DGS

MEMORANDUM

Date: November 24, 2009 File No. 8163

To: Maria Lopez, Personnel Officer
Office of Human Resources
707 3rd Street, 7th Floor
West Sacramento, CA 95605

From: **Department of General Services**
Office of Audit Services

Subject: **REVIEW OF THE SYSTEMS OF INTERNAL CONTROL FOR PERSONNEL AND PAYROLL**

This report presents the results of our review of the systems of internal control for personnel and payroll. These systems are primarily administered by the Office of Human Resources (OHR). This review was conducted as part of the Office of Audit Services' biennial review of the Department of General Services' (DGS) systems of internal control. The objective of the review was to determine the adequacy and effectiveness of the systems of internal control for personnel and payroll. Our review was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

Overall, we found that OHR has implemented sufficient policies and procedures for five of the seven control objectives evaluated during our review. Specifically, OHR has established adequate and effective systems of internal control for: (1) initiating and processing personnel/payroll transactions; (2) separating duties involved in the personnel/payroll function; (3) approving and certifying personnel/payroll transactions by authorized personnel only; (4) recording payroll expenditures correctly, staying within budget and allocating costs to the correct fund and program; and, (5) following State policies and procedures regarding employee leave. Further, except for a need for improvement in the process used to calculate lump sum pay due to separating employees, we found that OHR is maintaining adequate clearance procedures for separating employees.

As discussed under the Review Results section of the report, we identified areas for improvement related to policies and procedures used to process salary overpayments and advances and to calculate lump sum pay due to separating employees. Recommendations to address the following issues are presented in this report.

- Salary overpayment policies and procedures are not ensuring that amounts owed by current and separated employees are promptly collected by the department.

- Current policies and procedures are not ensuring that supervisory personnel verify the accuracy of lump sum pay calculations for separating employees. Because of the complexity of its calculation and the importance of its accuracy, the performance of a supervisory review of each lump sum payment calculation is a necessary control procedure.

- Policies and procedures have not been implemented which ensure that salary advances are recovered in a timely manner.

During our review we also identified other matters requiring attention that we discussed with the OHR's management but are not included in this report.

OBJECTIVE AND SCOPE

The objective of our review was to determine the adequacy and effectiveness of the systems of internal control for the personnel and payroll transaction cycle. A transaction cycle is defined as the route by which a type of transaction flows from inception to final reporting.

Our review of personnel and payroll operations primarily involved determining whether sufficient policies and procedures have been implemented to provide reasonable assurance that: (1) assets are safeguarded against loss from unauthorized use or disposition; (2) transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements; and, (3) financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual (SAM). Reasonable assurance is provided when cost-effective actions are taken to restrict deviations to a tolerable level. These actions should result in material errors and improper or illegal acts being prevented or detected and corrected within a timely period by employees in the normal course of performing assigned duties.

METHODOLOGY

To determine the adequacy and effectiveness of the systems of internal control for personnel and payroll, we reviewed policies and procedures, interviewed parties involved, observed operations, tested records and transactions and performed other tests as deemed necessary. An audit guide issued by the Department of Finance was used to assist us in our evaluation of the systems of internal control. The audit guide identified the following seven control objectives that were evaluated during our review: (1) established policies and procedures exist for initiating and processing personnel/payroll transactions; (2) adequate separation of duties exist over the personnel/payroll function; (3) personnel/payroll transactions are properly approved and certified by authorized personnel only; (4) payroll expenditures are recorded correctly, stay within budget and are allocated to the correct fund and program; (5) State policies and procedures are followed regarding employee leave; (6) adequate clearance procedures exist for separating employees; and, (7) collection procedures for salary overpayments and advances assure appropriate action on outstanding accounts.

The following information was developed based on our fieldwork that was primarily completed in December 2008. We also performed limited follow-up work in October 2009 related to the current status of salary overpayment collection activities. Although the finalization of our report was delayed due to other high priority assignments, as findings were observed and developed during our audit fieldwork, OHR's management was promptly advised of any areas of concern so that they could begin taking corrective action. Further, at a December 2008 audit exit conference, OHR was provided a detailed written summary of issues noted during our review.

REVIEW RESULTS

Overall, we found that OHR has implemented sufficient policies and procedures for five of the seven control objectives evaluated during our review. Specifically, OHR has established adequate and effective systems of internal control for (1) initiating and processing personnel/payroll transactions; (2) separating duties involved in the personnel/payroll function; (3) approving and certifying personnel/payroll transactions by authorized personnel only; (4) recording payroll expenditures correctly, staying within budget and allocating costs to the

correct fund and program; and, (5) following State policies and procedures regarding employee leave. Further, except for a need for improvement in the process used to calculate lump sum pay due to separating employees, we found that OHR is maintaining adequate clearance procedures for separating employees. As discussed below, OHR needs to improve its collection procedures for salary overpayments and advances to assure appropriate action on outstanding accounts.

The following sections present our detailed findings and recommendations based on our review of policies and procedures used to collect employee salary overpayments and advances and to calculate lump sum pay due to separating employees. Our recommendations are provided to aid management in improving systems of internal control. The three findings discussed in this section represent repeat issues that were originally included in our last audit report on OHR's systems of internal control which was issued on December 29, 2003.

SALARY OVERPAYMENTS – COLLECTION PROCESS

The OHR has not established and implemented adequate and effective policies and procedures for the collection of employee salary overpayments. In brief, based on our original evaluation and testing of policies and procedures performed in late 2008 and limited follow-up work in October 2009, we determined that the salary overpayment collection process does not provide for the: maintenance of comprehensive written policies and procedures governing the collection process; assignment of staff to perform follow-up collection activities for long-outstanding receivables; supervisory review of collection activities performed by staff; maintenance of complete and comprehensive files of collection activities; monthly reconciliation of outstanding amounts owed as shown on records maintained by the State Controller's Office, Office of Fiscal Services (OFS) and the OHR; monitoring of past-due aging reports; coordination of collection activities with the OFS; and, timely performance of discharge from accountability activities.

As shown in the following paragraph, the large number of long outstanding accounts and associated dollar amounts disclose an obvious need to more actively manage the collection process. In general, salary overpayments owed by current employees should be collected within a year and amounts owed by separated employees should be immediately pursued for recovery. Further, departments are to review their accounts receivable no less than quarterly to identify receivables for processing for discharge from further collection activities. Because of the obvious lack of systematic collection procedures, we did not attempt to perform in-depth testing of a large sample of individual transactions. However, we found that only 3 of 14 separated employees included in our sample tests had at least some documentation readily available of actions taken by the OHR to collect the long-outstanding receivable and even those three receivables had no recent collection or discharge actions noted in the OHR's files.

Based on information provided by OFS during our original audit fieldwork, as of September 30, 2008, outstanding salary overpayment receivables totaled $581,109, with $249,991 (43%) dating prior to June 30, 2007, i.e., over 15 months old. Further, as of September 30, 2009, outstanding salary overpayment receivables increased to $694,984, with $384,793 (55%) dating prior to June 30, 2008. The number of accounts outstanding totaled over two thousand during these periods.

Our observations and discussions with OHR management and staff disclosed that other operating responsibilities and priorities have impacted the office's ability to perform ongoing,

timely and effective collection activities. Further, staff turnover has impacted the office's ability to effectively perform these responsibilities.

State employees may not legally receive more money than they have earned for each pay period, however, inadvertent overpayments do occur. Overpayments occur for various reasons, such as: certification of erroneous salary rates, effective dates, or time worked; disapproval by control agencies of appointments or promotions; and, coding or key data entry errors. The State's requirements for the collection of salary overpayments are contained in SAM Sections 8593, 8776.6 and 8776.7, and include detailed policies and procedures for the timely collection of overpayments made to both current and separated employees. As a governing principle, each department must have in-place procedures that ensure the prompt collection of amounts owed to the State.

This finding is a repeat issue that was previously reported by us in an audit report issued on December 29, 2003. In a written response to that report and a subsequent August 11, 2004 status report, OHR indicated that it had taken actions to improve its salary overpayment policies and procedures. The response included such key activities as ensuring that staff review and research outstanding salary overpayments monthly and perform immediate collection activities. Further, a specialist was to be assigned to actively manage the overpayment process and supervisors were also to actively monitor that process. Our current audit disclosed that the activities presented to us in the responses to our previous audit are no longer being actively performed.

Recommendation

1. Implement policies and procedures that ensure the prompt collection of salary overpayments. As part of this process, the collection function should be actively managed through the: use of comprehensive written policies and procedures; timely performance of supervisory review activities; documentation of collection activities; monthly reconciliation of outstanding receivables; monitoring of past-due aging reports; close coordination of activities with the OFS; and, timely performance of discharge from accountability activities. As part of this process, the OHR should consider assigning a staff member(s) whose duties and responsibilities are primarily focused on the salary overpayment collection process.

SEPARATING EMPLOYEES – LUMP SUM PAY

Operating policies and procedures continue to not ensure that supervisory personnel verify the accuracy of lump sum pay calculations prior to the disbursement of the pay to separating employees. Specifically, our review of the separation documents for a sample of 38 employees found that in 22 instances documentation was not available which showed that a supervisor had reviewed the lump sum pay calculation. A lump sum payment for compensable leave balances is made to employees upon their separation from State service. The balances that are compensable are vacation, annual leave, holiday credits, excess hours, compensating time off and Personal Leave Program credits. Because of the complexity of calculating the payment and the importance of its accuracy, OHR's written procedures require that supervisors review lump sum pay calculations for separating employees.

Our in-depth review of lump sum pay calculations did disclose instances whereby a supervisory review process may have prevented an erroneous payment. In sampling the accuracy of lump sum payments made to the 38 separating employees, we found that six of them had errors made in calculating or paying lump sum pay. Of the six payments, five did not have

documentation available which showed that a supervisor reviewed the separation calculation. It should be noted that the OHR, when advised of the results of our audit testing, took prompt action to address the six exceptions noted in our review including either recovering overpaid amounts or paying underpaid amounts.

The above finding is a repeat issue that was previously reported by us in an audit report issued on December 29, 2003. In a written response to that report and a subsequent August 11, 2004 status report, OHR indicated that it agreed with our finding and had taken actions to improve separation pay policies and procedures.

Recommendation

2. Reemphasize to supervisors the importance of reviewing the accuracy of lump sum pay calculations. Further, the completion of this duty should be clearly documented on the separation documents.

SALARY ADVANCES – COLLECTION AND DOCUMENTATION PROCESSES

The OHR has not implemented policies and procedures which ensure that salary advances are being recovered in a timely manner. Specifically, in its response to our previous December 2003 audit and in a subsequent August 2004 status report, OHR indicated that effective in February 2003 it had implemented a process that required staff to submit and supervisors to review a monthly status report on outstanding salary advances. The status report was to include comments on actions taken to clear each advance. The process was implemented due to recognized deficiencies in the performance of timely salary advance collection actions within the OHR.

During our current review we found that the above salary advance monitoring process was no longer in use. In fact, the current manager of the Personnel Transactions Unit, who has been in that position since June 2008, was not aware of the existence of the previous process until advised by audit staff. To ensure sufficient control of the salary advance and collection process, we believe the procedures for monthly monitoring of outstanding salary advances should be reinstituted.

As of September 30, 2008, $16,126 (21%) of the $77,926 in salary advances was outstanding over 90 days, with the oldest dating to March 1999. Based on our review of the 28 advances comprising the $16,126 amount, we found that most of the transactions had little if any documentation readily available describing staff's collection activities, such as an installment plan being established for repayment. Since most salary advances should be promptly collected through offset by a State Controller's pay warrant, any balance outstanding over 90 days should be closely monitored by supervisors to ensure that appropriate and timely collection actions are being taken. The State's accounts receivable collection policies are provided in SAM Sections 8776.6 and 8776.7.

In addition, we developed concerns that current procedures are not ensuring that staff always complete the Reason for Request section of the salary advance revolving fund request form, ASD-950. The ASD-950 form is used to document details on each individual salary advance, including the reason for the request and how the advance was computed. Our review of 48 advance request forms found that 19 did not have sufficient information on the ASD-950 form to allow us to readily determine the reason for the advance. Although we found that both OHR and Office of Fiscal Services' supervisors approved the requests which lessen the risk of

noncompliance, an adequate audit trail should be maintained for all salary advance transactions.

SAM Section 8595 requires that the specific reason for the advance must be written on the advance request form and provides that, normally, agencies will make office revolving fund payments to employees for salary earned only when: (1) there have been errors or delays in submitting or processing documents making it impossible for the State Controller's Office to prepare and deliver proper salary warrants within a reasonable time; or, (2) separating employees are in immediate need of their final salary payments. However, agencies may, at their discretion, make payments of salaries earned where it is necessary to alleviate serious, unforeseeable hardship.

Recommendations

3. Reinstitute the policies and procedures that require staff to submit and supervisors to review a monthly status report on outstanding salary advances.
4. Reemphasize to staff the necessity of completing the Reason for Request section of the salary advance revolving fund request form, ASD-950.

CONCLUSION

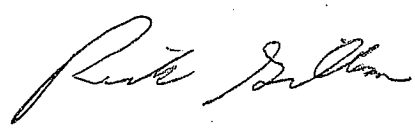
The issues presented in this report should be addressed to assist in improving the DGS' systems of internal control for its personnel and payroll operations. It should be noted that when advised of areas for improvement during our audit fieldwork the OHR's management either took immediate action or indicated that appropriate action would be taken to address our concerns. This provides an indication of management's significant commitment to improving systems of internal control.

Management should be aware that controls cannot prevent all problems because they would not be cost-effective. Moreover, the effectiveness of controls change over time. Limitations which may hinder the effectiveness of an otherwise adequate system of controls include resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. The presence of these limitations may not always be detected by an audit.

Your response to each of our recommendations (Attachment I), as well as our evaluation of the response (Attachment II), are presented as attachments to this report.

We greatly appreciated the cooperation and assistance provided by OHR's personnel.

If you need further information or assistance on this report, please contact me at (916) 376-5058, or Andy Won, Audit Supervisor, at 376-5052.



RICK GILLAM, CPA, CIA
Chief, Office of Audit Services

cc: Scott Harvey, Chief Deputy Director
Deborah Baker, Deputy Director, Administration Division
Louise Norton, Manager, Personnel Transaction Unit

State of California • State and Consumer Services Agency • Arnold Schwarzenegger, Governor

DGS DEPARTMENT OF GENERAL SERVICES
Administration Division Office of Human Resources

November 17, 2009

Department of General Services
Rick Gillam, CPA, CIA
Chief, Office of Audit Services
707 3rd Street
West Sacramento, CA 95605

Dear Mr. Gillam:

This letter outlines the Office of Human Resources (OHR), Personnel Transaction Unit (PTU) responses to the areas of concern raised in the review of the Systems of Internal Control for Personnel and Payroll.

Salary Overpayments – Collection Process

Findings: The OHR has not established and implemented adequate and effective policies and procedures for the collection of employee salary overpayments.

Recommendation: Implement policies and procedures that ensure the prompt collection of salary overpayments.

OHR Response: The internal audit was already in progress at the time a newly appointed Staff Services Manager I assumed the PTU managerial duties. The PTU manager met with the auditor and an audit supervisor during the various stages of the audit to gain an understanding of areas of concern noted by the auditors and to provide responses to their questions and concerns.

The PTU manager met with the PTU analyst to review the procedures already in place. Feedback from the review was provided to the analyst and the necessary changes have been made, which has resulted in new procedures that are in draft format. PTU management has implemented some of the changes in the procedures even though they have not been finalized.

The PTU manager has met with OFS staff to gain a clear understanding of the Past Due Invoice Report. This report contains information that is utilized by both PTU and OFS staff and as such, contains terminology specific to each area. It was necessary to have an understanding of this report in order to accurately use it in the reconciliation of the Accounts Receivables process. During this meeting, it was discovered that the report did not contain all of the information that the PTU staff need in order to reconcile the outstanding A/Rs. The PTU manager will work with the ABMS and ITSD staff to incorporate these changes into the report.

One of OHR-PTU's objectives in our Strategic Plan is to reduce the number of outstanding A/R's by 25% by the end of this Fiscal Year. A form has been developed to track the monthly outstanding A/Rs by Program utilizing the Past Due Invoice Report.

A PTU staff member has been identified to be the lead on reconciling and tracking the A/Rs. This will ensure that the A/Rs are established, the employees are notified timely and the correct collection method is implemented (Agency Collect or Payroll Deduction). This staff member will also be the lead on the discharge from accountability activities, monitoring past-due aging reports and will work closely with the PTU staff and supervisors. The outstanding A/Rs will be tracked using the newly developed form as another means of ensuring the A/R collection process is implemented correctly. The PTU manager met with this staff member and a timeline for implementation of the new duties has been established and the timeline has been incorporated into PTU's action plan.

The PTU manager and several staff members participated in a Better, Faster, Cheaper workgroup. In this workgroup it was determined that one way to reduce some of the A/Rs was to change the way the hiring paperwork for new State employees was handled. This change has been implemented with all Program Attendance Clerks and Personnel Liaisons. They are responsible for providing the new employee information to the PTU staff prior to their start date or within one to two days of their actual start date. This change helps to eliminate A/Rs by ensuring health benefit forms are processed timely and the employee's information is keyed timely into the State Controllers Office (SCO) system.

Another challenge that PTU staff have, is the timely completion and approval of timesheets in PAL. Timesheets that are not completed and approved timely may result in Late Dock. When warrants are released by the specialist without knowledge of the late dock, than an A/R must be established to collect the salary overpayment. OHR and PTU management will continue to educate Program supervisors and managers as to the importance of timely completion and approval of timesheets.

PTU staff will continue to work with the OFS staff to identify and implement process improvements.

Separating Employees – Lump Sum Pay

Findings: Operating policies and procedures do not ensure that supervisory personnel verify the accuracy of lump sum pay calculations prior to the disbursement of the pay to separating employees.

Recommendation: Reemphasize to supervisors the importance of reviewing the accuracy of lump sum pay calculations. Further, the completion of this duty should be clearly documented on the separation documents.

OHR Response: The procedures for separating employees who have lump sum pay are being reviewed and necessary changes are being made. The lump sum calculation worksheet will be revised to include the Personnel Specialist and Supervisor signatures and date of review. This worksheet will be required to be kept in the Official Personnel File (OPF) along with the completed separation Personnel Action Request (PAR) and separation checklist.

Supervisors and Specialists will be reminded of the required second review of the lump sum calculation during monthly All Staff meetings.

Salary Advances – Collection and Documentation Processes

Findings: The OHR has not implemented policies and procedures which ensure that salary advances are being recovered in a timely manner.

Recommendations: A. Reinstitute the policies and procedures that require staff to submit and supervisors to review a monthly status report on outstanding salary advances

and

B. Reemphasize to staff the necessity of completing the Reason for Request section of the salary advance revolving fund request form, ASD-950.

OHR Response: The PTU manager met with the PTU analyst to review the procedures already in place. Feedback from the review was provided to the analyst and the necessary changes have been made, which has resulted in new procedures that are in draft format. PTU management has implemented most of the changes in the procedures even though they have not been finalized.

Reducing the number of outstanding S/As by 25% by the end of this Fiscal Year is also in OHR-PTU's Strategic Plan.

A. Reinstitute the policies and procedures that require staff to submit and supervisors to review a monthly status report on outstanding salary advances

While the current PTU manager was not aware of the previous process that was implemented in August 2004, upon starting her assignment, she was made aware of a monthly report provided to PTU staff by OFS. This report is a listing of all outstanding Salary Advances (S/As) and contains pertinent information for the employees who have received the S/As. The new manager took it upon herself to monitor the report monthly by sending email notices to the PTU staff whose roster contained the employees with outstanding A/Rs and requiring staff to respond with a status of action taken or to be taken on the S/A. The manager compared the previous month's report to the current month's report upon receipt from OFS to track the S/As that had been cleared or not cleared. This responsibility was then assigned to a Personnel Supervisor I (PS I)after the vacant PS I positions had been filled. The assigned PS I is currently following the same format implemented by the PTU manager. These steps will be incorporated into the updated procedures.

B. Reemphasize to staff the necessity of completing the Reason for Request section of the salary advance revolving fund request form, ASD-950.

The updated procedures include detailed steps in completing the ASD-950. (The ASD-950 form has been updated and renumbered to GS 950.) The PTU manager will meet with OFS management to ensure that the updated form includes all pertinent information required by OFS to process the S/A request. The Reason for Request is under item 6 on the GS 950 form and a box has been added to indicate How the S/A will be Cleared.

PTU management is also looking at making the S/A request process automated and have briefly spoken with OFS management regarding the change and has received positive feedback from them.

PTU staff will be reminded of the importance of completing the S/A request form completely during PTU All Staff meetings.

In closing, the OHR is committed to improving the effectiveness and efficiency of our internal control processes, and we believe significant steps have been implemented which will generate positive results.

Please feel free to contact me at (916) 376-5413 if you have any questions.

Deborah Vaughn, Chief
Office of Human Resources

cc: Maria Lopez, Manager, Personnel Operations
Louise Norton, Manager, Personnel Transaction Unit

ATTACHMENT II

OFFICE OF HUMAN RESOURCES
INTERNAL CONTROL REVIEW

EVALUATION OF OHR'S RESPONSE

We have reviewed the response by the Office of Human Resources (OHR) to our draft report. The response indicates that appropriate actions are being taken to address our recommendations. We appreciate the efforts taken or being taken by the OHR's personnel to improve internal controls. The promptness of these efforts continues to disclose their significant commitment to improving operating policies and procedures.