

CALIFORNIA DEPARTMENT OF JUSTICE

Review Report

PAYROLL PROCESS REVIEW

July 1, 2012, through June 30, 2015



BETTY T. YEE
California State Controller

June 2019



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California State Controller

June 13, 2019

Xavier Becerra, Attorney General
California Department of Justice
1300 I Street
Sacramento, CA 95814

Dear Attorney General Becerra:

The State Controller's Office reviewed the California Department of Justice (DOJ) payroll process for the period of July 1, 2012, through June 30, 2015. DOJ management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our review found material weaknesses in internal control over the DOJ payroll process. These weaknesses contributed to DOJ employees' excessive vacation and annual leave balances, improper and questioned payments for employee separation lump-sum pay and leave buy-back, improper holiday compensation, and long-outstanding unrecovered salary advances, costing the State an estimated net total of \$10,743,096.

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

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California Department of Justice
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Review Report

Summary

The State Controller's Office (SCO) reviewed the California Department of Justice (DOJ) payroll process for the period of July 1, 2012, through June 30, 2015. DOJ 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 DOJ payroll process that leave DOJ at risk of additional improper payments if not mitigated. We found that DOJ 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, DOJ lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. In addition, DOJ inappropriately granted 21 employees keying access to the State's payroll system. These deficiencies have a pervasive effect on the DOJ payroll process, and impair the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively.

We also found that DOJ lacked sufficient controls over the processing of specific payroll-related transactions to ensure that it complied with collective bargaining agreements and state laws, and that only valid and authorized payments were processed. As quantified in the Schedule, these deficiencies contributed to DOJ employees' excessive vacation and annual leave balances, improper and questioned payments for employee separation lump-sum pay and leave buy-back, improper holiday compensation, and long-outstanding unrecovered salary advances, costing the State an estimated net total of \$10,743,096.

Background

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

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

Review Authority

Authority for this review is provided by California Government Code (GC) section 12476, which states, "The Controller may audit the uniform

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

Objectives, Scope, and Methodology

We performed this review to determine whether DOJ:

- Processed payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures;
- Established adequate internal control over payroll to meet the following control objectives:
 - Payroll and payroll-related transactions are properly approved and certified by authorized personnel;
 - Only valid and authorized payroll and payroll-related transactions are processed;
 - Payroll and payroll-related transactions are accurate and properly recorded;
 - Payroll systems, records, and files are adequately safeguarded;
 - State laws, regulations, policies, and procedures are complied with regarding payroll and payroll-related transactions;
- Complied with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures;
- Maintained accurate records of leave balances; and
- Administered and recorded salary advances properly and in accordance with state laws, regulations, policies, and procedures.

We reviewed the DOJ payroll process and transactions for the period of July 1, 2012, through June 30, 2015.

To achieve our objectives, we:

- Reviewed state and DOJ policies and procedures related to the payroll process to understand DOJ’s methodology for processing various payroll and payroll-related transactions;
- Interviewed the DOJ payroll personnel to understand DOJ’s methodology for processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to the 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 criteria for review;
- Analyzed and tested transactions recorded in the State’s payroll database, and reviewed relevant files and records to determine the accuracy of payroll and payroll-related payments; accuracy of leave transactions; propriety of review and approval of transactions; adequacy of internal control over the payroll process and systems; and compliance with collective bargaining agreements and state laws, regulations, policies, and procedures (errors found from statistically-determined samples were projected to the intended population); and
- Reviewed salary advances to determine whether DOJ administered and recorded them in accordance with state laws, regulations, policies, and procedures.

Conclusion

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

- Did not process payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures (see Findings 3 through 7);
- Lacked adequate internal control over payroll and payroll-related transactions (see Findings 1 through 7);
- Did not comply with existing controls as part of the ongoing management and monitoring of payroll and payroll-related expenditures (see Findings 2 and 3);
- Did not maintain accurate records of leave balances (see Findings 5 and 6); and
- Did not administer salary advances in accordance with state laws, regulations, policies, and procedures (see Finding 7).

As quantified in the Schedule and described in the Findings and Recommendations section of this review report, these material weaknesses¹ in internal control over the payroll process contributed to

¹An evaluation of an entity’s payroll process may identify deficiencies in its internal control over the process. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements in financial information, impairments of effectiveness or efficiency of operations, or noncompliance with provisions of laws, regulations, or contracts on a timely basis.

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

DOJ employees' excessive vacation and annual leave balances, improper and questioned payments, and long-outstanding unrecovered salary advances, costing the State an estimated net total of \$10,743,096.

Views of Responsible Officials

We issued a draft review report on April 19, 2019. Christine Allison, Director, Office of Human Resources, responded by letter dated May 15, 2019 (Attachment), acknowledging the findings and indicating that DOJ has taken steps since the review period to correct the deficiencies noted in the findings. We will follow up during the next payroll review to ensure that the corrective actions were adequate and appropriate. DOJ also provided a response regarding the collection overpayments for holiday compensation, as described in Finding 5. Our comments to DOJ's response to Finding 5 are included in the Findings and Recommendations section.

Restricted Use

This report is solely for the information and use of the DOJ and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record, and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

June 13, 2019

Schedule— Summary of Findings July 1, 2012, through June 30, 2015

Finding Number	Issues	Number of Selections Reviewed	Method of Selection	Selection Unit	Dollar Amount of Selections Reviewed	Number of Selections with Issues	Issues as a Percentage of Selections Reviewed *	Dollar Amount of Known Issues	Dollar Amount of Likely Issues	Total Dollar Amount of Known and Likely Issues
1	Inadequate segregation of duties and compensating controls over payroll transactions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2	Inappropriate keying access to the State's payroll system	52	Targeted	Employee	\$ -	21	40%	\$ -	\$ -	\$ -
3	Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances	708	Targeted	Employee	10,844,519	708	100%	10,844,519	N/A	10,844,519
4	Inadequate controls over employee separation lump-sum pay, resulting in underpayments									
	Underpayments	46	Statistical	Employee	1,000,745	6	13%	(2,945)	(43,727)	(46,672)
	Underpayments	8	Targeted	Employee	630,097	6	75%	(65,794)	N/A	(65,794)
5	Inadequate controls over holiday compensation, resulting in improper payments									
	Overpayments	38	Statistical	Holiday pay transaction	11,064	3	8%	981	7,844	8,825
	Underpayments			-- Same selections above --		1	3%	(119)	(952)	(1,071)
6	Inadequate controls over leave buy-back, resulting in improper and questioned payments									
	Underpayments	38	Statistical	Leave buy-back transaction	55,662	1	3%	(996)	(7,653)	(8,649)
	Questioned payments			-- Same selections above --		1	3%	978	7,514	8,492
7	Inadequate controls over salary advances, resulting in failure to recover outstanding amounts	4	Targeted	Salary advance transaction	3,446	4	100%	3,446	N/A	3,446
Total					<u>\$ 12,545,533</u>			<u>\$ 10,780,070</u>	<u>\$ (36,974)</u>	<u>\$ 10,743,096</u>

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

Findings and Recommendations

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

DOJ lacked adequate segregation of duties within its payroll transactions unit to ensure that only valid and authorized payroll transactions were processed. DOJ 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 DOJ 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. DOJ failed to demonstrate that it implemented compensating controls to mitigate the risks associated with such a deficiency. We found no indication that these functions were subjected to periodic supervisory review.

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

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

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

Recommendation

We recommend that DOJ:

- 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, DOJ should implement compensating controls. For example, if the payroll transactions unit staff member responsible for recordkeeping also performs a reconciliation process, then the supervisor should perform and document a detailed review of the reconciliation to provide additional control over the assignment of conflicting functions. Compensating controls may also include dual authorization requirements and documented reviews of payroll system input and output; and

- Develop formal procedures for performing and documenting compensating controls.

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

DOJ lacked adequate controls to ensure that only appropriate staff had keying access to the State’s payroll system. DOJ inappropriately granted 21 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 information system. The system is decentralized, thereby allowing employees of state agencies to access it. PPSD has established a *Decentralized Security Program Manual* that all state agencies are required to follow in order to access the payroll system. The program’s objectives are to secure and protect the confidentiality and integrity of payroll data against misuse, abuse, and unauthorized use.

We reviewed the records of 52 employees who had keying access to the State’s payroll system at various times between July 2012 and June 2015. Of the 52 employees, 21 had inappropriate keying access to the State’s payroll system. Specifically, DOJ did not immediately remove or modify keying access for 17 employees after the employees’ separation from state service, transfer to another agency or unit, or change in classification. For example, one employee continued to have keying access for 151 days after leaving state service. Of the 17 employees, three also had keying access while appointed to classifications other than those allowed to have keying access. For example, an employee had keying access while appointed as Associate Personnel Analyst—a classification that is not eligible to have keying access without a written justification. DOJ did not provide the required justification.

In addition, a manager involved with workers’ compensation had keying access to the system. The employee had been provided keying access before becoming a manager, and DOJ did not modify the employee’s access after the employee became a manager. We also noted that the manager had previously been appointed to ineligible classifications; DOJ did not provide the required justification.

Furthermore, three additional employees had keying access while appointed to ineligible classifications without the required justification. The employees' classifications changed to Staff Services Analyst or Associate Personnel Analyst. However, DOJ did not submit the required justification letters for these employees.

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

The PPSD data base contains sensitive and confidential information. Access is restricted to persons with a legitimate requirement to complete their duties. Currently, PIMS, HIST, KEYM and PIP applications are restricted to Personnel Specialists (PS) or Personnel 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 PS/PT series to access PIMS, HIST, KEYM and/or PIP requires a written justification from the Authorizing Manager. The justification must describe the individual's specific job duties that requires the need to each type of information (i.e., PIMS=Employment History, HIST=Payroll History, etc.) as well as level of access to that application, in order to perform their duties. Manager classifications will be granted inquiry access only.

To prevent unauthorized use of a transferred, terminated or resigned employee's user ID, 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 an old user ID.

Recommendation

We recommend that DOJ:

- Update keying access to the State's payroll system immediately after employees leave DOJ, transfer to another 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

DOJ failed to implement controls to ensure that it adheres to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. This deficiency resulted in liability for excessive leave balances that could cost the State at least \$10,844,519 as of June 30, 2015. We expect the liability to increase if DOJ 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 should work with the employee to develop a written plan to reduce leave balances below the applicable limit.

Our review of DOJ's leave accounting records determined that DOJ had 4,248 employees with unused vacation or annual leave credits at June 30, 2015. Of those employees, 708 exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 2,400 hours of vacation, or 1,760 hours beyond the 640-hour limit. Collectively, the 708 employees accumulated 217,785 hours of excess vacation and annual leave, worth at least \$10,844,519 as of June 30, 2015. This estimated liability does not adjust for salary rate increases and additional leave credits.² Accordingly, we expect that the amount needed to pay for this liability will be higher. For example, a DOJ employee separated from state service with 1,928 hours in leave credits, including 1,748 hours in vacation. After adjusting for additional leave credits, the employee was paid for 2,274 hours, or 18% more.

We performed an additional review of the records for 20 of 708 employees to determine whether DOJ complied with collective bargaining agreements and state regulations. We determined that DOJ could not demonstrate that it had complied with collective bargaining agreements and state regulations when allowing these 20 employees to maintain excess vacation or annual leave balances. In addition, the 20 employees had no plans in place during the review period to reduce their leave balances below the limit.

If DOJ does not take action to reduce the excessive leave balances, the liability for accrued vacation and annual leave will most 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 separation lump-sum payment, regardless of where the employee accrued the leave balance.

² Most state employees receive pay rate increases every year pursuant to state laws 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 from state service 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.

Recommendation

We recommend that DOJ:

- 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.

**FINDING 4—
Inadequate
controls over
employee
separation lump-
sum pay, resulting
in underpayments**

DOJ lacked adequate controls over the processing of employee separation lump-sum payments. We identified \$112,466 in underpayments for separation lump-sum pay, consisting of \$68,739 based on actual transactions reviewed (“known”); and \$43,727 based on the results of statistical sampling (“likely”). If not mitigated, the control deficiencies leave DOJ at risk of additional improper separation lump sum payments.

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

Payroll records show that DOJ processed separation lump-sum payments for 748 employees between July 2012 and June 2015, as follows:

Separation Lump-Sum Payment Type	Unit	Amount
Payments that included sick leave (items examined 100%)	8	\$ 630,097
Payments that did not include sick leave (statistically sampled)	740	15,858,899
Total population	748	\$ 16,488,996

We examined the separation lump-sum pay that included sick leave payments for all eight employees, totaling \$630,097. Of the eight employees, DOJ underpaid six of them by an approximate total of \$65,794 because it did not project the accumulated sick leave as required.

GC section 19991.4 states, in part:

...If an employee is unable to return to work at the time or during the period he or she is entitled to permanent disability compensation under Division 4 or 4.5 of the Labor Code, he or she shall be paid any sick leave balance....The payment shall be computed by projecting the accumulated time on a calendar basis as though the employee was taking time off....

Of the remaining separation lump-sum payments for 740 employees, totaling \$15,858,899, we randomly selected a statistical sample (as described in the Appendix) of 46 employees who were paid separation lump-sum pay, totaling \$1,000,745.

Of the 46 employees, DOJ underpaid six of the employees by an approximate total of \$2,945. As we used a statistical sampling method to select the separation lump-sum payments examined, we projected the amount of likely underpayments to be \$43,727. Accordingly, the known and likely underpayments totaled an approximate \$46,672.

The following table summarizes the results of our statistical sampling:

Known underpayments	\$ 2,945
Divide by: Sample	1,000,745
Error rate for projection (differences due to rounding)	<u>0.29%</u>
Population that was statistically sampled	\$ 15,858,899
Multiply by: Error rate for projection	<u>0.29%</u>
Known and likely underpayments (differences due to rounding)	46,672
Less: Known underpayments	<u>2,945</u>
Likely underpayments	<u>\$ 43,727</u>

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

The known underpayments occurred because payroll transactions unit staff members miscalculated the employees' accrued leave balances and incorrectly entered the leave hours for separation lump-sum payments into the State's payroll system. DOJ also lacked adequate supervisory review to ensure accurate processing of employee separation lump-sum payments.

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 DOJ:

- Properly compensate those employees who were underpaid;
- Establish adequate controls to ensure accurate calculation and payment of employee separation lump-sum pay; and
- Conduct a review of employee 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 laws.

**FINDING 5—
Inadequate
controls over
holiday
compensation,
resulting in
improper
payments**

DOJ lacked adequate controls over the processing of holiday compensation. We identified \$8,825 in overpayments and \$1,071 in underpayments for holiday compensation, consisting of \$981 in overpayments and \$119 in underpayments based on actual transactions reviewed (“known”); and \$7,844 in overpayments and \$952 in underpayments based on the results of statistical sampling (“likely”). If not mitigated, this control deficiency leaves DOJ at risk of improper holiday compensation payments.

GC section 19853 specifies the compensation that an eligible employee is entitled to receive when required to work on a qualifying holiday. Collective bargaining agreements between the State and Bargaining Units 1, 4, and 7 include similar provisions regarding holiday compensation for represented employees.

We identified holiday pay transactions for 357 employees between July 2012 and June 2015. We stratified a total of \$99,570 in holiday pay transactions to these employees and randomly selected a statistical sample (as described in the Appendix) of holiday pay transactions for 38 employees, totaling \$11,064.

Of the 38 holiday pay transactions, DOJ overpaid three employees by \$981 and underpaid one by \$119, or a net total exception of \$862. As we used a statistical sampling method to select the holiday pay examined, we projected the amount of likely net improper payments to be \$6,892, consisting of \$7,844 in overpayments and \$952 in underpayments. Accordingly, the known and likely improper payments totaled a net \$7,754, consisting of \$8,825 in overpayments and \$1,071 in underpayments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	\$ 862
Divide by: Sample	11,064
Error rate for projections (differences due to rounding)	<u>7.79%</u>
Population that was statistically sampled	\$ 99,570
Multiply by: Error rate for projection	7.79%
rounding)	<u>7,754</u>
Less: Known improper payments, net	862
Likely improper payments, net	<u>\$ 6,892</u>

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

The overpayments occurred because payroll transactions unit staff members overstated the total number of compensated hours. The underpayment occurred because payroll transactions unit staff members paid the employees at the straight-time rate instead of the time-and-a-half rate for each hour worked. DOJ also lacked adequate supervisory review to ensure accurate processing of holiday compensation.

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 DOJ:

- Conduct a review of holiday compensation granted during the past three years to ensure that compensation complied with collective bargaining agreements and state laws; and
- Recover overpayments made to employees pursuant to GC section 19838 and *State Administrative Manual* (SAM) sections 8776 and 8776.7, and properly compensate those employees who were underpaid; and correct any improper holiday credits in the State’s leave accounting system.

DOJ’s Response

DOJ has no authority to collect overpayments as recommended in the draft report. Government Code section 19838 sets forth a three-year statute of limitations from the date of overpayment, and the period under review is beyond the three years.

SCO’s Comment

Our finding remains unchanged. We communicated this finding to DOJ on several occasions during the course of our fieldwork in 2017 and before issuing this report. Specifically, in September 2017, we communicated this finding to payroll transactions unit management. We believe that these communications, which were made within three years from the date of some, if not all, of the overpayments noted in this finding, provided DOJ with the required information with which to promptly initiate collection efforts.

FINDING 6— Inadequate controls over leave buy-back, resulting in improper and questioned payments

DOJ lacked adequate controls over the processing of leave buy-back payments. We identified \$8,649 in underpayments and \$8,492 in questioned payments for leave buy-back, consisting of \$996 in underpayments and \$978 in questioned payments based on actual transactions reviewed (“known”); and \$7,653 in underpayments and \$7,514 in questioned payments based on the results of statistical sampling (“likely”). If not mitigated, the control deficiencies leave DOJ at risk of additional improper and questioned leave buy-back payments.

A leave-buy back occurs when an employee receives payment at the regular salary rate in exchange for accrued vacation, annual leave, personal leave, personal holiday, and/or holiday credits.

The collective bargaining agreement between the State and Bargaining Unit 7 allows for the annual cash-out of a certain number of hours of accumulated vacation and annual leave if funds are available. The California Department of Human Resources (CalHR) Policy Memos 2014-008 and 2015-011 provide the State’s policies and

procedures regarding cash-out of vacation and annual leave for Bargaining Unit 7 employees for fiscal year (FY) 2013-14 and FY 2014-15.

Title 2, *California Code of Regulations*, section 599.744 provides that CalHR may authorize a leave buy-back program for employees excluded from collective bargaining. Pursuant to Policy Memos 2014-009 and 2015-012, CalHR authorized leave buy-backs for excluded employees in FY 2013-14 and FY 2014-15.

Payroll records show that DOJ processed 350 leave buy-back payment transactions, totaling \$483,829, between July 2012 and June 2015. Of the 350 payments, we randomly selected a statistical sample (as described in the Appendix) of 38 leave buy-back payment transactions, totaling \$55,662.

Of the 38 transactions, DOJ underpaid one leave buy-back payment by \$996, and we questioned another payment of \$978 due to lack of supporting documentation. These payments resulted in a net total exception of \$18. As we used a statistical sampling method to select the leave buy-back payments examined, we projected the amount of likely net improper and questioned payments to be \$139, consisting of \$7,653 in underpayments and \$7,514 in questioned payments. Accordingly, the known and likely improper and questioned payments totaled a net \$157, consisting of \$8,649 in underpayments and \$8,492 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	\$ (18)
Divide by: Sample	55,662
Error rate for projection (difference due to rounding)	<u>(0.03%)</u>
Population that was statistically sampled	\$ 483,289
Multiply by: Error rate for projection	<u>(0.03%)</u>
Known and likely improper payments, net (difference due to rounding)	(145)
Less: Known improper payments, net	<u>(18)</u>
Likely improper payments, net	<u>\$ (127)</u>

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

The underpayment occurred because DOJ paid the employee for fewer leave hours than were actually reduced. DOJ lacked adequate supervisory review to ensure accurate processing of leave buy-back payments. In addition, DOJ could not provide documentation to support at least one payment; therefore, we were unable to verify that the payment complied with the requirements.

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 DOJ:

- Provide adequate supervisory review to ensure that payroll transactions unit staff members process leave buy-back payments accurately; and
- Maintain documentation to support payment transactions.

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

DOJ lacked adequate controls over salary advances to ensure that they were recovered in accordance with state law and policies. The four salary advances that we reviewed, totaling \$3,446, remained outstanding as of June 30, 2015, due to DOJ's noncompliance with the State's collection policies and procedures. The oldest unrecovered salary advance was outstanding for over eight years. This control deficiency leaves DOJ at risk of further failures to collect salary advances if not mitigated.

At June 30, 2015, DOJ's accounting records showed 31 outstanding salary advances totaling \$80,139, including four salary advances totaling \$3,446 that had been outstanding for more than 60 days. Generally, the prospect of collection diminishes as an account ages. When an agency is unable to collect after three years, the possibility of collection is remote.

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

In our review of the four salary advances that were over 60 days old, DOJ did not comply with State's collection policies and procedures. DOJ could not provide required documentation to support its collection efforts for two salary advances. For the other two salary advances, DOJ did not send collection notices promptly.

We also found that in at least one instance, an employee separated from state employment after receiving a salary advance. Salary advances made to employees who later separate can be collected by withholding amounts from their final separation pay, pursuant to GC section 19838, if proper verification shows that the advances were paid. If the former employee has unpaid salary advances, DOJ is responsible for pursuing collections as described in SAM section 8776.6.

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

Recommendation

We recommend that DOJ:

- Ensure that it recovers salary advances in a timely manner and maintains documentation of its collection efforts and payment of

salary advances, if any, pursuant to GC section 19838 and SAM sections 8776 and 8776.7; and

- Pursue collections as described in SAM section 8776.6 if former employees have unpaid salary advances. If reasonable collection procedures do not result in payment, DOJ may request discharge from accountability of uncollectible amounts.

Appendix— Sampling Methodology July 1, 2012, through June 30, 2015

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

Review Area	Type of Test	Population (Units)	Population (Dollars)	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	740	\$ 15,858,899	Employee	Computer-generated simple random	95%	10%	1 (0.25% - 2%)	46	Yes	4
Holiday compensation	Compliance	357	\$ 99,570	Holiday pay transaction	Computer-generated simple random	90%	10%	1 (0.25% - 2.5%)	38	Yes	5
Leave buy-back	Compliance	350	\$ 483,829	Payment transaction	Computer-generated simple random	90%	10%	1 (0.25% - 2.5%)	38	Yes	6

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

**Attachment—
California Department of Justice’s
Response to Draft Review Report**

XAVIER BECERRA
Attorney General

State of California
DEPARTMENT OF JUSTICE



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May 15, 2019

Jim Spano, Chief
State Controllers' Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5870

Dear Mr. Spano:

This letter represents the Department of Justice's (DOJ) response to the State Controller's Office (SCO) draft report of the Payroll Process Review for the period of July 1, 2012, through June 30, 2015.

The draft SCO report describes "material weaknesses in internal control" in the area of payroll transactions, access to the State's payroll system, monitoring of excessive vacation and annual leave balances, and reconciliation of salary advances. While the SCO review was admittedly limited, DOJ acknowledges these findings during the specific time period reviewed. Fortunately, in the nearly four years since the end of the review period we have implemented the necessary measures to address nearly all the deficiencies identified in the draft report. This letter describes the actions we have already taken to address the identified issues, as well as additional steps we plan to implement because of the review.

SCO Recommendation Finding 1 - Inadequate segregation of duties and compensating controls over payroll transactions

1. *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, DOJ should implement compensating controls. For example, if the payroll transactions unit staff member responsible for recordkeeping also performs a reconciliation process, then the supervisor should perform and document a detailed review of the reconciliation to provide additional control over the assignment of conflicting functions. Compensating controls

may also include dual authorization requirements and documented reviews of payroll system input and output; and

2. *Develop formal procedures for performing and documenting compensating controls.*

DOJ Response Finding 1:

Since June of 2015, DOJ has restructured the Payroll and Benefit Service Unit (PBS) by adding management- and associate-level staff to provide an additional level of review, which has improved the segregation of duties and compensating controls over the processing of the department's payroll transactions. With the addition of two assistant managers and four lead analysts, we have separated conflicting payroll duties and increased the level of review to provide more oversight and minimize the error rate of payroll transactions. The managers and analysts oversee the day-to-day operations of our Personnel Specialists (specialists) to ensure transactions are reviewed and processed in accordance with collective bargaining agreements and state laws, rules and regulations governing personnel transactions. In addition, the managers and/or analysts review and approve all payroll processes prior to the specialist keying any transaction. Each manager regularly monitors the various transactions processed by the specialist throughout each month to ensure transactions are keyed into the SCO system accurately and as instructed. DOJ has and continues to implement and periodically review written procedures and expectations for all payroll transactions performed within PBS. These implemented controls align with the recommendations provided in the draft report.

SCO Recommendation Finding 2 - Inappropriate keying access to the State's Payroll system

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

DOJ Response Finding 2:

While DOJ acknowledges there were some delays in timely notification to SCO regarding system access, it is important to recognize that while the classifications of individuals in our office may have changed, job duties still required those employees to have access to the SCO system. One of the four employees that changed classifications was a manager within the Risk Management Unit who was acting as a back-up for processing workers' compensation personnel transactions. Since 2017, DOJ has consistently provided justification packages for employees that change classifications and need to retain SCO keying or view access. Specifically, DOJ now has an analyst who is responsible for providing timely notification to SCO of any staff departures or classification changes that require a justification. Our new process dictates the analyst responsible for these duties emails SCO the day of the change in duties or departure of staff and promptly submits the proper documents terminating the access or justifying the change in access based on the new duties; these documents are approved by the OHR Director. Additionally, the analyst conducts

regular audits of staff access to the SCO system to ensure we remain in compliance with the Decentralized Security Program.

SCO Recommendation Finding 3 - Inadequate controls over vacation and annual leave balances, resulting in liability for excessive credits

5. *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;*
6. *Conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively; and*
7. *Participate in leave buy-back programs if the State offers such programs and funds are available.*

DOJ Response Finding 3:

DOJ acknowledges the finding of 708 employees over the leave cap as well as the 20 employees missing proper justification to carry leave balances over the applicable limit. Beginning in December 2017, DOJ implemented corrective measures to ensure compliance with the requirements set forth in collective bargaining agreements and state regulations that limit the accrual of excessive leave credits. DOJ notifies employees annually of their required participation in a Vacation or Annual Leave Reduction Plan for all employees who are over, or projected to be over, 640 vacation or annual leave hours at year-end. The identified employees are required to submit a leave reduction plan outlining how they intend to reduce their excess leave over the next year. Our office provides each program director and administrative manager with a listing of employees who are required to submit a leave reduction plan. Programs work closely with OHR to ensure each identified employee submits a plan, and OHR tracks all plans received and files them in the employees' Official Personnel Files. Beginning in 2019, the DOJ will audit the leave usage for each identified employee to ensure leave plans are followed or justifications are submitted to document changes.

In addition to requiring the submission of leave reductions plans, the DOJ has and continues to participate in the Annual Leave Cash-Out and Buy-Back Programs authorized by the California Department of Human Resources (CalHR) as mentioned in the audit's recommendations. Finally, DOJ is in compliance with CalHR HR Policy 2124 that was issued in December 2017.

SCO Recommendation Finding 4 - Inadequate controls over employee separation lump sum, resulting in underpayments

8. *Properly compensate those employees who were underpaid;*
9. *Establish adequate controls to ensure accurate calculation and payment of employee separation lump-sum pay; and*

10. *Conduct a review of employee separation lump-sum payments during the past three years to ensure that the payments are accurate and in compliance with collective bargaining agreements and state laws.*

DOJ Response Finding 4:

DOJ acknowledges it lacked adequate controls during the period under review when processing lump sum pay for industrial disability retirements. The inconsistency in projecting sick leave accumulation was due to a lack of adequate training provided to the specialist responsible for processing these payment types. Furthermore, the specialist performing these lump sum transactions was the only specialist in the Risk Management Unit (RMU) and was physically separated from the rest of the PBS team. Following SCO's review, DOJ provided the specialist with additional training and implemented a second level of review when processing industrial disability separations. Additionally, the specialist responsible for processing these transactions now works alongside other specialists within the FMLA and Special Leaves Unit to allow for cross-training. The FMLA and Special Leaves Unit is under the management of PBS and is directly involved in payroll, payroll training, and payroll updates. This allows for a uniform and consistent application of non-industrial disability retirement, industrial disability retirement, and regular retirement lump sum payments. These changes will mitigate the risk of future underpayments associated with processing this type of separation. DOJ will also conduct a review of these separations consistent with SCO's recommendation.

DOJ also acknowledges it lacked adequate controls when processing lump sum payments for employees separating from state service who were not entitled to sick leave projections. Since 2016, the DOJ implemented a third level of review for all separations with lump sum projections. The specialist projects the lump sum, their backup independently projects the lump sum, and the manager or analyst also independently projects the lump sum. Prior to processing the separation, the specialist verifies that all projections are aligned. This process improvement has allowed the department to identify and correct errors prior to processing this type of separation.

As recommended in the SCO findings, DOJ will consider the feasibility of correcting any underpayments to impacted employees. Furthermore, the DOJ's implementation of additional controls have mitigated the likelihood of further errors, ensuring payments are accurate and in compliance with collective bargaining agreements and state laws.

SCO Recommendation Finding 5 - Inadequate controls over holiday compensation, resulting in improper payments

11. *Conduct a review of holiday compensation granted during the past three years to ensure that compensation complied with collective bargaining agreements and state laws; and*
12. *Recover overpayments made to employees pursuant to GC section 19838 and State Administrative Manual (SAM) sections 8776 and 8776.7, and properly compensate those employees who were underpaid; or correct any improper holiday credits in the leave accounting system.*

DOJ Response Finding 5:

DOJ acknowledges there were discrepancies in processing holiday compensation for some employees during the period under review; however, we have since implemented internal controls that will prevent future miscalculations. PBS managers and analysts provide regular training to the specialists to ensure they understand how holiday compensation is processed. In addition to providing regular training to the specialists, overtime and holiday compensation transactions are reviewed by the specialists' backup prior to processing the payment. The current structure, level of review over these transactions, and continued staff development has ensured accurate processing of payments and has helped eliminate over or underpayments. In addition, CalHR published on November 30, 2017, the Holiday Guidance Chart in the Human Resources Manual, which has provided state departments with a clearer understanding of how holiday compensation is to be processed. The DOJ's implementation of additional controls, along with the Holiday Guidance Chart have mitigated the likelihood of further discrepancies related to holiday compensation.

DOJ has no authority to collect overpayments as recommended in the draft report. Government Code section 19838 sets forth a three-year statute of limitations from the date of overpayment, and the period under review is beyond the three years.

SCO Recommendation Finding 6 - Inadequate controls over leave buy-back, resulting in improper and questioned payments

- *Provide adequate supervisory review to ensure that payroll transactions unit staff members process leave buy-back payments accurately; and*
- *Maintain documentation to support payment transactions.*

DOJ Response Finding 6:

DOJ acknowledges the importance of ensuring payments to employees are processed accurately and timely. Beginning in 2016, DOJ implemented controls to prevent similar errors with leave buy-back payments. PBS lead analysts maintain documentation of all requests for payment and a backup lead analyst reviews the transaction prior to processing. PBS lead analysts process all leave requests in the same week of June, and once the payments issue, another lead analyst or manager reviews them. By ensuring multiple levels of review by lead analysts, along with assigning the lead analysts to document and process the transactions, DOJ has mitigated the risk for future calculation errors.

SCO Recommendation Finding 7 - Inadequate controls over salary advances, resulting in failure to recover outstanding accounts

13. *Ensure that it recovers salary advances in a timely manner and maintains documentation of its collection efforts and payment of salary advances, if any, pursuant to GC section 19838 and SAM sections 8776 and 8776.7; and*

Jim Spano
May 15, 2019
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14. Pursue collections as described in SAM section 8776.6 if former employees have unpaid salary advances. If reasonable collection procedures do not result in payment, DOJ may request discharge from accountability of uncollectible amounts.

DOJ Response Finding 7:

DOJ acknowledges there was a need for stronger controls in the collection of outstanding salary advances. In 2016, the department implemented a process to ensure timely notification to employees who were overpaid via a salary advance. Once an overpayment is confirmed, PBS notifies the employee and allows 15 days to respond. If the employee does not respond within 15 days, PBS sends a second notice with an additional 15 days to respond. If after the second notice there is no response, DOJ will take action depending on the status of the employee. If the employee is currently employed with DOJ, we will notify the employee that we will collect the amount owed from their next pay warrant. If the employee has separated, PBS will notify our Accounting Office who will then notify the employee a third time of the overpayment. If no response is received, the employee's information will be submitted to the Franchise Tax Board for collections. In addition, PBS managers review monthly reports provided by our Accounting Office that identify outstanding salary advances. The managers or analysts follow up with the specialists to ensure they are addressing salary advance overpayments with the impacted employees. DOJ continues to ensure we are collecting salary advance overpayments within a reasonable amount of time, and takes additional action when attempts to collect fail. In addition, DOJ will maintain documentation of its collection efforts and payment of salary advances.

We appreciate the recommendations provided by SCO in your review, and have used the results to further strengthen our controls, which as we described above have significantly improved since the review period. If you have any questions or concerns about these changes, please contact me at (916) 210-6244, or via email at christine.allison@doj.ca.gov.

Sincerely,



Christine Allison
Director, Office of Human Resources

For XAVIER BECERRA
Attorney General

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