

CALIFORNIA DEPARTMENT OF STATE HOSPITALS – COALINGA

Audit Report

PAYROLL AUDIT

February 1, 2015, through January 31, 2018



BETTY T. YEE
California State Controller

July 2019



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California State Controller

July 31, 2019

Stephanie Clendenin, Acting Director
California Department of State Hospitals
1600 9th Street
Sacramento, CA 95814

Dear Ms. Clendenin:

The State Controller's Office audited the California Department of State Hospitals – Coalinga (DSH – Coalinga) payroll process and transactions for the period of February 1, 2015, through January 31, 2018.

Our audit found material weaknesses in internal control over the DSH – Coalinga payroll process. These weaknesses contributed to DSH – Coalinga employees' excessive vacation and annual leave balances, improper and questioned payments, and long-outstanding salary advances, costing the State an estimated net total of \$1,151,276.

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

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Mark Ghaly, Secretary

California Health and Human Services Agency

Sterling Price, Acting Chief Deputy Director

California Department of State Hospitals

George Maynard, Deputy Director, Administration

California Department of State Hospitals

Cindy Woolston, Chief, Office of Audits

California Department of State Hospitals

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Contents

Audit Report

Summary	1
Background	1
Objectives, Scope, and Methodology	2
Conclusion	3
Follow-up on Prior Audit Finding	4
Views of Responsible Officials.....	5
Restricted Use	5
Schedule—Summary of Findings	6
Findings and Recommendations.....	7
Appendix—Audit Sampling Methodology.....	A1
Attachment—California Department of State Hospitals’ Response to Draft Audit Report	

Audit Report

Summary

The State Controller's Office (SCO) audited the California Department of State Hospitals – Coalinga's (DSH – Coalinga) payroll process and transactions for the period of February 1, 2015, through January 31, 2018. DSH – Coalinga management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures. We completed our audit fieldwork on May 30, 2019.

Our audit determined that DSH – Coalinga:

- Did not maintain adequate and effective internal controls over its payroll process. We found the following deficiencies in internal control over the payroll process that we consider to be material weaknesses:
 - Lack of adequate segregation of duties and compensating controls over the processing of payroll transactions (see Finding 1);
 - Inappropriate keying access to the State's payroll system (see Finding 2);
 - Lack of sufficient controls over the processing of specific payroll-related transactions to ensure that DSH – Coalinga complied with collective bargaining agreements and state laws, and that only valid and authorized payments were processed (see Findings 3, 4, 5, 6 and 8);
- Did not process payroll and payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. We found the following instances of noncompliance with the requirements of collective bargaining agreements and state laws, regulations, policies, and procedures:
 - Failure to adhere to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits, resulting in liability for excessive leave balances with a value of at least \$650,502 as of January 31, 2018 (see Finding 3);
 - Improper and questioned payments made for overtime pay, separation lump-sum pay, and Medical Officer of the Day (MOD) pay; and improper holiday credits, costing an estimated net total of \$484,374 (see Findings 4, 5, 6, and 8); and
- Did not administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures (see Finding 7).

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 PPCS was the State's centralized payroll processing center for all payroll related-transactions.

PPSD decentralized the processing of payroll, allowing state agencies and departments to process their own payroll-related transactions. Periodic audits of the decentralized payroll processing at state agencies and departments ceased due to the budget constraints in the late 1980s.

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

Audit Authority

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

Objectives, Scope, and Methodology

We performed this audit to determine whether DSH – Coalinga:

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

The audit covered the period from February 1, 2015, through January 31, 2018.

To achieve our audit objectives, we:

- Reviewed state and DSH – Coalinga policies and procedures related to the payroll process to understand DSH – Coalinga’s methodology for processing various payroll and payroll-related transactions;
- Interviewed DSH – Coalinga payroll personnel to understand DSH – Coalinga’s methodology for processing various payroll and payroll-related transactions, determine their level of knowledge and ability relating to payroll transaction processing, and gain an understanding of existing internal control over the payroll process and systems;
- Selected transactions recorded in the State’s payroll database using statistical sampling, as outlined in the Appendix, and targeted selection based on risk factors and other relevant criteria;

- Analyzed and tested the selected transactions, and reviewed relevant files and records to determine the accuracy of payroll and payroll-related payments, accuracy of leave transactions, adequacy and effectiveness of internal control over the payroll process, and compliance with collective bargaining agreements and state laws, regulations, policies, and procedures; and
- Reviewed salary advances to determine whether DSH – Coalinga administered and recorded them in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

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

Conclusion

Our audit determined that DSH – Coalinga:

- Did not maintain adequate and effective internal controls over its payroll process¹. We found the following deficiencies in internal control over the payroll process that we consider to be material weaknesses:
 - Lack of adequate segregation of duties and compensating controls over the processing of payroll transactions (see Finding 1);
 - Inappropriate keying access to the State’s payroll system (see Finding 2);
 - Lack of sufficient controls over the processing of specific payroll-related transactions to ensure that DSH – Coalinga complied with

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

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

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with provisions of laws, regulations, or contracts on a timely basis. Control deficiencies, either individually or in combination with other control deficiencies, may be evaluated as significant deficiencies or material weaknesses. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over compliance with provisions of laws, regulations, or contracts that is less severe than a material weakness, yet important enough to merit attention from those charged with governance.

collective bargaining agreements and state laws, and that only valid and authorized payments were processed (see Findings 3, 4, 5, 6, and 8).

- Did not process payroll and payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures. We found the following instances of noncompliance with the requirements of collective bargaining agreements and state laws, regulations, policies, and procedures:
 - Failure to adhere to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits, resulting in liability for excessive leave balances with a value of at least \$650,502 as of January 31, 2018 (see Finding 3);
 - Improper and questioned payments made for overtime pay, employee separation lump-sum pay, and MOD pay; and improper holiday credits, costing an estimated net total of \$484,374 (see Findings 4, 5, 6, and 8); and
- Did not administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures (see Finding 7).

Follow-up on Prior Audit Finding

The Department of Finance, Office of State Audits and Evaluations (Finance) issued a report on January 31, 2008 for its Internal Control Review (December 2007 Internal Control Review) of the California Department of Mental Health (DMH) for the period of July 2007, through December 2007. The December 2007 Internal Control Review report included a finding that involved DSH – Coalinga regarding overtime that was not pre-approved, errors in processing payments, and an employee who was under investigation for fraudulent reporting. Among its recommendations in the December 2007 Internal Control Review report, Finance recommended that DSH – Coalinga:

1. Institute timekeeping procedures to ensure attendance records are adequately prepared, certified, and retained for audit;
2. Require overtime be reviewed and pre-approved by a designated supervisor and second-level reviewer; and
3. Conduct random overtime audits to reduce fraud and abuse.

On March 25, 2013, Finance issued a report on its audit (March 2013 Audit), which was conducted to determine whether the California Department of State Hospitals² (DSH) implemented the recommendations presented in Finance's December 2007 Internal Control Review report as of June 30, 2012. The March 2013 Audit report indicated that DSH – Coalinga had implemented Recommendation 2, but had not implemented Recommendations 1 and 3, as described above. Based on the work performed during our current audit, we noted that DSH – Coalinga has

²On July 1, 2012, DMH was abolished and the responsibilities for the state hospitals transferred to the then-newly established DSH.

taken corrective actions in response to Recommendation 1. We also noted that although DSH – Coalinga stated that it has taken corrective actions to implement Recommendation 3 by conducting monthly audits of payroll transactions unit staff, we could not verify that the actions were adequate and appropriate because there is no sufficient record of their implementation. Furthermore, based on the work performed during our current audit, we noted a similar finding regarding errors in processing of overtime payments (see Finding 4).

Views of Responsible Officials

We issued a draft audit report on June 24, 2019. Stephanie Clendenin, Acting Director, DSH, responded by letter dated July 15, 2019 (Attachment), acknowledging the findings and indicating that DSH – Coalinga 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. DSH also provided additional information regarding Finding 8. Our comments on DSH's response to Finding 8 are included in the Findings and Recommendations section.

Restricted Use

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

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

July 31, 2019

Schedule—

Summary of Findings

February 1, 2015, through January 31, 2018

Finding Number	Issues	Number of Selections Audited	Method of Selection	Selection Unit	Dollar Amount of Selections Audited	Number of Selections with Issues	Issues as a Percentage of Selections Audited *	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	40	Targeted	Employee	-	12	30%	-	N/A	-
3	Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances	51	Targeted	Employee	\$ 517,382	51	100%	\$ 650,502	N/A	\$ 650,502
4	Inadequate controls over overtime pay, resulting in improper payments									
	Overpayments	125	Statistical	Payment transaction	483,538	22	18%	6,956	880,611	887,567
	Underpayments			--Same selections above--		7	6%	(3,601)	(455,876)	(459,477)
5	Inadequate controls over separation lump-sum pay, resulting in improper and questioned payments									-
	Overpayments	105	Statistical	Employee	587,524	15	14%	7,100	12,923	20,023
	Underpayments			--Same selections above--		11	10%	(6,468)	(11,775)	(18,243)
	Questioned payments			--Same selections above--		2	2%	15,140	27,559	42,699
6	Inadequate controls over Medical Officer of the Day pay, resulting in overpayments	105	Statistical	Payment transaction	1,223,187	5	5%	2,388	5,487	7,875
7	Inadequate controls over salary advances, resulting in failure to recover outstanding amounts	24	Targeted	Salary advance transaction	16,400	24	100%	16,400	N/A	16,400
8	Inadequate controls over holiday credit transactions, resulting in improper credits	11	Targeted	Holiday credit transaction	4,161	10	91%	3,930	N/A	3,930
Total					<u>\$ 2,832,192</u>			<u>\$ 692,347</u>	<u>\$ 458,929</u>	<u>\$ 1,151,276</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

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

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

Our audit found that DSH – Coalinga 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. DSH – Coalinga 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 DSH – Coalinga payroll process, and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively. These control deficiencies, in combination with other deficiencies discussed in Findings 2 through 8, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that material noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

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

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

Recommendation

We recommend that DSH – Coalinga:

- 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, DSH – Coalinga 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

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

The SCO maintains the State’s payroll system. The system is decentralized, 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 examined the records of 40 DSH – Coalinga employees who had keying access to the State’s payroll system at various times between February 2015 and January 2018. Of the 40 employees, we determined that DSH – Coalinga did not immediately remove or modify keying access for 12 employees after the employees’ separation from state service, transfer to another agency, or change in classification. For example, a Staff Services Manager II transferred to another state agency on May 13, 2016. DSH – Coalinga did not request to remove the employee’s access until October 26, 2016, 166 days later.

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

The PPSD system contains sensitive and confidential information. Access is restricted to persons with an authorized, legal, and legitimate business requirement to complete their duties. . . .

Currently, PIMS, HIST, KEYM, PIP, LAS, MPC and/or ACAS applications are restricted to Personnel Specialists or Personnel Technician 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/campus. . . .

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

Recommendation

We recommend that DSH – Coalinga:

- Update keying access to the State's payroll system immediately after employees leave DSH – Coalinga, transfer to another unit, or change classifications;
- 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

DSH – Coalinga failed to implement controls to ensure that it adheres to the requirement of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. These deficiencies resulted in liability for excessive leave balances with a value of at least \$517,382 as of January 31, 2018. We expect the liability to increase if the DSH – Coalinga 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 for reducing leave balances below the applicable limit.

Our examination of DSH – Coalinga's leave accounting records determined that DSH – Coalinga had 1,739 employees with unused vacation or annual leave credits at January 31, 2018. Of those employees, 51 exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 2,257 hours in annual leave, or 1,617 hours beyond the 640-hour limit. Collectively, the 51 employees accumulated 8,529 hours in excess vacation and annual leave, with a value of at least \$517,382 as of January 31, 2018. This estimated liability does not adjust for salary rate

increases and additional leave credits.³ Accordingly, we expect that the amount needed to pay for the liability will be higher. For example, a DSH – Coalinga employee separated from state service with 892 hours in leave credits, including 600 hours in annual leave. After adjusting for additional leave credits, the employee was paid for 1,058 hours, or approximately 19% more.

We further examined the records of 51 employees to determine DSH – Coalinga’s compliance with collective bargaining agreements and state regulations. DSH – Coalinga 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 also found that DSH – Coalinga had no plans in place during the audit period to reduce leave balances below the limit.

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

Recommendation

We recommend that DSH – Coalinga:

- 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 overtime pay, resulting in improper payments

DSH – Coalinga lacked adequate controls over the processing of overtime pay. We identified \$887,567 in overpayments and \$459,477 in underpayments for overtime, consisting of \$6,956 in overpayments and \$3,601 in underpayments based on actual transactions examined (“known”); and \$880,611 in overpayments and \$455,876 in underpayments based on the results of statistical sampling (“likely”). If

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

not mitigated, these control deficiencies leave DSH – Coalinga at risk of additional improper payments for overtime.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding overtime pay. Payroll records show that DSH – Coalinga processed 78,908 overtime pay transactions, totaling \$61,700,119, between February 2015 and January 2018. Of the 78,908 overtime pay transactions, we randomly selected a statistical sample (as described in the Appendix) of 125 transactions, totaling \$483,538. Of the 125 transactions, DSH – Coalinga overpaid 22 by approximately \$6,956 and underpaid seven by approximately \$3,601. The known improper payments totaled a net of approximately \$3,355.

As we used a statistical sampling method to select the overtime pay transactions examined, we projected the amount of likely overpayments to be \$880,611 and likely underpayments to be \$455,876. The likely improper payments totaled a net of approximately \$424,735. Therefore, the known and likely improper payments totaled a net of approximately \$428,090, consisting of \$887,567 in overpayments and \$459,477 in underpayments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	\$ 3,355
Divide by: Sample	483,538
Error rate for projection (differences due to rounding)	0.69%
Population that was statistically sampled	61,700,119
Multiply by: Error rate for projection	0.69%
Known and likely improper payments, net (differences due to rounding)	428,090
Less: Known improper payments, net	3,355
Likely improper payments, net	\$ 424,735

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

The known improper payments were made because the payroll transactions unit staff members miscalculated overtime hours worked; incorrectly paid hours worked at the time-and-a-half rate instead of the straight-time rate or vice-versa; and incorrectly entered overtime pay into the payroll system. DSH – Coalinga also lacked adequate supervisory review to ensure 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 ensure compliance with applicable laws and other requirements, and an effective system of internal review.

Recommendation

We recommend that DSH – Coalinga:

- Conduct a review of payments for overtime pay made during the past three years to ensure that the payments complied with collective bargaining agreements and state laws and policies; and

- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838, and properly compensate those employees who were underpaid.

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

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

**FINDING 5—
Inadequate controls
over separation
lump-sum pay,
resulting in
improper payments**

DSH – Coalinga lacked adequate controls over the processing of employee separation lump-sum pay. We identified \$20,023 in overpayments, \$18,243 in underpayments, and \$42,699 in questioned payments for separation lump-sum pay, consisting of \$7,100 in overpayments, \$6,468 in underpayments, and \$15,140 in questioned payments based on actual transactions examined (“known”); and \$12,923 in overpayments, \$11,775 in underpayments, and \$27,559 in questioned payments based on the results of statistical sampling (“likely”). If not mitigated, these control deficiencies leave DSH – Coalinga 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 DSH – Coalinga processed payments for separation lump-sum pay, totaling \$1,656,957, for 285 employees between February 2015 and January 2018. Of the 285 employees, we randomly selected a statistical sample (as described in the Appendix) of 105 employees who received separation lump-sum pay, totaling \$587,524. Our examination of lump-sum payments made to these 105 employees found that DSH – Coalinga overpaid 15 of them by approximately \$7,100 and underpaid 11 of them by approximately \$6,468. Our review of lump-sum payments also showed a lack of supporting documentation for payments, totaling \$15,140, made to two employees. Without the required documentation, there is no record of calculation and approval of payments for separation lump-sum pay. Therefore, we could not determine the validity, accuracy, and propriety of the payment made to these employees. As a result, we questioned these payments. These payments resulted in net total improper and questioned payments of \$15,772.

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 likely overpayments to be \$12,923, likely underpayments to be \$11,775, and likely questioned payments to be \$27,559. These payments resulted in net total improper and questioned payments of \$28,707. Therefore, the known and likely improper and questioned payments totaled a net of approximately \$44,479, consisting of \$20,023 in

overpayments, \$18,243 in underpayments, and \$42,699 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	\$ 15,772
Divide by: Sample	587,524
Error rate for projection (differences due to rounding)	2.68%
Population that was statistically sampled	1,656,957
Multiply by: Error rate for projection	2.68%
Known and likely improper and questioned payments, net (differences due to rounding)	44,479
Less: Known improper and questioned payments, net	15,772
Likely improper and questioned payments, net	\$ 28,707

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

The known improper payments were made because payroll transactions unit staff members miscalculated leave balances paid. DSH – Coalinga 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 DSH – Coalinga:

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

FINDING 6— Inadequate controls over Medical Officer of the Day pay, resulting in overpayments

DSH – Coalinga lacked adequate controls over the processing of MOD pay. We identified \$7,875 in overpayments for MOD pay, consisting of \$2,388 based on actual transactions examined (“known”) and \$5,487 based on the results of statistical sampling (“likely”). If not mitigated, this control deficiency also leaves DSH – Coalinga at risk of additional improper payments.

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

Payroll records show that DSH – Coalinga processed 365 MOD payment transactions, totaling \$4,034,198, between February 2015 and January 2018. Of the 365 transactions, we randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling \$1,223,187. Of the 105 transactions, DSH – Coalinga overpaid five by \$2,388. As we used a statistical sampling method to select the transactions examined, we projected the amount of likely overpayments to be \$5,487. Therefore, the known and likely overpayments \$7,875.

The following table summarizes the results of our statistical sampling:

Known overpayments	\$ 2,388
Divide by: Sample	1,223,187
Error rate for projection (differences due to rounding)	0.20%
Population that was statistically sampled	4,034,198
Multiply by: Error rate for projection	0.20%
Known and likely overpayments (differences due to rounding)	7,875
Less: Known overpayments	2,388
Likely overpayments	\$ 5,487

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

The known overpayments were made because payroll transactions unit staff members granted MOD pay to ineligible employees. DSH – Coalinga also lacked adequate supervisory review to ensure accurate processing of MOD pay.

Recommendation

We recommend that DSH – Coalinga:

- Establish adequate controls to ensure proper payment of MOD pay;
- Conduct a review of payments for MOD pay made during the past three years to ensure that the payments were accurate and in compliance with collective bargaining agreements and state policy; and
- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838.

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

DSH – Coalinga lacked adequate controls over salary advances to ensure that advances were recovered in accordance with state law and policies. Twenty-four salary advances, totaling \$16,400, remained outstanding as of January 31, 2018, due to DSH – Coalinga’s noncompliance with the State’s collection policies and procedures. The oldest unrecovered salary advance was outstanding for over 10 years. This control deficiency leaves DSH – Coalinga at risk of further failures to collect salary advances if not mitigated.

At January 31, 2018, DSH – Coalinga’s accounting records showed 49 outstanding salary advances totaling \$86,731, including 24 balances, totaling \$16,400, that had been outstanding for more than 90 days.

Generally, the prospect of collection diminishes as an account ages. When an agency fails to initiate collection of the overpayment within 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 DSH – Coalinga to collect salary advances in a timely manner and maintain proper records of collection efforts.

We examined the 24 outstanding salary advances that had been outstanding for more than 90 days. Based on this examination, we noted that DSH – Coalinga did not comply with the State's collection policies and procedures for all of them. DSH – Coalinga did not send collection notices promptly, or did not send the notices at all.

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 DSH – Coalinga ensure that it recovers salary advances in a timely manner pursuant to GC section 19838 and SAM sections 8776 and 8776.7.

FINDING 8— Inadequate controls over holiday credit transactions, resulting in improper credits

DSH – Coalinga lacked adequate controls over the processing of holiday credit transactions. We identified approximately \$3,930 in improper holiday credits. If not mitigated, this control deficiency leaves DSH – Coalinga 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 agreements between the State and Bargaining Units 7, 17, 18, and 19 include similar provisions regarding holiday compensation for represented employees.

We examined 11 holiday credit transactions, with an estimated value of \$4,161, because they involved unusual credits. Of the 11 transactions, 10 involved improper credits, with an estimated value of \$3,930.

The improper holiday credit transactions occurred because payroll transactions unit staff members granted holiday credits to employees during pay periods with no holidays. DSH – Coalinga 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 DSH – Coalinga:

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

DSH’s Response

. . . . Given the platform and the process to input information into the [California Leave Accounting System (CLAS)], DSH-Coalinga uses the tools available including SCO exception reports. However, DSH would appreciate the SCO providing more audit tools (exception reports) that could help DSH in the CLAS input process.

SCO Comment

PPSD periodically provides the Leave Activity & Balances report and exception reports to state agencies. These reports can assist state agencies in verifying the accuracy and completeness of the data entered into CLAS.

Appendix— Audit Sampling Methodology February 1, 2015, through January 31, 2018

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

Audit 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
Overtime pay	Compliance	78,908	\$ 61,700,119	Payment transactions	Computer-generated simple random	95%	5%	2 (1.50%)	125	Yes	4
Separation lump-sum pay	Compliance	285	1,656,957	Employee	Computer-generated simple random	90%	5%	2 (1.75%)	105	Yes	5
MOD pay	Compliance	365	4,034,198	Payment transactions	Computer-generated simple random	90%	5%	2 (1.75%)	105	Yes	6

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

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

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July 15, 2019

Andrew Finlayson,
Chief, State Agency Audits Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Finlayson:

The Department of State Hospitals (DSH) received the California State Controller's Office (SCO) draft report on payroll processes and transactions performed at the DSH-Coalinga Hospital. As agreed, an extension of time to submit a response to the draft report regarding the findings was granted to July 15, 2019.

The draft report identifies internal control weaknesses in the areas of payroll transactions, keying access for the State's payroll system, vacation and annual leave balances, holiday credits, salary advances, medical officer of the day pay, overtime compensation and lump-sum payments.

Attached please find DSH's corrective action plan, which details steps to implement each recommendation proposed by SCO.

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

Sincerely,

A handwritten signature in black ink, appearing to read "S. Clendenin", with a long horizontal flourish extending to the right.

Stephanie Clendenin
Acting Director

cc: Mark Ghaly, Secretary
California Health and Human Service Agency
Department of State Hospitals
Stirling Price, Chief Deputy Director (A)
Department of State Hospitals

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Department of State Hospitals
Brandon Price, Executive Director
Department of State Hospitals-Coalinga
George Maynard, Deputy Director, Administrative Services Division
Department of State Hospitals

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**California State Controller
Corrective Action Plan
Department of State Hospitals**

The Department of State Hospitals (DSH) will implement a corrective action plan to mitigate the findings identified by SCO:

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

SCO Recommendation

We recommend that DSH – Coalinga:

- 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, DSH – Coalinga 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.

DSH Corrective Action Plan

While DSH-Coalinga does provide for separation of duties or have compensating controls in place to perform conflicting functions as mandated by California Government Code sections 13402 and 13403, DSH acknowledges that DSH-Coalinga should further strengthen its controls and will take the following actions:

- In January 2015, DSH implemented a Timekeeping Manual, which improved how timekeeping/attendance records are processed throughout the DSH system. This manual is currently being updated and further enhanced to include clear policies and procedures for ensuring payroll transactions are accurate, clear and documented. The newly updated Timekeeping Manual will be complete by January 2020.

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- In June of 2019, DSH formed a system-wide Training Manual Group that meets on a monthly basis to identify strategies to further address and resolve time keeping issues such as, the proper reporting of leave time, time worked and attendance issues. DSH-Coalinga is participating in this workgroup. This work group will identify issues and solutions to ensure timesheet documentation issues are resolved prior to sending the timesheet for processing to Human Resources.
- While DSH-Coalinga does perform and document some random supervisory reviews of personnel specialists work to identify potential keying errors, DSH agrees these should be strengthened. DSH-Coalinga will require by August 2, 2019, that Human Resource Supervisors implement more formalized randomized audits on transactions performed by Personnel Specialists. This process will identify keying problem areas, identify potential staff training needs, and monitor staff progress/work. In addition, documentation to support the audits have been conducted will be retained for a minimum of 3 years.

Planned Completion Date: Completed.

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

SCO Recommendation

We recommend that DSH – Coalinga:

- Update keying access to the State's payroll system immediately after employees leave DSH – Coalinga, transfer to another unit, or change classifications;
- Periodically review access to the system to verify that access complies with the *Decentralized Security Program Manual*.

DSH Corrective Action Plan

DSH agrees that DSH-Coalinga did not adequately maintain keying access to the State's payroll system. DSH-Coalinga will implement the following actions:

- DSH-Coalinga Human Resource Director sent an email to all Human Resources staff on July 11, 2019 to mandate that keying access to the State's payroll system be updated immediately upon an employee's separation from the DSH or transfer to an unapproved position classification.
- DSH-Coalinga will monitor and update the access as separations, appointments, and classification changes occur within Personnel to ensure that only

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appropriately designated staff have access to the State's payroll system. DSH-Coalinga will report required access changes to the SCO Decentralized Security Unit immediately via email, with subsequent completion and processing of required documentation.

Planned Completion Date: Completed.

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

SCO Recommendation

We recommend that DSH – Coalinga:

- 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.

DSH Corrective Action Plan

DSH agrees that it is important that departments implement policies and procedures, to ensure leave balances are not excessive. DSH hospitals operate 24 hours a day/seven days a week to serve mentally ill patients who are mandated for treatment by a criminal or civil court judge. Vacation/leave requests, particularly for level-of-care employees, are managed at DSH based on operational needs, the need to maintain licensing standards for patient-to-care ratios, and available staffing. Due to the need to provide adequate care to DSH patients on a 24-hour basis and other operational factors of a 24-hour hospital system, it is difficult to ensure all of DSH employees maintain leave balances within the 640 cap. Strictly enforcing caps would increase overtime costs and drive mandatory overtime to ensure the hospitals can meet patient care needs and maintain licensing standards. At DSH-Coalinga, over 88 percent of DSH-Coalinga employees that have accrued excess annual or vacation leave are in direct patient care classifications.

DSH-Coalinga will implement the following actions to help reduce leave balances:

- DSH approved Policy Directive 5314 on March 1, 2017 to establish a policy to ensure that each employee uses leave balances in a manner, which is consistent

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with DSH's operational needs and complies with existing leave statutes/regulations. DSH-Coalinga management will work with the employees to reduce leave balances to the extent feasible as required by this Policy Directive.

- To the extent that funding is available, DSH will continue to participate in buy-back programs as it has in previous years. Specifically, DSH-Coalinga participated in the State buy-back program in June 2014, June 2015, June 2016 and June 2019.

Planned Completion Date: Completed.

FINDING 4: Inadequate controls over overtime pay, resulting in improper payments

SCO Recommendation

We recommend that DSH – Coalinga:

- Conduct a review of payments for overtime pay made during the past three years to ensure that the payments complied with collective bargaining agreements and state laws and policies; and
- Recover overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838, and properly compensate those employees who were underpaid.
- We further recommend that, to prevent improper and questioned payments for overtime pay from recurring, DSH – Coalinga:
- Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreements and state laws and policies; and
- Provide adequate oversight to ensure that payroll transactions unit staff process only valid and authorized payments that comply with collective bargaining agreements and state laws and policies.

DSH Corrective Action Plan

DSH agrees that DSH-Coalinga should improve its controls over overtime pay and improve accuracy of overtime pay issued to its employees. DSH-Coalinga will implement the following actions:

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- DSH-Coalinga will require that overtime payments be validated by a Transaction Supervisor prior to being issued to ensure that payments are accurate and comply with collective bargaining agreements, state laws and policies.
- DSH-Coalinga Transaction Supervisors will develop and implement a monthly monitoring process to ensure that the Payroll Transaction Unit processes and issues accurate overtime pay and in accordance collective bargaining agreements and state laws and policies by August 2019.
- DSH-Coalinga will conduct a review of overtime payments made for the past three years, as resources are available. Given the complexity and volume of overtime transactions and limited staff resources it is anticipated that this review will be completed by July 2020.

During the SCO fieldwork phase, DSH collected \$6,104.46 in overpayments for 14 employees identified in the audit. DSH was unable to collect \$851.32 in overpayments for eight employees because the statute of limitations to collect monies expired. In addition, underpayments totaling \$3,563.82 for six employees has been paid to the employees. DSH provided evidence and SCO accepted on October 18, 2019 that this was completed.

Planned Completion Date: July 2020.

FINDING 5: Inadequate controls over separation lump-sum pay, resulting in improper payments

SCO Recommendation

We recommend that DSH – Coalinga:

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

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DSH Corrective Action Plan

DSH agrees. DSH-Coalinga has implemented the following actions to mitigate this finding:

- During the SCO audit fieldwork phase, DSH-Coalinga provided supporting documentation that the collection/overpayment of lump sum payment calculation errors were corrected. Some of the overpayments identified were not collected because the statute of limitations expired. SCO accepted this as mitigated on October 18, 2019.
- DSH-Coalinga revised and implemented a Resignation Check List (job aide form) in October 2018, to simplify the accurate calculation and payment of separation lump-sum pay. The use of this form is mandatory and monitored for compliance.
- In October of 2018, DSH-Coalinga mandated that all separations be reviewed by a Transactions Supervisor for accuracy, prior to the keying and issuance of the transaction.
- DSH-Coalinga will also take the following actions:
 - ✓ DSH-Coalinga will conduct a review of lump sum payments made for the past three years by November 2020.
 - ✓ DSH-Coaling will provide additional formal training to the personnel specialists on the proper calculation of lump-sum payments on an as-needed basis and/or when new staff are hired to perform this function.

Planned Completion Date: November 2020.

FINDING 6: Inadequate controls over Medical Officer of the Day pay, resulting in overpayments

SCO Recommendation

We recommend that DSH – Coalinga:

- Establish adequate controls to ensure proper payment of MOD pay;
- Conduct a review of payments for MOD pay made during the past three years to ensure that the payments were accurate and in compliance with collective bargaining agreements and state policy; and

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

DSH Corrective Action Plan

DSH agrees with the finding; however notes that of the five inappropriate payments, two were payments made to Bargaining Unit 18 employees. These payments were appropriate Education Pay for the two employees that were inadvertently keyed as MOD pay. DSH-Coalinga has corrected the keying error, however, this money will not be collected as it was appropriately earned and due to the employees. DSH-Coalinga as of December 2018 collected the remaining three payments made due to calculation errors.

To further strengthen its controls in this area, DSH-Coalinga will take the following action:

- Conduct a review, by December 31, 2019, of MOD pay made during the past three years to ensure that the payments were accurate and in compliance with collective bargaining agreements and state law; and
- Transaction Supervisors will conduct and document random audits to ensure ongoing compliance.

Planned Completion Date: December 2019

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

SCO Recommendation

We recommend that DSH–Coalinga ensure that it recovers salary advances in a timely manner pursuant to GC section 19838 and SAM sections 8776 and 8776.7.

DSH Corrective Action Plan

DSH agrees with this finding and DSH-Coalinga will collect the outstanding salary advances for employees, as applicable. DSH has implemented the following to mitigate the past, current and future accounts receivable:

- DSH-Coalinga requires Personnel Supervisors meet with Accounting Supervisors, to review outstanding payroll accounts receivables, collection activity and ensure that collections activities are in compliance with state rules.

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- On January 22, 2016, DSH issued Policy Directive 2300 Accounts Receivable which is currently being updated to include new FISCAL collection business processes. This policy directive provides clear direction to human resource and accounting staff to ensure that proper controls are in place to collect employee accounts receivable timely and accurately. This policy directive includes a consistent review process for all outstanding accounts receivables. Plans are in place to have this policy directive updated and implemented by December 2019.

Planned Completion Date: December 2019.

FINDING 8: Inadequate controls over holiday credit transactions, resulting in improper credits

SCO Recommendation

We recommend that DSH – Coalinga:

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

DSH Corrective Action Plan

We agree that DSH-Coalinga had input errors for 10 employees in the California Leave Accounting System (CLAS).

DSH will implement the following measures to reduce the amount of input errors into CLAS:

- On or before December 31, 2019, DSH will implement a system-wide Informational Bulletin with guidance on appropriate calculation of holiday credit.
- DSH-Coalinga will provide additional 1:1 training for Personnel Specialists along with formal SCO training classes on an as needed basis to improve the skills and abilities of current DSH-Coalinga staff members. In addition, new staff members will be appropriately trained.

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- Beginning August 2019, random audits will be conducted on a monthly basis, to ensure that the Personnel Specialist are correctly inputting information in the California Leave Accounting System reflecting correct usage and accruals of time. These random audits will be accomplished through a supervisory and peer review process.

Given the platform and the process to input information into the CLAS¹, DSH-Coalinga uses the tools available including SCO exception reports. However, DSH would appreciate the SCO providing more audit tools (exception reports) that could help DSH in the CLAS input process.

Planned Completion Date: December 31, 2019.

¹ Per report 2012-603 California State Audit High Risk Update, August 26, 2014: State Agencies Credited their employees with millions of dollars' worth of unearned leave states in part that the SCO lacks sufficient automated controls to prevent state agencies from processing erroneous transactions. (See page 24 and 25)

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