NOT WAIT until another employee fills this position; this only increases the chances for breach of security, utilizing and old userid.

Recommendation

DSH-Napa should update the keying access to the payroll system after employees change classifications. DSH-Napa’s designated security monitor should periodically review access to the system to determine that access complies with the Decentralized Security Program.

DSH’s Response

DSH agrees and has updated the justification for the four employees identified as having inappropriate access to the State’s payroll system. Documentation to support the resolution of this issue was provided to the SCO on August 3, 2015.

DSH-Napa will monitor and update the access as separations, appointments, and classification changes occur within Personnel to ensure that only appropriately designated staff have access to the State’s payroll system.

SCO’s Comment

DSH agreed with the finding and indicated that DSH-Napa has implemented actions subsequent to our review period to correct the deficiencies noted in the finding. We will follow up at the next payroll
review to ensure that such corrective actions were adequate and appropriate.

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

DSH-Napa 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 $2,594,300 as of December 31, 2014. We expect the liability to increase if DSH-Napa 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 in certain circumstances. 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 DSH-Napa had 1,992 employees with unused vacation or annual leave credits at December 31, 2014. Of the 1,992 employees, 185 (9%) exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 3,013 hours in annual leave, or 2,373 hours beyond the 640-hour limit. Collectively, the 185 employees accumulated more than 62,500 hours in excess vacation and annual leave, costing at least $2,594,300 as of December 31, 2014. This estimated liability does not adjust for salary rate increases and additional leave credits. Accordingly, we expect that the amount needed to pay for the liability would be higher. For example, a DSH-Napa employee separated from state service with 3,548 hours in leave credits, including 2,079 hours in annual leave. After adjusting for additional leave credits, the employee should have been paid for 4,348 hours, or 23% more.

We performed an additional review of 10 of the 185 employees to determine whether DSH-Napa complied with collective bargaining agreements and state regulations. We found that DSH-Napa could not demonstrate that it allowed the 10 employees to carry vacation or annual leave balances beyond the limit based on exceptions specified in agreements and state regulations. DSH-Napa also did not take action to bring leave balances below the limit. The 10 employees did not have plans in place to reduce leave balances below the limit.

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2 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.
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:

<table>
<thead>
<tr>
<th>As of</th>
<th>Number of employees</th>
<th>Year-to-year percentage increase (decrease)</th>
<th>Number of hours</th>
<th>Year-to-year percentage increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1, 2012</td>
<td>166</td>
<td>-</td>
<td>42,192</td>
<td>-</td>
</tr>
<tr>
<td>December 31, 2012</td>
<td>175</td>
<td>5%</td>
<td>47,976</td>
<td>14%</td>
</tr>
<tr>
<td>December 31, 2013</td>
<td>187</td>
<td>7%</td>
<td>54,922</td>
<td>14%</td>
</tr>
<tr>
<td>December 31, 2014</td>
<td>185</td>
<td>(1%)</td>
<td>69,411</td>
<td>26%</td>
</tr>
</tbody>
</table>

*Source: State’s leave accounting system*

If DSH-Napa does not take action to reduce the excessive credits, the liability for accrued vacation and annual leave will likely increase because most employees will receive salary increases and 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 these 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**

DSH-Napa 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. DSH-Napa should conduct ongoing monitoring of controls to ensure that the controls are implemented and operating effectively.

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

**DSH’s Response**

DSH approved Policy Directive 5314 on March 1, 2017 to ensure that each employee uses leave balances in a manner which is consistent with DSH’s operational needs and complies with existing leave statutes/regulations. DSH-Napa management will work with the
employees to reduce leave balances to the extent feasible as mandated by this Policy Directive.

Excess leave credits is a statewide systemic issue that may require more clear direction and consideration for departments that have 24-hour operations with minimum staffing requirements. Vacation/leave requests are managed at DSH based on operational needs and licensing standards, which may not provide for employees always being able to take vacation and/or other leaves to limit leave balances accrued.

To the extent that funding is available, DSH will continue to participate in buy-back programs as it has in previous years. Specifically, DSH-Napa participated in the State buy-back program in June 2014, June 2015, and June 2016.

SCO’s Comment

DSH did not dispute the finding and indicated that DSH and DSH-Napa have implemented corrective actions subsequent to our review period to address the deficiencies noted in the finding. We will follow up at the next payroll review to ensure that such corrective actions were adequate and appropriate.

FINDING 4—Inadequate controls over holiday credits, resulting in improper accruals

DSH-Napa lacked adequate controls over the accrual of its employees’ holiday credits. DSH-Napa improperly granted at net total of 901 holiday credit hours in 21 of the 31 transactions (68%) we reviewed, costing the State approximately $30,125. If not corrected, the control deficiency also leaves DSH-Napa at risk of recording additional improper accruals of holiday credit.

Collective bargaining agreements and GC section 19853 specify the number of hours of holiday credit an employee would receive per qualifying holiday. Leave accounting records showed that DSH-Napa had 2,298 employees who received holiday credits between January 2012 and December 2014. We reviewed 31 selected holiday credit transactions for 29 of these employees. Of the 31 transactions, 21 were improper accruals totaling 901 holiday credit hours, as shown in the following table:

<table>
<thead>
<tr>
<th>Issues</th>
<th>Number of Employees</th>
<th>Number of Holiday Credit Transactions</th>
<th>Number of Hours of Improper Holiday Credits</th>
<th>Estimated Net Cost to the State as of December 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holiday credit used entered as earned in the system</td>
<td>6</td>
<td>6</td>
<td>455</td>
<td>$16,257</td>
</tr>
<tr>
<td>Holiday credit exceeded the limit set by collective bargaining agreements, net¹</td>
<td>13</td>
<td>14</td>
<td>438</td>
<td>13,641</td>
</tr>
<tr>
<td>Holiday credit granted on pay period with no holidays</td>
<td>1</td>
<td>1</td>
<td>8</td>
<td>227</td>
</tr>
<tr>
<td>Total</td>
<td>20</td>
<td>21</td>
<td>901</td>
<td>$30,125</td>
</tr>
</tbody>
</table>

Source: State’s leave accounting system and DSH-Napa’s payroll records

¹One employee also received eight hours, costing approximately $196, less than allowed by collective bargaining agreement.
For instance, DSH-Napa overstated the holiday credit balances of six employees by a total of 455 hours because the payroll transactions unit staff entered holiday credit used as earned in the system. 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.

**Recommendation**

DSH-Napa should conduct a review of the State’s leave accounting system to ensure that the accrual of holiday credits complies with collective bargaining agreements and state law. DSH-Napa should correct any improper holiday credits in the State’s leave accounting system.

To prevent recording of improper holiday credits in the State’s leave accounting system from recurring, DSH-Napa should:

- Provide adequate oversight to ensure that payroll transactions unit staff accurately records leave transactions; and
- Train payroll transactions unit staff members who key transactions into the State’s leave accounting system to ensure that they understand the requirements under collective bargaining agreements and state law regarding holiday credits.

**DSH’s Response**

We agree that Napa had input errors of about 901 hours in the California Leave Accounting System (CLAS). These input errors were corrected in CLAS in April 2015 with the applicable documentation provided to the SCO auditor on July 20, 2015.

DSH-Napa implemented a new time keeping business process in January of 2015. This conversion from a manual handwritten process to a computer generated time sheet process makes it easier for the DSH-Napa Personnel Specialist to identify errors and/or inaccurate time keeping data. DSH-Napa shifted workload from some of the Personnel Specialists to provide them with more time to focus on inputting accurate timesheet data. Moreover, additional 1:1 training for Personnel Specialists along with formal SCO training classes is provided on a consistent and regular basis. This has improved the skills and abilities of current DSH-Napa staff members which, in turn, reduced the amount of input errors. DSH-Napa established “quiet hours” in 2015 during which phones go to voicemail and employee interactions are limited so that transactions staff have uninterrupted time to focus on accurately processing payroll transactions.

Given the platform and the process to input information into the CLAS, DSH-Napa uses the tools available including SCO exception reports. However, DSH would appreciate the SCO providing more audit tools (exception reports) that could help DSH in the CLAS input process.
SCO’s Comment

DSH agreed with the finding and indicated that DSH and DSH-Napa have implemented actions subsequent to our review period to correct the deficiencies noted in the finding. We will follow up at the next payroll review to ensure that such corrective actions were adequate and appropriate.

In reference to DSH’s comments regarding audit tools, the PPSD already provides the Leave Activity & Balance report and exception reports periodically to state agencies. These reports can assist state agencies to verify the accuracy and completeness of the data keyed into CLAS.

FINDING 5—Inadequate controls over salary advances, resulting in failure to collect and maintain accurate balances

DSH-Napa lacked adequate controls over salary advances to ensure that they comply with state law and policies. This control deficiency resulted in long-outstanding salary advances and inaccurate balances. Of the 10 salary advance transactions we reviewed, six, totaling $9,504, remained outstanding because DSH-Napa failed to implement procedures to ensure timely collection, and four were overstated by $11,150 because DSH-Napa did not record collections in the accounting system. If not corrected, this control deficiency leaves DSH-Napa at risk of further failures to collect salary advances and maintain accurate records.

GC section 19838 and State Administrative Manual (SAM) section 8776.7 allow DSH-Napa to collect salary advances in a timely manner. At December 31, 2014, DSH-Napa’s accounting records indicated that 107 individuals had $212,658 in uncollected salary advances, including $51,718 that has been outstanding for more than 120 days. The longest outstanding salary advance was 15 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.

We reviewed 10 selected salary advances, totaling $20,654, made to nine individuals that have been outstanding for more than 120 days as of December 31, 2014. We found that DSH-Napa failed to record collections of $11,150 from four of the 10 salary advances in the accounting system; therefore, the total outstanding salary advance was overstated by the same amount. The remaining six salary advances, totaling $9,504, remained uncollected because DSH-Napa failed to initiate collection efforts, pursuant to state law and policies. One of the six salary advances also had no documentation to support its authorization. SAM section 8776 requires agencies to maintain proper records of collection efforts and payment of salary advances.

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

Recommendation

DSH-Napa should ensure that salary advances are recovered in a timely manner pursuant to GC section 19838 and SAM section 8776.7. If all
reasonable collection procedures do not result in payment from former employees, DSH-Napa may request discharge from accountability of uncollectable amounts. The accounting unit should review the outstanding salary advances in the accounting system with the human resources unit to identify those for discharge.

Pursuant to SAM section 8776, DSH-Napa also should:

- Maintain documentation of its authorization, collection efforts, and payment of salary advances; and
- Ensure that salary advance transactions are recorded timely and accurately into the accounting system.

DSH’s Response

DSH-Napa agrees and has implemented the following to mitigate the past, current and future accounts receivable:

- On February 1, 2016 established an analyst position to work with Personnel and Accounting staff to identify and collect Accounts Receivables due. The role of the analyst is to ensure that accounts receivable are documented accurately and collected timely. This analyst has made great progress in collecting/clearing old debts and monitoring the ongoing collection of current debts.

- Personnel supervisors are auditing the Personnel Specialist work to ensure that notifications are made to employees in a timely manner and that collections are made and applied correctly.

- Personnel Supervisors meets with Accounting Supervisors as needed to ensure that collections are appropriately applied and reported accurately in accounting records.

- On January 22, 2016, DSH issued Policy Directive 2300 Accounts Receivable to ensure that proper controls are in place to collect employee accounts receivable timely and accurately.

In addition, the following actions have been implemented to resolve the outstanding salary advances of $20,022:

- $15,753 of the $20,022 identified has been collected and the applicable documentation has been provided to the SCO auditor on May 1, 2015, and May 14, 2015
- $2,506 has been referred to Franchise Tax Board for collection and the applicable documentation has been provided to the SCO auditor on May 1, 2015
- The DSH is in the process of collecting $1,129 from current employees and the applicable documentation has been provided to the SCO auditor on May 12, 2015, and
- $634 will be written-off as a bad debt.

One of the salary advances identified by SCO for $632 is not a salary advance but was an interest payment that was misclassified. This was an expense incurred by DSH-Napa for the closed Stockton facility. This will be corrected in the accounting records as a journal entry. The applicable documentation has been provided to the SCO auditor on May 12, 2015.
SCO’s Comment

DSH agrees with the finding and indicated that DSH-Napa is implementing actions to correct the deficiencies. We will follow up at the next payroll review to ensure that such corrective actions were adequate and appropriate.

DSH asserted that the salary advance total of $20,654, as described in the finding, included $632 for an interest payment that was misclassified as a salary advance. While DSH-Napa included this amount in salary advance aging report, it had no documentation to support the transaction during our review, as described in the finding. DSH also did not provide additional documentation to support its assertion.

Of the salary advances listed as outstanding in the aging report, DSH stated that $15,753 has been collected. DSH did not provide additional documentation to support this assertion. The amount that we described in the finding as collected but not recorded in the accounting system was based on the available documentation and DSH-Napa’s representation during the review.

The finding remains as stated.

FINDING 6—Inadequate controls over out-of-class compensation, resulting in improper and questioned payments

DSH-Napa lacked adequate controls necessary to ensure that payment of out-of-class compensation complied with collective bargaining agreements and state policy. DSH-Napa made a total of approximately $14,112 in improper and questioned payments for out-of-class compensation during the review period. If not corrected, this control deficiency leaves DSH-Napa at risk of additional improper payments.

Payroll records showed that DSH-Napa paid out-of-class compensation to 194 employees between January 2012 and December 2014. We reviewed the out-of-class compensation for 12 selected employees to determine whether DSH-Napa granted the compensation in accordance with collective bargaining agreements and state policy. Of the 12 employees, nine received compensation beyond the limits set by collective bargaining agreements and state policy as follows:

- Eight employees were covered by collective bargaining, including four who were subject to agreements that restrict an employee’s out-of-class assignment to 120 days and four who were subject to agreements that allow assignment beyond 120 days if approved by CalHR (previously the California Department of Personnel Administration), but DSH-Napa did not obtain such approval. We questioned approximately $13,977 in out-of-class compensation for the eight employees.

- One managerial employee who was excluded from collective bargaining received compensation exceeding nine months, in violation of CalHR policy. The employee was improperly paid approximately $135 in compensation exceeding the limit.
CalHR’s *California State Civil Service Pay Scales* section 14, Pay Differential 101 and Policy Memo No. 2007-026 allow managerial out-of-class assignments for up to one year. The compensation begins on the ninety-first day but not to exceed nine months.

Policy Memo No. 2007-026 also reminds departments that there are no exceptions to request extensions of out-of-class assignments beyond the provisions of collective bargaining agreements for represented employees. The collective bargaining agreements between the State and Bargaining Units 1, 4 and 15 restrict represented employees to up to 120 days of out-of-class assignment within 12 consecutive months. The collective bargaining agreements between the State and Bargaining Units 16 and 19 include the following provisions:

<table>
<thead>
<tr>
<th>Unit</th>
<th>Section</th>
<th>Collective bargaining agreement states, in part…</th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td>12.11A</td>
<td>. . . An employee may be assigned to work out of class for more than 120 consecutive days only with approval of the Department of Personnel Administration (DPA). . . .</td>
</tr>
<tr>
<td>19</td>
<td>15.3A</td>
<td>. . . . An employee may be assigned to work out of class for more than 120 consecutive days only with the approval of the Department of Personnel Administration (DPA). . . .</td>
</tr>
</tbody>
</table>

**Control deficiencies over the processing of out-of-class compensation**

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including a system of authorization and recordkeeping procedures over expenditures, and an effective system of internal review. State agencies also should ensure that these controls are functioning as prescribed. However, our review of out-of-class compensation found significant control deficiencies that leave DSH-Napa at risk of additional improper payments and practices if not mitigated. Specifically, we found that:

- DSH-Napa failed to implement existing policies and procedures related to out-of-class assignment and compensation consistently. For example, as described previously, CalHR policies allow out-of-class assignments only as provided in collective bargaining agreements. However, DSH-Napa payroll transactions unit staff processed compensation for out-of-class assignments even though the assignments exceeded the limits set by collective bargaining agreements.

- DSH-Napa management did not provide adequate oversight to ensure that the processing of out-of-class compensation complies with collective bargaining agreements and state policies.

**Recommendation**

DSH-Napa should conduct a review of out-of-class compensation it paid during the past three years to ensure that the compensation complies with collective bargaining agreements and state policies. DSH-Napa should seek reimbursement for overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838.
To prevent improper out-of-class compensation from recurring, the DSH-Napa should:

- Implement existing state policies and procedures regarding out-of-class assignments and compensation. DSH-Napa should conduct ongoing monitoring of controls to ensure that they are consistently implemented and operating effectively.

- Provide adequate oversight to ensure that the payroll transactions unit staff processes only valid and authorized out-of-class compensation that complies with collective bargaining agreements and state policies.

**DSH’s Response**

DSH does not agree that improperly granted out-of-class compensation to employees cost the state $14,112. DSH did not overpay the nine (9) employees by $14,112 because the labor contract required DSH to pay applicable compensation to employees performing job duties at a higher-level classification. The employees performed the job duties. The nine employees paid beyond 120 days filled positions that, if vacant, would have created licensing and accreditation issues at DSH-Napa. These positions were mission critical and could not be filled due to various external statewide conditions. DSH was forced during this period to implement internal processes necessary to provide 24-hour level(s) of patient care, which included an in-house approval process for out-of-class assignments beyond 120 days. DSH worked with applicable contract labor unions to ensure that all contract labor laws were appropriately followed.

The DSH Office of Audits conducted a statistically valid test of out-of-class assignments in place on May of 2015. The test found that DSH is following current established out-of-class policies and procedures.

**SCO’s Comment**

The finding remains as stated. As described in the finding, our review found $14,112 in improper and questioned payments for out-of-class compensation. This include $135 that was paid to a managerial employee for out-of-class compensation exceeding nine months. According to CalHR’s Policy Memo No. 2007-026, “As members of the management team, employees in managerial classes can reasonably be expected to perform work as needed to help the department function smoothly. For limited periods of time, a manager should be expected to fulfill a wide range of assignments not normally part of his/her assignment and classification without additional compensation.” Policy Memo No. 2007-026 and CalHR’s California State Civil Service Pay Scales section 14, Pay Differential 101 allow managerial out-of-class compensation beginning on the ninety-first day but not to exceed nine months. Therefore, the compensation exceeding that limit is improper.

The payments also include $13,977 in out-of-class compensation for eight employees beyond the limits set by their respective collective bargaining agreements. According to Policy Memo No. 2007-026, there are no exceptions to request extensions of out-of-class assignments beyond the agreement provisions. DSH-Napa did not obtain CalHR’s approval to extend assignments beyond the limits.
FINDING 7—
Inadequate controls over Medical Officer of the Day pay, resulting in improper payments

We have not reviewed and cannot comment on DSH’s statements regarding its Office of Audits’ test of out-of-class assignments as this test covered a different scope.

DSH-Napa lacked adequate controls necessary to ensure that payment of Medical Officer of the Day (MOD) compensation complied with the collective bargaining agreement and state policy. DSH-Napa improperly paid $6,235 to seven of the 13 (54%) employees whose MOD payments we reviewed. If not corrected, this control deficiency also leaves DSH-Napa at risk of additional improper payments to employees who did not meet the requirements to receive the pay.

The collective bargaining agreement between the State and Bargaining Unit 16 and CalHR’s California State Civil Service Pay Scales, section 14, Pay Differential 76 allow compensation for MOD work shifts of at least eight continuous hours in addition to the employee’s regularly scheduled work week.

Payroll records showed that DSH-Napa granted MOD compensation to 45 employees between January 2012 and December 2014. We reviewed the MOD payments for 13 of these employees. Of the 13 employees, seven received MOD compensation even though they had fewer than eight hours of MOD work shifts. Accordingly, DSH-Napa improperly paid seven employees an estimated total of $6,235. We found no indication that the processing of these MOD payments was reviewed by an authorized individual.

Recommendation

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

To prevent improper payments for MOD compensation from recurring, DSH-Napa should:

- Implement existing policies and procedures for MOD compensation;
- Conduct ongoing monitoring of controls to ensure that they are consistently implemented and operating effectively;
- Provide adequate supervisory review to ensure that the payroll transactions unit staff processes only valid and authorized payments for MOD compensation; and
- Provide training to managers, supervisors, and staff who might be involved in MOD payment transactions to ensure that they understand the requirements under the collective bargaining agreement and state policy regarding MOD compensation.
DSH’s Response

DSH agrees. DSH will collect the $6,235 improperly paid to seven employees, as applicable.

SCO’s Comment

DSH agrees with the finding and indicated that it will collect the improper payments.

FINDING 8—Inadequate controls over overtime compensation, resulting in improper payments

DSH-Napa lacked adequate controls to ensure that the payroll transactions unit staff processes only valid and authorized overtime compensation that comply with collective bargaining agreements and state laws. DSH-Napa overpaid four employees totaling approximately $3,327 and underpaid one employee approximately $314 in overtime compensation. If not mitigated, the control deficiencies also leave DSH-Napa at risk of additional improper overtime compensation.

Payroll records showed that DSH-Napa paid overtime compensation to more than 1,600 employees between January 2012 and December 2014. We reviewed 21 selected overtime payments totaling $108,134 to 20 of these employees. Of the 21 payments we reviewed, six (29%) were improper because DSH-Napa miscalculated the overtime hours. The miscalculation resulted in net overpayments to four employees totaling approximately $3,327 and an underpayment to one employee by approximately $314.

Recommendation

DSH-Napa should conduct a review of overtime payments made during the past three years to ensure that the payments comply with collective bargaining agreements and state law. DSH-Napa should seek reimbursement of overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838, and properly compensate those employees who were underpaid.

To prevent improper overtime payments from recurring, DSH-Napa should:

- Establish adequate internal controls to ensure that payments for overtime compensation comply with collective bargaining agreements and state law. These controls should require payroll transactions unit staff to verify that payment does not exceed the amount allowed by collective bargaining agreements and state law.

- Provide adequate oversight to ensure that payroll transactions unit staff processes only valid and authorized overtime payments that comply with collective bargaining agreements and state law.

- Train payroll transactions unit staff who process overtime payment transactions to ensure that they understand the requirements under collective bargaining agreements and state laws and policies.
DSH’s Response

DSH-Napa agrees and will conduct random internal audits of overtime for the period of April 2014 to March of 2017. Moreover, ongoing random audits will be performed based on the DSH audit tool developed and implemented in July of 2016 for transactions after March of 2017. DSH-Napa requires that all overtime slips be compared to the timesheets with all discrepancies reconciled and corrected (if applicable) prior to the Personnel Specialist processing the overtime for payment. This has reduced the error rate.

DSH will collect the $3,327 overpaid to four employees. As of March 15, 2017, DSH has already collected $2,125 of the outstanding balances with plans to collect the remaining $1,202 in the next few months. The employee that was underpaid $314 has been paid. The documentation to support these actions has been provided to the SCO auditor on March 3, 2016.

SCO’s Comment

DSH agrees with the finding and stated that it has implemented corrective measures after our review period to address the deficiencies discussed in the finding. We will follow up at the next payroll review to ensure that such corrective actions were adequate and appropriate.
Attachment—
California Department of State Hospitals’ Response to Draft Review Report
March 24, 2017

Jeffrey V. Brownfield, CPA
Chief, Division of Audits
State Controller’s Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Brownfield:

The Department of State Hospitals (DSH) has received the California State Controller Division of Audits (SCO) draft report on payroll controls at DSH-Napa dated February 21, 2017. As agreed, an extension of time to submit DSH comments regarding the findings was granted to March 24, 2017.

The draft report identifies internal control weaknesses in the areas of payroll transactions, keying access for the State’s payroll system, vacation and annual leave credits, attendance reporting, salary advances, out-of-class compensation, medical officer of the day, pay, and overtime compensation. DSH does not agree with all of the findings contained in the report but agrees that 901 hours of improper holiday credit accruals, medical officer of the day payments of $6,235, improper overtime payments of $3,013, and $20,022 in salary advances will be recovered, as applicable.

DSH acknowledges it is faced with a significant unfunded liability of $2.6 million based on the amount of annual leave and vacation balances currently carried by DSH-Napa employees. DSH operates 24 hours a day/seven days a week to serve mentally ill patients who are mandated for treatment by a criminal or civil court judge. Historical personnel issues with recruitment, retention and hard to fill positions has contributed to the accumulation of leave balances for DSH-Napa employees. For example, over 90 percent of DSH-Napa employees that have accrued excess annual or vacation leave are in direct patient care classifications. To enforce mandatory vacation and annual leave may result in a greater cost due to the payment of overtime to cover vacations/leaves for employees taking time off.

The DSH Office of Audits will work with appropriate staff at the facility to identify the systemic causes of internal control deficiencies and implement additional controls, or compensating controls, as applicable. Specifically, existing policies and procedures will be emphasized and followed.
Attached please find DSH’s corrective action plan, which details steps to implement each recommendation proposed by SCO.

Thank you for the opportunity to respond to your draft report. If you have any questions, please contact Cindy Woolston, Chief, Office of Audits at (916) 651-9984 or by email at cindy.woolston@dsh.ca.gov.

Sincerely,

[Signature]

Pam Ahlin, Director
Department of State Hospitals

cc: Diana Dooley, Secretary
California Health and Human Service Agency
Stephanie Clendenin, Chief Deputy Director
California Department of State Hospitals
Lupe Alonzo-Diaz, Deputy Director, Administration
California Department of State Hospitals
Dolly Matteucci, Executive Director
California Department of State Hospitals
George Watanabe, Assistant Hospital Administrator
California Department of State Hospitals
Cindy Woolston, Chief, Office of Audits
California Department of State Hospitals
California State Controller
Corrective Action Plan
Department of State Hospitals

The Department of State Hospitals (DSH) did not agree with all of the SCO findings. However, DSH will implement a corrective action plan to mitigate the findings identified that require correction:

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

SCO Recommendation

DSH-Napa should separate conflicting payroll function duties to the extent possible.

DSH Corrective Action Plan

DSH does not agree with the finding identified by SCO. DSH-Napa has compensating controls in place to perform conflicting functions as mandated by California Government Code sections 13402 and 13403.

The internal controls have been strengthened by the following actions taken by DSH-Napa:

- In January 2015 a Timekeeping Manual was implemented which changed how timekeeping/attendance records are processed. Specifically, DSH-Napa converted from a manual timekeeping process to a streamlined computer based time reporting process. This new process mandates that the supervisor validate the employees time worked with sign in/out attendance records. In addition, each unit is assigned a timekeeper that will review the timesheet prior to sending the timesheet for processing to Personnel. Thus, there are two levels of review before a timesheet is provided to Personnel which has reduced the amount of errors.
- All supporting documents are submitted with the employee’s timesheet to Personnel which results in better documentation to support pay/leave transactions keyed. Personnel Specialists review these individual attendance records and return them for resolution of discrepancies prior to keying into the SCO system.
- In May 2015, DSH-Napa established a benefits analyst position to process Health/Dental Benefits enrollments/changes and FMLA requests in order to reduce workload on Personnel Specialists so they could have more time to focus on the accuracy of payroll transactions.
- During the SCO audit period of January 1, 2012 to December 31, 2014, the DSH-Napa Personnel office experienced a high vacancy rate and did not have the staff to perform internal audits of payroll transactions. A concerted effort to fill the critical vacancies and provide training has improved the ability of DSH-Napa to provide more separation of duties necessary to mitigate input errors.
The work performed by personnel specialists for keying personnel information is subject to supervisor review. The supervisor's review is performed on a random basis. The intent of the supervisor's review is to identify any potential keying discrepancies inadvertently entered by the personnel specialist.

In addition, DSH has developed and implemented audit tools in July of 2016 for DSH personnel specialists to identify keying problem areas, mandate staff training, and monitors staff progress/work.

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

SCO Recommendation

DSH-Napa should update the keying access to the payroll system after employees change classifications. DSH-Napa's designated security monitor should periodically review access to the system to determine that access complies with the Decentralized Security Program.

DSH Corrective Action Plan

DSH agrees and has updated the justification for the four employees identified as having inappropriate access to the State’s payroll system. Documentation to support the resolution of this issue was provided to the SCO on August 3, 2015.

DSH-Napa will monitor and update the access as separations, appointments, and classification changes occur within Personnel to ensure that only appropriately designated staff have access to the State’s payroll system.

FINDING 3: Inadequate controls over vacation and annual leave credits, resulting in liability for excessive credits.

SCO Recommendation

DSH-Napa 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. DSH-Napa should conduct ongoing monitoring of controls to ensure that the controls are implemented and operating effectively.

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

DSH Corrective Action Plan

DSH approved Policy Directive 5314 on March 1, 2017 to ensure that each employee uses leave balances in a manner which is consistent with DSH's operational needs and complies with existing leave statutes/regulations. DSH-Napa management will work with the employees to reduce leave balances to the extent feasible as mandated by this Policy Directive.
Excess leave credits is a statewide systemic issue that may require more clear direction and consideration for departments that have 24-hour operations with minimum staffing requirements. Vacation/leave requests are managed at DSH based on operational needs and licensing standards, which may not provide for employees always being able to take vacation and/or other leaves to limit leave balances accrued.

To the extent that funding is available, DSH will continue to participate in in buy-back programs as it has in previous years. Specifically, DSH-Napa participated in the State buy-back on program in June 2014, June 2015, and June 2016.

FINDING 4: Inadequate controls over holiday credits, resulting in improper accruals.

SCO Recommendation

DSH-Napa should conduct a review of the State’s leave accounting system to ensure that the accrual of holiday credits complies with collective bargaining agreements and state law. DSH-Napa should correct any improper holiday credits in the State’s leave accounting system.

To prevent recording of improper holiday credits in the State’s leave accounting system from recurring, DSH-Napa should:

- Provide adequate oversight to ensure that payroll transactions unit staff members accurately record leave transactions; and
- Train payroll transactions unit staff members who key transactions into the State’s leave accounting system to ensure that they understand the requirements under collective bargaining agreements and state law regarding holiday credits.

DSH Corrective Action Plan

We agree that Napa had input errors of about 901 hours in the California Leave Accounting System (CLAS). These input errors were corrected in CLAS in April 2015 with the applicable documentation provided to the SCO auditor on July 20, 2015.

DSH-Napa implemented a new time keeping business process in January of 2015. This conversion from a manual handwritten process to a computer generated time sheet process makes it easier for the DSH-Napa Personnel Specialist to identify errors and/or inaccurate time keeping data. DSH-Napa shifted workload from some of the Personnel Specialists to provide them with more time to focus on inputting accurate timesheet data. Moreover, additional 1:1 training for Personnel Specialists along with formal SCO training classes is provided on a consistent and regular basis. This has improved the skills and abilities of current DSH-Napa staff members which, in turn, reduced the amount of input errors. DSH-Napa established "quiet hours" in 2015 during which phones go to voicemail and employee interactions are limited so that transactions staff have uninterrupted time to focus on accurately processing payroll transactions.
Given the platform and the process to input information into the CLAS\textsuperscript{1}, DSH-Napa uses the tools available including SCO exception reports. However, DSH would appreciate the SCO providing more audit tools (exception reports) that could help DSH in the CLAS input process.

**FINDING 5: Inadequate controls over salary advances, resulting in failure to collect and maintain accurate balances.**

**SCO Recommendation**

DSH-Napa should ensure that salary advances are recovered in a timely manner pursuant to GC section 19838 and SAM section 8776.7. If all reasonable collection procedures do not result in payment from former employees, DSH-Napa may request discharge from accountability of uncollectable amounts. The accounting unit should review the outstanding salary advances in the accounting system with the human resources unit to identify those for discharge.

Pursuant to SAM section 8776, DSH-Napa also should:

- Maintain documentation of its authorization, collection efforts, and payment of salary advances; and
- Ensure that salary advance transactions are recorded timely and accurately into the accounting system.

**DSH Corrective Action Plan**

DSH-Napa agrees and has implemented the following to mitigate the past, current and future accounts receivable:

- On February 1, 2016 established an analyst position to work with Personnel and Accounting staff to identify and collect Accounts Receivables due. The role of the analyst is to ensure that accounts receivable are documented accurately and collected timely. This analyst has made great progress in collecting/clearing old debts and monitoring the ongoing collection of current debts.
- Personnel supervisors are auditing the Personnel Specialist work to ensure that notifications are made to employees in a timely manner and that collections are made and applied correctly.
- Personnel Supervisors meets with Accounting Supervisors as needed to ensure that collections are appropriately applied and reported accurately in accounting records.
- On January 22, 2016, DSH issued Policy Directive 2300 Accounts Receivable to ensure that proper controls are in place to collect employee accounts receivable timely and accurately.

\textsuperscript{1} Per report 2012-603 California State Audit High Risk Update, August 26, 2014: State Agencies Credited their employees with millions of dollars’ worth of unearned leave states in part that the SCO lacks sufficient automated controls to prevent state agencies from processing erroneous transactions. (See page 24 and 25)
In addition, the following actions have been implemented to resolve the outstanding salary advances of $20,022:

- $15,753 of the $20,022 identified has been collected and the applicable documentation has been provided to the SCO auditor on May 1, 2015, and May 14, 2015.
- $2,506 has been referred to Franchise Tax Board for collection and the applicable documentation has been provided to the SCO auditor on May 1, 2015.
- The DSH is in the process of collecting $1,128 from current employees and the applicable documentation has been provided to the SCO auditor on May 12, 2015, and
- $634 will be written-off as a bad debt.

One of the salary advances identified by SCO for $632 is not a salary advance but was an interest payment that was misclassified. This was an expense incurred by DSH-Napa for the closed Stockton facility. This will be corrected in the accounting records as a journal entry. The applicable documentation has been provided to the SCO auditor on May 12, 2015.

**FINDING 6: Inadequate controls over out-of-class compensation, resulting in improper payments.**

**SCO Recommendation**

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

To prevent improper out-of-class compensation from recurring, DSH-Napa should:

- Implement existing state policies and procedures regarding out-of-class assignments and compensation. The DSH-Napa should conduct ongoing monitoring of controls to ensure that they are consistently implemented and operating effectively.
- Provide adequate oversight to ensure that payroll transactions unit staff members process only valid and authorized out-of-class compensation that complies with collective bargaining agreements and state policies.

**DSH Corrective Action Plan**

DSH does not agree that improperly granted out-of-class compensation to employees cost the state $14,112. DSH did not overpay the nine (9) employees by $14,112 because the labor contract required DSH to pay applicable compensation to employees performing job duties at a higher-level classification. The employees performed the job duties. The nine employees paid beyond 120 days filled positions that, if vacant, would

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2 The correct amount is $627. SCO reviewer did not account for a credit of $4 that was applied.
have created licensing and accreditation issues at DSH-Napa. These positions were mission critical and could not be filled due to various external statewide conditions. DSH was forced during this period to implement internal processes necessary to provide 24-hour level(s) of patient care, which included an in-house approval process for out-of-class assignments beyond 120 days. DSH worked with applicable contract labor unions to ensure that all contract labor laws were appropriately followed.

The DSH Office of Audits conducted a statistically valid test of out-of-class assignments in place on May of 2015. The test found that DSH is following current established out-of-class policies and procedures.

FINDING 7: Inadequate controls over Medical Officer of the Day pay, resulting in improper payments.

SCO Recommendation

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

To prevent improper payments for MOD compensation from recurring, DSH-Napa should:

- Implement existing policies and procedures for MOD compensation;
- Conduct ongoing monitoring of controls to ensure that they are consistently implemented and operating effectively;
- Provide adequate supervisory review to ensure that the payroll transactions unit staff members process only valid and authorized payments for MOD compensation; and
- Provide training to managers, supervisors, and staff members who might be involved in MOD payments transactions to ensure that they understand the requirements under the collective bargaining agreement and state policy regarding MOD compensation.

DSH Corrective Action Plan

DSH agrees. DSH will collect the $6,235 improperly paid to seven employees, as applicable.

FINDING 8: Inadequate controls over overtime compensation, resulting in improper payments.

SCO Recommendation

DSH-Napa should conduct a review of overtime payments made during the past three years to ensure that the payments comply with collective bargaining agreements and state law. DSH-Napa should seek reimbursement of overpayments made to employees
through an agreed-upon collection method in accordance with GC section 19838, and properly compensate those employees who were underpaid.

To prevent improper overtime payments from recurring, DSH-Napa should:

- Establish adequate internal controls to ensure that payments for overtime compensation comply with collective bargaining agreements and state law. These controls should require payroll transactions unit staff to verify that payment does not exceed the amount allowed by collective bargaining agreements and state law.
- Provide adequate oversight to ensure that payroll transactions unit staff processes only valid and authorized overtime payments that comply with collective bargaining agreements and state law.
- Train payroll transactions unit staff members who process overtime payment transactions to ensure that they understand the requirements under collective bargaining agreements and state laws and policies.

**DSH Corrective Action Plan**

DSH-Napa agrees and will conduct random internal audits of overtime for the period of April 2014 to March of 2017. Moreover, ongoing random audits will be performed based on the DSH audit tool developed and implemented in July of 2016 for transactions after March of 2017.

DSH-Napa requires that all overtime slips be compared to the timesheets with all discrepancies reconciled and corrected (if applicable) prior to the Personnel Specialist processing the overtime for payment. This has reduced the error rate.

DSH will collect the $3,327 overpaid to four employees. As of March 15, 2017, DSH has already collected $2,125 of the outstanding balances with plans to collect the remaining $1,202 in the next few months. The employee that was underpaid $314 has been paid. The documentation to support these actions has been provided to the SCO auditor on March 3, 2016.