

CALIFORNIA DEPARTMENT OF EDUCATION

Review Report

PAYROLL PROCESS REVIEW

March 1, 2015, through February 28, 2018



BETTY T. YEE
California State Controller

July 2019



BETTY T. YEE
California State Controller

July 31, 2019

Tony Thurmond, State Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, CA 95814

Dear Mr. Thurmond:

The State Controller's Office has reviewed the California Department of Education (CDE) payroll process for the period of March 1, 2015, through February 28, 2018. CDE's management is responsible for maintaining a system of internal control over 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 CDE's payroll process. These weaknesses contributed to CDE's employee's excessive vacation and annual leave balances, improper and question payments of overtime and separation lump-sum payments, costing the State an estimated net total of \$2,123,754.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Nick Schweizer, Deputy Superintendent of Public Instruction
California Department of Education
Valarie Bliss, Director
Personnel Services Division
California Department of Education
Mark Rodriguez, Chief
Administrative Services Division
California Department of Human Resources
Marissa Revelino, Chief
Personnel and Payroll Services Division
State Controller's Office

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Review Report

Summary

The State Controller's Office (SCO) reviewed the California Department of Education (CDE) payroll process for the period of March 1, 2015, through February 28, 2018. CDE's management is responsible for maintaining a system of internal control over 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 CDE's payroll process that leaves CDE at risk of additional improper payments if not mitigated. We found that CDE 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, CDE lacked adequate segregation of duties and compensating controls over its processing of payroll transactions. In addition, CDE inappropriately granted six employees keying access to the state payroll system, which leaves payroll data at risk of misuse, abuse, and unauthorized use. These deficiencies have a pervasive effect on the CDE payroll process, and impair the effectiveness of other controls by rendering their design ineffective or by keeping them operating effectively.

We also found that CDE lacked sufficient controls over the processing of specific payroll related transactions to ensure that CDE complied with collective bargaining agreements and state laws, and that only valid and authorized payments were processed. As quantified in the Schedule, these control deficiencies contributed to CDE employee's excessive vacation and annual leave balances; improper and questioned payments for separation lump-sum pay and overtime pay costing the State an estimated net total of \$2,123,754.

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 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 CDE:

- 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 in accordance with state laws, regulations, policies, and procedures.

We reviewed CDE payroll process for the period of March 1, 2015, through February 28, 2018.

To achieve our review objectives, we:

- Reviewed state and CDE policies and procedures related to payroll process to understand CDE’s methodology for processing various payroll and payroll-related transactions;
- Interviewed CDE payroll personnel to understand CDE’s methodology for processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to

the payroll transaction processing, to gain an understanding of 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 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 in statistically-determined samples were projected to the intended population); and
- Reviewed salary advances to determine whether CDE properly administered and recorded them in accordance with state laws, regulations, policies, and procedures.

Conclusion

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

- 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 6);
- Lacked adequate internal controls over payroll and payroll-related transactions (see Findings 1 through 6); and
- Did not maintain accurate records of leave balances (see Findings 4 and 5).

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 CDE employees' excessive vacation and annual leave balances, improper payments, and improper holiday credit transactions, costing the State an estimated net total of \$2,123,754.

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 from those charged with governance.

**Views of
Responsible
Officials**

We issued a draft review report on June 28, 2019. Lupita Cortez Alcalá, Chief Deputy Superintendent of Public Instruction, responded by letter dated July 26, 2019 (Attachment), agreeing with the review findings and stating that CDE has taken steps to correct the deficiencies noted. We will follow up during the next payroll audit to verify that these corrective actions were adequate and appropriate.

Restricted Use

This report is solely for the information and use of CDE 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

July 31, 2019

Schedule— Summary of Findings March 1, 2015, through February 28, 2018

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	Inappropriate keying access to the State's payroll system	27	Targeted	Employee	N/A	6	22%	N/A	N/A	N/A
2	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
3	Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments									
	-Overpayments	120	Statistical	Employee	\$ 1,737,121	4	3%	\$ 3,196	\$ 5,554	\$ 8,750
	-Underpayments		-- Same selections above --			11	9%	(4,765)	(8,280)	(13,045)
	-Questioned payments		-- Same selections above --			11	9%	45,551	79,158	124,709
4	Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances	160	Targeted	Employee	2,000,913	160	100%	2,000,913	N/A	2,000,913
5	Inadequate controls over holiday credit transactions, resulting in improper credits	18	Targeted	Holiday credit transaction	5,677	6	33%	508	N/A	508
6	Inadequate controls over overtime pay, resulting in improper and questioned payments									
	-Overpayments	125	Statistical	Payment transaction	56,427	3	2%	141	376	517
	-Underpayments		-- Same selections above --			2	2%	(606)	(1,611)	(2,217)
	-Questioned payments		-- Same selections above --			8	6%	989	2,630	3,619
Total					<u>\$ 3,800,138</u>			<u>\$ 2,045,927</u>	<u>\$ 77,827</u>	<u>\$ 2,123,754</u>

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

Findings and Recommendations

FINDING 1— Inappropriate keying access to the State’s payroll system

CDE lacked adequate controls to ensure that only appropriate staff have keying access to the State’s payroll system. Of the 27 employees we reviewed, six (22%) had improper key access to the system. If not mitigated, this control deficiency leaves payroll data at risk of misuse, abuse, and unauthorized use.

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

CDE had 27 employees with keying access to the State’s payroll system at various times between March 1, 2015, and February 28, 2018. Our review of the 27 employees found that CDE did not immediately remove or modify their keying access after the employees’ separation from state service, transfer to another agency or unit, or change in classification. The six employees’ keying accesses should have been deleted when the employees either separated or transferred from the CDE Personnel Office. One employee’s keying access was not removed until 113 days after the employee’s separation date.

The *Decentralized 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 employees’ 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 individuals’ 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

We recommend that CDE:

- Update the keying access to the payroll system after employees separate from state service, transfer to another agency or unit, or change classifications;
- Periodically review access to the system to determine that access complies with the *Decentralized Security Program Manual*.

**FINDING 2—
Inadequate
segregation of
duties and
compensating
controls over
payroll
transactions**

CDE lacked adequate segregation of duties within its payroll transactions unit to ensure that only valid and authorized payroll transactions were processed. CDE 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 CDE payroll transactions unit staff performed conflicting duties. Staff members perform multiple steps in processing payroll transactions, including data entry into the State's payroll system; auditing employee timesheets; reconciling payroll, including reconciling system output to source documentation; and processing adjustments. For example, the staff members keyed in regular and overtime pay and reconciled the master payroll, overtime, and other supplemental warrants. CDE failed to demonstrate that it had implemented compensating controls to mitigate the risks associated with such a deficiency. We found no indication that these functions were subjected to periodic supervisory review.

The lack of adequate segregation of duties and compensating controls has a pervasive effect on the CDE 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 Finding 1 and Findings 3 through 6, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that a material misstatement in financial information or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

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 amount* – This duty refers to making comparisons of information at regular intervals and taking action to resolve differences.

Recommendation

We recommend that CDE:

- 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 due to specific circumstances, CDE should implement compensating controls. For example, if the payroll transaction 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 review of payroll system input and output; and

- Develop formal procedures for performing and documenting compensating controls.

**FINDING 3—
Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments**

CDE lacked adequate controls over the processing of employee separation lump-sum pay. Of the 120 employees whose records we reviewed, four were overpaid by \$3,196, 11 were underpaid by \$4,765, and 11 payments in the amount of \$45,551 could not be verified because the agency purged the employees’ official personnel files based on the employee’s birthday instead of the employee’s separation date (“known”); and we identified \$5,554 in overpayments, \$8,280 in underpayments, and \$79,158 in questioned payments based on the results of statistical sampling (“likely”). If this control deficiency is not mitigated, CDE is at risk of additional improper 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 CDE processed payments for separation lump-sum pay, totaling \$4,755,876, for 337 employees between March 1, 2015, and February 28, 2018, as follows:

Separation Lump-Sum Pay Group	Unit	Amount
Payments (statistically sampled)	337	4,755,876
Total population	337	\$ 4,755,876

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

As we used a statistical sampling method to select the employees whose payments for separation lump-sum pay were examined, we projected the amount of improper and questioned payments to be \$76,432. Therefore, the known and likely improper payments totaled a net approximate of \$120,414. The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	\$ 43,982
Divide by: Sample	<u>1,737,121</u>
Error rate for projection (differences due to rounding)	<u>2.53%</u>
Population that was statistically sampled	4,755,876
Multiply by: Error rate for projection	<u>2.53%</u>
Known and likely improper and questioned payments, net (differences due to rounding)	120,414
Less: Known improper and questioned payments, net	<u>43,982</u>
Likely improper and questioned payments, net	<u>\$ 76,432</u>

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

These improper payments resulted from miscalculation of the employees' accrued leave credits by the payroll transactions unit staff. CDE also lacked adequate supervisory review to ensure accurate processing of separation lump-sum pay.

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 CDE:

- Establish adequate controls to ensure accurate calculation and payment of employee separation lump-sum pay;
- 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;
- Recover overpayments made to separated employees in accordance with GC section 19838 and SAM section 8776.6; and
- Properly compensate those employees who were underpaid.

FINDING 4— Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances

CDE 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 credits with a value of at least \$2,000,913 as of February 28, 2018. We expect the liability to increase if CDE 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 higher leave balances 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 employees to develop a written plan for reducing leave balances below the applicable limit.

Our review of CDE's leave accounting records determined that CDE had 160 employees whose unused vacation or annual leave as of February 28, 2018, exceeded the limit set by collective bargaining agreements and state regulations. Collectively, the 160 employees accumulated 40,718 hours of excess vacation and annual leave, with a value of at least \$2,000,913 as of February 28, 2018. 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.

We performed an additional review of the records for 10 out of 160 employees to determine whether CDE complied with collective bargaining agreements and state regulations. We determined that CDE could not demonstrate that it had complied with collective bargaining agreements and state regulations when allowing these employees to maintain excess vacation or annual leave balances. We found that only three of the 10 had justification or a plan in place during the review period.

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

²Most state employees receive pay rate increases every year pursuant to stat laws and/or collective bargaining agreements until they reach the top of their pay scale, or promote into a higher-paying position. In addition, when an employee's accumulated leave balances upon separation are calculated for lump-sum pay, the employee is credited with additional leave credits equal to the amount that the employee would have earned had the employee taken time off and not separated from state service.

Recommendation

We recommend that CDE:

- 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 5— Inadequate controls over holiday credit transactions, resulting in improper credits

CDE lacked adequate controls over the processing of holiday credit transactions. We identified approximately \$508 in improper holiday credits. If not mitigated, this control deficiency leaves CDE at risk of additional improper holiday credits.

GC section 19853 specifies the compensation that an eligible employee is entitled to receive when required to work on a qualifying holiday. The collective bargaining agreement between the State and Bargaining Unit 6 includes similar provisions regarding holiday compensation for represented employees.

We examined 18 holiday credit transactions, totaling approximately \$5,677, because they involved unusual credits. Of the 18 transactions, three were under-accrued by four hours (or \$146) and three were over-accrued by a total of 24 hours (or \$654), for a net total of \$508. The improper holiday credit transactions occurred because the CDE timekeeping system allowed employees to enter improper holiday credit hours. CDE also lacked adequate supervisory review to ensure accurate processing of holiday credits.

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

Recommendation

We recommend that CDE:

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

**FINDING 6—
Inadequate
controls over
overtime pay,
resulting in
improper and
questioned
payments**

CDE lacked adequate controls over the processing of overtime pay. We reviewed the records of 125 employees who received overtime payments. Of these payments, we identified \$517 in overpayments, \$2,217 in underpayments, and \$3,619 in questioned payments for overtime pay, consisting of \$141 in overpayments, \$606 in underpayments, and \$989 in questioned payments based on actual transactions (“known”); and \$376 in overpayments, \$1,611 in underpayments, and \$2,630 in questioned payments based on the results of statistical sampling (“likely”). If not mitigated, these control deficiencies leave CDE at risk of additional improper payments for overtime.

Collective bargaining agreements, and state law and policies, contain specific clauses regarding the calculation of overtime compensation. Payroll records show that CDE processed 437 payments for overtime pay, totaling \$206,528, between March 1, 2015, and February 28, 2018, as follows:

Overtime Payment Type by Group	Unit	Amount
Work Week Group 2 – Overtime hours (statistically sampled)	437	206,528
Total population	437	\$ 206,528

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

Of the 437 payments for overtime pay, totaling \$206,528, we randomly selected a statistical sample (as described in the Appendix) of 125 payments, totaling \$56,427. Of the 125 payments sampled, CDE overpaid three by approximately \$141 and underpaid two by approximately \$606. We also questioned eight payments totaling \$989. These payments resulted in an estimated net total improper payments of \$524.

As we used a statistical sampling method to select the overtime transactions examined, we projected the amount of likely improper and questioned payments to be \$1,395. Therefore, the known and likely improper payments totaled an estimated \$1,919.

The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	\$ 524
Divide by: Sample	56,427
Error rate for projection (difference due to rounding)	0.93%
Population that was statistically sampled	206,528
Multiply by: Error rate for projection	0.93%
Known and likely improper and questioned payments, net (differences due to rounding)	1,919
Less: Known improper and questioned payments, net	524
Likely improper and questioned payments, net	\$ 1,395

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

The known improper payments were made because personnel specialists were making calculation and keying errors. CDE also lacked adequate supervisory review to ensure the accurate processing of overtime pay.

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

Recommendation

We recommend that CDE:

- Conduct a review of overtime payments made during the past three years to ensure that the payments complied with collective bargaining agreements and state law;
- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838; and
- Properly compensate those employees who were underpaid.

We further recommend that, to prevent improper overtime payments from recurring, CDE:

- Establish adequate internal controls to ensure that overtime payments are accurate and comply with collective bargaining agreements and state law;
- Provide adequate oversight to ensure that payroll transactions unit staff process only valid and authorized overtime payments that comply with collective bargaining agreements and state laws and policies;
- Provide training to payroll transactions unit staff who process overtime payment transactions to ensure that they understand the requirements under collective bargaining agreements and state law; and
- Maintain supporting documentation for overtime payments pursuant to retention policies.

Appendix— Sampling Methodology March 1, 2015, through February 28, 2018

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 (Unit)	Population (Dollar)	Sampling Unit	Sample Selection Method	Confidence Level	Tolerable Error Rate	Expected Error (Rate) ¹	Sample Size	Results Projected to Intended Population	Finding Number
Separation lump-sum pay	Compliance	337	\$ 4,755,876	Employee	Computer-generated simple random	95%	5%	2 (1.75%)	120	Yes	3
Overtime pay	Compliance	437	\$ 206,528	Payment transactions	Computer-generated simple random	95%	5%	2 (1.75%)	125	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 Education’s
Response to Draft Review Report**



**CALIFORNIA DEPARTMENT
OF EDUCATION**

TONY THURMOND
STATE SUPERINTENDENT OF
PUBLIC INSTRUCTION

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July 26, 2019

Andrew Finlayson, Chief
State Agency Audits Bureau
State Controller's Office, Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Mr. Finlayson:

The California Department of Education (CDE) appreciates the opportunity to comment and provide proposed corrective actions for the recommendations outlined in the State Controller's Office (SCO) Audit Report titled, *Payroll Process Review*.

Finding 1 – Concur

Recommendation 1

We recommend that CDE:

- Update the keying access to the payroll system after employees separate from state service, transfer to another agency or unit, or change classifications.

CDE's Comments and Corrective Actions

Effective July 2019, the Payroll and Benefits Office will submit an email to remove an employee's access immediately from the system; CDE will then follow up with the PSD125A form.

- Periodically review access to the system to determine that access complies with the *Decentralized Security Program Manual*.

CDE's Comments and Corrective Actions

Prior to the annual certification, CDE management will conduct an internal review of all staff with access to the system to ensure that CDE is in compliance with the *Decentralized Security Program Manual*.

Finding 2 – Concur

Recommendation 2

We recommend that CDE:

- 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 due to specific circumstances, CDE should implement compensating controls. For example, if the payroll transaction 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 review of payroll system input and output.

CDE's Comments and Corrective Actions

The CDE is currently reviewing the organization of the Payroll and Benefits Office and plans to restructure the work to build in the separation of conflicting payroll functions or dual authorizations.

- Develop formal procedures for performing and documenting compensating controls.

CDE's Comments and Corrective Actions

The CDE will develop formal procedures for performing and documenting compensating controls once it has been determined which course of action is the most feasible; separating conflicting payroll functions or building in dual authorizations.

Finding 3 – Concur

Recommendation 3

We recommend that CDE:

- Establish adequate controls to ensure accurate calculation and payment of employee separation lump-sum pay.

CDE's Comments and Corrective Actions

The CDE will ensure adequate controls are in place to verify the accuracy of the calculation and payment of employee separation lump sum pay. Specifically, the Payroll and Benefits Office has a Separation Check Sheet which includes a control signature to confirm accuracy. In July 2019, management met with each Personnel Specialist individually to discuss the importance of using the Separation Check Sheet; a reminder email was also sent to reinforce this process.

- 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.

CDE's Comments and Corrective Actions

CDE is in the process of correcting improper separation lump-sum payments discovered during the audit; corrections include issuing payments and setting up account receivables accordingly.

- Recover overpayments made to separated employees in accordance with GC section 19838 and SAM section 8776.6.

CDE's Comments and Corrective Actions

CDE is in the process of setting up account receivables for overpayments discovered during the audit, and will make every effort to recover overpayments made to separated employees.

- Properly compensate those employees who were underpaid.

CDE's Comments and Corrective Actions

CDE is in the process of correcting improper lump-sum payments discovered during the audit, and will properly compensate those employees who were underpaid.

Finding 4 – Concur

Recommendation 4

We recommend that CDE:

- 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.

CDE's Comments and Corrective Actions

CDE will strengthen existing policies and procedures regarding maintenance of vacation and annual leave balances and implement additional controls where permitted to assist employees in managing leave balances within the levels allowed by collective bargaining agreements and state regulations. Each year the Human Resources Division (HRD) sends out excessive leave balance notifications to all managers that supervise employees with excessive leave balances. Managers are directed to work with employees to develop, implement, and maintain a plan to reduce leave balances.

- Conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively.

CDE's Comments and Corrective Actions

The HRD will continue to annually send out notifications to managers and track the number of employees with excessive leave balances to determine if notification efforts are successful.

- Participate in leave buy-back programs if the State offers such programs and funds are available.

CDE's Comments and Corrective Actions

The CDE continues to participate in the leave buy-back program every fiscal year as long as funds are available.

Finding 5 – Concur

Recommendation 5

We recommend that CDE:

- Conduct a review of holiday credits granted during the past three years to ensure that credits complied with collective bargaining agreements and state laws.

CDE's Comments and Corrective Actions

The Payroll and Benefits Office will review holiday credits identified during the audit; moving forward, CDE will implement controls to ensure that all

holiday credits are correct and in compliance with collective bargaining agreements and state laws.

- Correct any improper holiday credit accruals in the State's leave accounting system.

CDE's Comments and Corrective Actions

CDE will review improper holiday credit accruals identified during the audit and correct errors, if permissible, in the State's leave accounting system.

- Establish adequate controls to ensure that holiday credits granted are valid and comply with collective bargaining agreements and state law.

CDE's Comments and Corrective Actions

As previously stated, moving forward, the CDE will implement controls to ensure that all holiday credits are correct and in compliance with collective bargaining agreements and state laws.

Finding 6 – Concur

Recommendation 6

We recommend that CDE:

- Conduct a review of overtime payments made during the past three years to ensure that the payments complied with collective bargaining agreements and state law.

CDE's Comments and Corrective Actions

CDE will review improper overtime payments identified during the audit and correct errors, if permissible, in the State's leave accounting system.

- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838.

CDE's Comments and Corrective Actions

CDE is in the process of setting up account receivables for improper overtime payments discovered during the audit, and will make every effort to recover overpayments made to separated employees.

- Properly compensate those employees who were underpaid.
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CDE's Comments and Corrective Actions

CDE is in the process of correcting improper overtime payments identified during the audit, and will properly compensate those employees who were underpaid.

We further recommend that, to prevent improper overtime payments from recurring, CDE:

- Establish adequate internal controls to ensure that overtime payments are accurate and comply with collective bargaining agreements and state law.

CDE's Comments and Corrective Actions

To strengthen our internal controls regarding overtime payments, the CDE will review internal processes to ensure that: (1) adequate oversight is a priority in the process; (2) supporting documentation is properly maintained; and (3) payments are in compliance with collective bargaining agreements and state law.

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

CDE's Comments and Corrective Actions

To strengthen our internal controls regarding overtime payments, the CDE will review internal processes to ensure that: (1) payroll transaction staff only process valid and authorized overtime payments; (2) supporting documentation is properly maintained; and (3) payments are in compliance with collective bargaining agreements and state law.

- Provide training to payroll transactions unit staff who process overtime payment transactions to ensure that they understand the requirements under collective bargaining agreements and state law.

CDE's Comments and Corrective Actions

All personnel specialists receive training on processing overtime payments. To further strengthen our process, the CDE will conduct annual training to keep all personnel specialists informed and up to date on overtime payment transactions.

- Maintain supporting documentation for overtime payments pursuant to retention policies.

Mr. Andrew Finlayson, Chief
July 26, 2019
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CDE's Comments and Corrective Actions

CDE will ensure that all appropriate documentation is retained as required. In addition, a reminder email will be sent to all personnel specialists emphasizing the importance of retaining supporting documentation.

If you have any questions regarding the CDE's comments and/or corrective actions, please contact Kimberly Tarvin, Director, Audits and Investigations Division, by phone at 916-323-1547 or by email at ktarvin@cde.ca.gov.

Sincerely,



Lupita Cortez Alcalá
Chief Deputy Superintendent of Public Instruction

LCA:kl

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