

VALLEY STATE PRISON

Audit Report

PAYROLL AUDIT

March 1, 2016, through February 28, 2019



BETTY T. YEE
California State Controller

June 2021



BETTY T. YEE
California State Controller

June 29, 2021

Raythel Fisher Jr., Warden
Valley State Prison
P. O. Box 99
Chowchilla, CA 93610

Dear Mr. Fisher:

The State Controller's Office audited the Valley State Prison's (VSP) payroll process and transactions for the period of March 1, 2016, through February 28, 2019. VSP management is responsible for maintaining a system of internal control over the payroll process within its organization, and for ensuring compliance with various requirements under state laws and regulations regarding payroll and payroll-related expenditures.

Our audit determined that VSP did not maintain adequate and effective internal controls over its payroll process. VSP lacked adequate segregation of duties and compensating controls over payroll transactions, resulting in improper regular, overtime, and separation lump-sum payments. VSP also granted inappropriate keying access to the State's payroll system.

In addition, VSP did not implement controls to limit the accumulation of vacation and annual leave credits, resulting in liability for excessive balances.

VSP administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, by telephone at (916) 324-6310, or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/as

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Audit Report

Summary

The State Controller's Office (SCO) audited the Valley State Prison's (VSP) payroll process and transactions for the period of March 1, 2016, through February 28, 2019. VSP 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 March 10, 2021.

Our audit determined that VSP:

- Did not maintain adequate and effective internal controls over its payroll process. VSP lacked adequate segregation of duties and compensating controls over payroll transactions, resulting in improper regular, overtime, and separation lump-sum payments. We also found that VSP granted inappropriate keying access to the State's payroll system;
- Did not implement controls to limit the accumulation of vacation and annual leave credits, resulting in liability for excessive balances; and
- Administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

Background

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

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

Audit Authority

Authority for this audit is provided by California Government Code (GC) section 12476, which states:

The Controller may audit the uniform state pay roll system, the State Pay Roll Revolving Fund, and related records of state agencies within the uniform state pay roll system, in such manner as the Controller may determine.

In addition, GC section 12410 stipulates that:

The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.

Objectives, Scope, and Methodology

We performed this audit to determine whether VSP:

- 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 March 1, 2016, through February 28, 2019. The audit population consisted of payroll transactions totaling \$287,933,832, as quantified in the Schedule.

To achieve our audit objectives, we:

- Reviewed State and VSP policies and procedures related to the payroll process to understand VSP's methodology for processing various payroll and payroll-related transactions;
- Interviewed the VSP payroll personnel to understand VSP's methodology for processing various payroll and payroll-related transactions, determine employees 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 VSP 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 VSP:

- Did not maintain adequate and effective internal controls over its payroll process.¹ We found the following deficiencies in internal control over the payroll process that we consider to be material weaknesses:
 - Inadequate segregation of duties and a lack of compensating controls over payroll transactions (see Finding 1);
 - Inappropriate keying access to the State's payroll system (see Finding 2);
 - Failure to implement controls to ensure that VSP adhered 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 balances (see Finding 3);
 - Inadequate controls to ensure that payments for regular pay were calculated correctly and adjusted properly for absences, resulting in overpayments (see Finding 4);
 - Inadequate controls to ensure that overtime payments were calculated correctly, granted for valid overtime hours worked, and supported with adequate documentation, resulting in improper and questioned payments (see Finding 5);
 - Inadequate controls to ensure that separation lump-sum payments were calculated correctly, supported with adequate documentation, and paid in a timely manner, resulting in improper, questioned, and late payments (see Finding 6);

¹ In planning and performing our audit of compliance, we considered VSP'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; it was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. As discussed in this section, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

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

- 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:
 - Excessive vacation and annual leave balances with a value of at least \$2,069,947 as of February 28, 2019 (see Finding 3);

On October 20, 2020, the California Department of Human Resources (CalHR) directed departments to immediately suspend policies that require leave balances to be reduced below the limit, and that require employees to implement leave-reduction plans. This suspension will be in effect until the 2020 Personal Leave Program (2020 PLP) ends, or July 1, 2022, whichever is sooner;
 - Improper payments made for regular pay (see Finding 4); improper and questioned payments made for overtime pay (see Finding 5); and improper, questioned, and late payments made for separation lump-sum pay (see Finding 6); costing an estimated net total of \$1,563,086; and
- Administered salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

Follow-up on Prior Audit Findings

There were no prior payroll audits and, consequently, no prior audit findings.

Views of Responsible Officials

We issued a draft audit report on April 26, 2021. Raythel Fisher, Jr., Warden responded by letter dated May 6, 2021 (Attachment), acknowledging the findings and indicating that VSP has taken steps to correct the noted deficiencies. This final audit report includes VSP's response.

Restricted Use

This audit report is solely for the information and use of VSP, the California Department of Corrections and Rehabilitation, 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

KIMBERLY TARVIN, CPA
Chief, Division of Audits

June 29, 2021

**Schedule—
Summary of Audit Results
March 1, 2016, through February 28, 2019**

Audit Area Tested	Method of Selection	Number of Units of Population	Dollar Amount of Population	Number of Selections Examined	Selection Unit	Dollar Amount of Selections Examined	Net Total Dollar Amount of Known and Likely Issues	Finding Number
Segregation of duties	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1
System access	Targeted	15	N/A	15	Employee	N/A	N/A	2
Excess vacation and annual leave	Targeted	80	\$ 2,069,947	80	Employee	\$ 2,069,947	\$ 2,069,947	3
Regular pay	Statistical	38,618	249,880,091	77	Transaction	498,906	1,147,629	4
Overtime pay	Statistical, targeted and judgmental	18,379	25,635,142	152	Transaction	334,517	334,571	5
Separation lump-sum pay	Statistical	210	5,488,991	76	Employee	1,860,111	80,886	6
Salary advance	Targeted	111	203,554	21	Transaction	38,770	-	
Holiday pay and credit	Statistical and targeted	11,978	4,656,107	146	Transaction	58,027	-	
			<u>\$ 287,933,832</u>			<u>\$ 4,860,278</u>	<u>\$ 3,633,033</u>	

Findings and Recommendations

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

VSP lacked adequate segregation of duties within its payroll transactions unit to ensure that only valid and authorized payroll transactions were processed. VSP 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 errors 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 VSP 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. VSP 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 VSP 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 6, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that a 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 VSP:

- 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, VSP 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**

VSP lacked adequate controls to ensure that only appropriate staff had keying access to the State’s payroll system. VSP inappropriately allowed five employees keying access to the State’s payroll system and failed to immediately notify SCO of three employee classification changes with eligible keying access. 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 15 VSP employees who had keying access to the State’s payroll system at various times between March 2016 and February 2019. Of the 15 employees, five had inappropriate keying access to the State’s payroll system. Specifically, VSP did not immediately remove or modify keying access for four employees after the employees’ transfer to another agency or change in classification. For example, a Senior Personnel Specialist changed to an ineligible classification on April 1, 2016; VSP did not request to remove the employee’s access until June 1, 2016 (61 days later). VSP also did not notify PPSD that three employees, which includes two of the four employees described above, were on extended leave of absence so that PPSD can temporarily lock the employees’ keying access. VSP failed to follow guidelines set forth in the *Decentralized Security Program Manual*.

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. . . .

A request to grant access to an individual in a classification other than in the Personnel Specialist/Payroll Technician series to access PIMS, HIST, KEYM, PIP, LAS, MPC and/or ACAS requires a written justification from the Authorizing Manager. The justification must describe the individual's specific job duties requiring the need to access system information (i.e., PIMS = Employment History, HIST=Payroll History, LAS=Leave Accounting System, etc.) as well as level of access to that application, in order to perform their regular daily duties. . . .

If a user will be on an extended leave of absence (LOA), notify the PPSD Decentralized Security Administrator immediately with the users name, user id and time frame so the user id can be locked temporarily and not deleted. When the user returns to work and notify [sic] the PPSD Decentralized Security Administrator to reactivate. . . .

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 VSP:

- Update keying access to the State's payroll system immediately after employees leave VSP or change classifications; and
- Periodically review access to the system to verify that access complies with the *Decentralized Security Program Manual*.

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

VSP failed to implement controls to ensure that it adheres to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. This deficiency resulted in liability for excessive leave balances with a value of at least \$2,069,947 as of February 28, 2019. We expect the liability to increase if VSP 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 to manage leave balances and control the State's liability for accrued leave credits. State agencies may allow employees to carry a higher leave balance only under limited circumstances. For example, an employee may not be able to reduce accrued vacation or annual leave hours below the limit due to business needs. When an employee's leave

accumulation exceeds or is projected to exceed the limit, state agencies should work with the employee to develop a written plan to reduce leave balances below the applicable limit.

Our examination of VSP's leave accounting records determined that VSP had 1,022 employees with unused vacation or annual leave credits at February 28, 2019. Of the 1,022 employees, 80 exceeded the limit set by collective bargaining agreements and state regulations. For example, one employee had an accumulated balance of 2,593 hours of annual leave, or 1,953 hours beyond the 640-hour limit. Collectively, the 80 employees accumulated 37,187 hours of excess vacation and annual leave, with a value of at least \$2,069,947 as of February 28, 2019.

This estimated liability does not adjust for salary rate increases and additional leave credits.² Accordingly, we expect that the amount needed to pay for this liability will be higher. For example, a VSP employee separated from state service with 3,114 hours of leave credits, including 1,223 hours of vacation leave. After adjusting for additional leave credits, the employee was paid for 3,613 hours, or 16% more.

We further examined the records of the 80 employees to determine whether VSP complied with collective bargaining agreements and state regulations. We determined that VSP 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 VSP had no plans in place during the audit period to reduce leave balances below the limit.

If VSP 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, thus increasing their vacation or annual leave balances.

The state agency responsible for paying these leave balances may face a cash flow problem if a significant number of employees with excessive vacation or annual leave balances separate from state service. Normally, state agencies are not budgeted to make these separation lump-sum payments. However, the State's current practice dictates that the state agency that last employed an employee pays for that employee's separation lump-sum payment, regardless of where the employee accrued the leave balance.

On October 20, 2020, CalHR directed departments to immediately suspend policies that require leave balances to be reduced below the limit, and that require employees to implement leave-reduction plans. This suspension will be in effect until the 2020 PLP ends, or July 1, 2022, whichever is sooner.

² 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.

Recommendation

We recommend that, after the 2020 PLP ends, or July 1, 2022, whichever is sooner, VSP:

- 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
regular pay,
resulting in
overpayments**

VSP lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls over the processing of regular pay. We identified a total of \$1,147,629 in overpayments for regular pay, consisting of \$2,291 based on actual transactions examined (“known”) and \$ 1,145,338 based on the results of statistical sampling (“likely”). If not mitigated, these control deficiencies leave VSP at risk of making additional improper payments for regular pay.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding regular pay. Payroll records show that VSP processed 38,618 regular pay transactions, totaling \$249,880,091, between March 2016 and February 2019. Of the 38,618 regular pay transactions, we randomly selected a statistical sample (as described in the Appendix) of 77 transactions, totaling \$498,906. Of the 77 transactions, three were overpaid by \$2,291. As we used a statistical sampling method to select the regular pay transactions examined, we projected the amount of likely overpayments to be \$1,145,338. Therefore, the known and likely overpayments totaled \$1,147,629.

The following table summarizes the results of our statistical sampling:

Known overpayments	\$ 2,291
Divide by: Sample	498,906
Error rate for projection (differences due to rounding)	<u>0.46%</u>
Population that was statistically sampled	249,880,091
Multiply by: Error rate for projection	0.46%
Known and likely overpayments, (differences due to rounding)	<u>1,147,629</u>
Less: Known overpayments	2,291
Likely overpayments	<u>\$ 1,145,338</u>

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

The known improper payments occurred because payroll transactions unit staff members failed to reduce, or incorrectly recorded reductions in, leave balances for absences in the leave accounting system. VSP also lacked adequate supervisory review to ensure accurate processing of regular pay.

GC sections 13400 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 VSP:

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

We further recommend that, to prevent improper payments for regular pay from recurring, VSP:

- 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 overtime pay, resulting in improper and questioned payments**

VSP lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls over the processing of overtime pay. We identified a net total of \$334,571 in improper overtime payments, consisting of \$784 in known overpayments, \$1,635 in known underpayments, \$4,905 in known questioned payments; and \$78,972 in likely overpayments, \$7,788 in likely underpayments, and \$259,333 in likely questioned payments. If not mitigated, these control deficiencies leave VSP at risk of making additional improper overtime payments.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding overtime pay. Payroll records show that VSP processed 18,379 overtime pay transactions, totaling \$25,635,142, between March 2016 and February 2019, as follows:

<u>Overtime Payment Type by Group</u>	<u>Unit</u>	<u>Amount</u>
Work Week Group 2 (statistically sampled)	18,134	\$25,057,427
Work Week Group E (items examined 100%)	31	35,413
Work Week Group SE (examined 16 selected payments)	214	542,302
Total population	<u>18,379</u>	<u>\$25,635,142</u>

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

Of the 18,134 overtime pay transactions, totaling \$25,057,427 for Work Week Group (WWG) 2 employees, we randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling \$141,041. Of the 105 transactions, three were overpaid by approximately

\$447 and one was underpaid by approximately \$44. We also questioned six payments, totaling \$1,468, because VSP could not provide the supporting documentation. Without the required documentation, there is no record of calculation or approval of payments for overtime pay. Therefore, we could not determine the validity, accuracy, and propriety of the payments made to the employees. As a result, we questioned these payments. The known improper and questioned payments represent a net total of \$1,871.

As we used a statistical sampling method to select the overtime pay transactions examined, we projected the amount of likely overpayments to be \$78,972, likely underpayments to be \$7,788, and likely questioned payments to be \$259,333. The known improper and questioned payments represent a net total of \$330,517. Therefore, the known and likely improper and questioned payments totaled a net of approximately \$332,388, consisting of \$79,419 in overpayments, \$7,832 in underpayments, and \$260,801 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper payments, net	\$ 1,871
Divide by: Sample	141,041
Error rate for projection (differences due to rounding)	<u>1.33%</u>
Population that was statistically sampled	25,057,427
Multiply by: Error rate for projection	<u>1.33%</u>
Known and likely improper payments, net (differences due to rounding)	332,388
Less: Known improper payments, net	<u>1,871</u>
Likely improper payments, net	<u>\$ 330,517</u>

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

We also examined all 31 overtime pay transactions, totaling \$35,413, for WWG E employees who normally do not receive overtime pay unless they perform on-call or call-back assignments or duties. Of the 31 transactions, three were underpaid by approximately \$906. We also questioned two payments, totaling \$972, because VSP could not provide the supporting documentation. Without the required documentation, there is no record of calculation or approval of payments for overtime pay. Therefore, we could not determine the validity, accuracy, and propriety of the payments made to the employees. The improper and questioned payments represent a net total of \$66.

Of the 214 overtime pay transactions, totaling \$542,302, for WWG SE employees who are eligible to receive pay for on-call assignments, we judgmentally selected 16 overtime pay transactions, totaling \$158,063. Our examination of the 16 transactions determined that two were overpaid by approximately \$337 and one was underpaid by approximately \$685. We also questioned one payment, totaling \$2,465, because VSP could not provide the supporting documentation. Without the required documentation, there is no record of calculation or approval of payment for overtime pay. Therefore, we could not determine the validity,

accuracy, and propriety of the payment made to the employee. As a result, we questioned this payment. The improper and questioned payments represent a net total of \$2,117. As we examined only a judgmental selection, there could be additional improper payments.

The known improper payments were made because payroll transactions unit staff members miscalculated overtime hours worked, and paid for overtime hours worked at the straight-time rate instead of the time-and-a-half rate, or vice-versa. Furthermore, VSP lacked adequate supervisory review to ensure accurate processing of overtime pay.

GC sections 13400 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 VSP:

- Conduct a review of overtime payments 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 overtime payments from recurring, VSP:

- Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreements and state laws and policies;
- 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; and
- Maintain supporting documentation for payments pursuant to retention policies.

FINDING 6— Inadequate controls over separation lump- sum pay, resulting in improper, questioned and late payments

VSP lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls over the processing of employee separation lump-sum pay. We identified a net total of \$80,886 in improper and questioned separation lump-sum payments, consisting of \$19,218 in known overpayments, \$7,627 in known underpayments, and \$15,820 in known questioned payments; and \$37,492 in likely overpayments, and \$14,880 in likely underpayments, and \$30,863 in likely questioned payments. VSP also did not make separation lump-sum payments to eight employees in a timely manner. If not mitigated, these control deficiencies leave VSP at risk of making additional improper and late separation lump-sum payments, noncompliance with agreements and laws, and liability for late 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 VSP processed separation lump-sum payments, totaling \$5,488,991, for 210 employees between March 2016 and February 2019. Of the 210 employees, we randomly selected a statistical sample (as described in the Appendix) of 76 employees who received separation lump-sum payments, totaling \$1,860,111. Of the 76 employees, 16 were overpaid by approximately \$19,218 and 12 were underpaid by approximately \$7,627. We also questioned three payments, totaling \$15,820, because VSP could not provide the supporting documentation. Without the required documentation, there is no record of calculation or approval of payments for separation lump-sum pay. Therefore, we could not determine the validity, accuracy, and propriety of the payments made to these employees. The improper and questioned payments represent a net total of \$27,411.

As we used a statistical sampling method to select the employees whose separation lump-sum payments were examined, we projected the amount of likely overpayments to be \$37,492, likely underpayments to be \$14,880, and likely questioned payments to be \$30,863. The improper and questioned payments represent a net total of \$53,475. Therefore, the known and likely improper and questioned payments totaled a net of approximately \$80,886, consisting of \$56,710 in overpayments, \$22,507 in underpayments, and \$46,683 in questioned payments.

The following table summarizes the results of our statistical sampling:

Known improper and questioned payments, net	\$ 27,411
Divide by: Sample	1,860,111
Error rate for projection (differences due to rounding)	<u>1.47%</u>
Population that was statistically sampled	5,488,991
Multiply by: Error rate for projection	<u>1.47%</u>
Known and likely improper and questioned payments, net (differences due to rounding)	80,886
Less: Known improper and questioned payments, net	27,411
Likely improper and questioned payments, net	<u>\$ 53,475</u>

* 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 for separation lump-sum pay. VSP also lacked adequate supervisory review to ensure accurate and timely processing of separation lump-sum pay.

Of the 76 employees whose separation lump-sum payments we examined, eight were not paid in a timely manner, in violation of collective bargaining agreements and state laws as summarized in CalHR's *Human Resources Manual*, section 1703.

GC sections 13400 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 VSP:

- Establish adequate controls to ensure accurate and timely separation lump-sum payments;
- 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;
- Recover overpayments made to separated employees in accordance with GC section 19838 and *State Administrative Manual* section 8776.6, and properly compensate those employees who were underpaid; and
- Maintain supporting documentation for payments pursuant to retention policies.

Appendix— Audit Sampling Methodology

We used attributes sampling for tests of compliance. The sample design was chosen because:

- It follows the American Institute of Certified Public Accountants (AICPA) guidelines;
- It allows us to achieve our objectives for tests of compliance in an efficient and effective manner; and
- Audit areas included both high and low volumes of transactions.

The following table outlines our audit sampling application for all audit areas where statistical sampling was utilized:

Audit Area	Type of Test	Population (Unit)	Population (Dollar)	Sampling Unit	Sample Selection Method	Confidence Level	Tolerable Error Rate	Expected Error (Rate) ^a	Sample Size ^b	Results Projected to Intended Population	Finding Number
Regular pay	Compliance	38,618	\$ 249,880,091	Transaction	Computer-generated simple random	90%	5%	1 (1.25%)	77	Yes	4
Overtime pay	Compliance	18,134	25,057,427	Transaction	Computer-generated simple random	90%	5%	2 (1.75%)	105	Yes	5
Separation lump-sum pay	Compliance	210	5,488,991	Employee	Computer-generated simple random	95%	5%	2 (0.95%)	76	Yes	6
Holiday pay	Compliance	5,901	2,246,114	Transaction	Computer-generated simple random	90%	5%	2 (1.75%)	105	Yes	

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

^b For populations of fewer than 250 items, we determined the sample size using a calculator that uses a hypergeometric distribution. For populations of 250 items or more, we determined the sample size using a calculator that uses a binomial distribution. As stated in Technical Notes on the AICPA Audit Guide: Audit Sampling (March 1, 2012), page 5, although the hypergeometric distribution is the exactly correct distribution to use for attributes sample sizes, the distribution becomes unwieldy for large populations unless suitable software is available. Therefore, more convenient approximations are frequently used instead.

**Attachment—
Valley State Prison's
Response to Draft Audit Report**

VALLEY STATE PRISON
P.O. Box 99
Chowchilla, CA 93610-0099



May 6, 2021

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

Dear Mr. Finlayson:

This letter is in response to the draft report issued by the State Controller's Office (SCO) on April 26, 2021, regarding the Payroll Process Review of Valley State Prison (VSP) for the period of March 1, 2016 through February 28, 2019. Please know that VSP takes seriously its responsibility to ensure that effective payroll processes are in place and is committed to continually improving these processes.

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

Finding #1 — Inadequate segregation of duties and a lack of compensating controls over payroll transactions.

Response: VSP agrees to the audit findings and will continue its efforts to segregate duties while also balancing the ongoing challenge of shifting workloads resulting from staff turnover and vacancies. The Personnel Specialist (PS) duties and responsibilities consist of processing various personnel/payroll transactions, including data entry, reconciliation, and processing adjustments and corrections. Over the years, these duties have increased significantly for the PS's, Senior PS, and Personnel Supervisor I. VSP continues with the implementation of the Business Information System and Telestaff programs, which have built-in controls to ensure segregation of duties. For example, the timekeeper's duties do not overlap with the personnel transactions staff who key into the payroll system.

In addition, we have implemented the Electronic Personnel Operation Manual (ePOM) Section 702, Accurate and Timely Leave Accounting Procedures, to ensure the Personnel Supervisor and Senior Personnel Specialists perform monthly reviews of timesheets to reconcile pay and leave, as well as periodic reviews of payments keyed into the payroll system by our personnel staff. VSP will also develop formal procedures for performing and documenting compensating controls.

Finding #2 — Inappropriate keying access to the State's payroll system.

Response: VSP has confirmed that all employees with current SCO access are authorized, in order to avoid inappropriate keying access to the State's payroll system. VSP will also follow the SCO Decentralized Handbook procedures for removing or adding SCO access for staff. VSP has also implemented internal controls such as risk assessments, control activities, information and communication, and monitoring to prevent errors or undesirable outcomes before they occur.

VSP has implemented a monthly audit tool to ensure the PSD 125A is properly tracked and monitored.

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

Response: VSP agrees to the audit findings and has implemented the leave reduction plan requirements effective July 2019 to comply with the applicable leave reduction effort policies. The requirements will require employees with leave balances over the cap to have leave reduction plans that are approved by their respective supervisors. On June 4, 2019, the "Leave Reduction Plan Requirements - Action Due by July 5, 2019" memorandum was distributed to all staff from the CDCR HR Mailbox, which requires the completion and documentation of leave reduction plans for all employees in excess of or approaching leave credit balance limitations. This annual process will assist in reducing vacation and annual leave balances in order to avoid future liability for excessive balances. VSP has implemented these internal controls to minimize the Department's future liabilities. However, effective October 26, 2020, the California Department of Human Resources suspended leave reduction plan requirements for the duration of the 2020 Personal Leave Program (PLP), or July 1, 2022. Although the leave reduction plan requirements are temporarily suspended, when operationally feasible, managers and supervisors are encouraged to work with employees to reduce leave balances utilizing PLP and vacation/annual leave for scheduled time off.

Finding #4 — Inadequate controls over regular pay, resulting in overpayments.

Response: To ensure accurate and timely controls over regular pay and to prevent improper or questionable payments, VSP will use the updated ePOM Section 730: Accurate and Timely Leave Accounting Records, released April 24, 2020. VSP will train personnel staff on ePOM Section 730 to ensure employee pay is correct and avoid any overpayments or underpayments. VSP will conduct a review of payments identified by SCO to ensure that the payments comply with collective bargaining agreements and State laws and policies. VSP will start the accounts receivable process to recover any overpayments made to employees through an agreed-upon collection method in accordance with Government Code (GC) Section 19838.

Finding #5 — Inadequate controls over overtime pay, resulting in improper and questioned payments.

Response: VSP will remind all personnel staff of the correct tools and processing to ensure adequate controls over the processing of overtime pay. In addition, VSP will use the updated ePOM Section 730, Accurate and Timely Leave Accounting Records, which provides procedures to audit timesheets to ensure accurate pay. VSP will also continue to ensure all personnel staff receive training provided by SCO. VSP will conduct an internal review of overtime payments made during the past 3 years to ensure that the payments comply with collective bargaining agreements and State laws and policies. VSP will start the accounts receivable process to recover any overpayments made to employees, through an agreed-upon collection method in accordance with GC Section 19838.

Finding #6 — Inadequate controls over separation lump-sum pay, resulting in improper, questioned, and late payments.

Response: VSP will use the Lump Sum Memorandum, Personnel Information Bulletin, and Form released in October of 2020 to ensure all lump sum calculations are correct and timely. This Personnel Information Bulletin provides processing instructions to PS's for deferring lump sum separation pay into the next calendar year, as well as instructions for deferrals into a Savings Plus Plan. VSP will also use the "Online Support for 2020 Lump Sum Separation Pay Documentation and Processing" toolkit. The toolkit provides a Guide for Avoiding Common Errors, Lump Sum Documentation and Processing, Lump Sum Worksheet, and Lump Sum Pretax Calculator. All of these tools will aid VSP to ensure all lump sum calculations are correct and timely.

VSP welcomes insights provided by the auditors and would like to thank SCO for its work on this report. Should you have any questions, please contact Nancy Clark, Institutional Personnel Officer, at (559) 665-6100, ext. 5536.

Sincerely,



RAYTHEL FISHER, JR.
Warden
Valley State Prison

**State Controller's Office
Division of Audits
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