

Date: November 22, 2017 File No. 6166

To: Estela Gonzales, Chief
Office of Human Resources
707 3rd Street, 7th Floor
West Sacramento, CA 95605

From: Department of General Services
Office of Audit Services

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

Attached is the final report on our review of the systems of internal control for personnel and payroll. The objective of our review was to determine the adequacy and effectiveness of those systems.

The Office of Human Resources' (OHR) written response dated November 9, 2017 to a draft copy of this report is included as an attachment to the report. The report also includes our evaluation of the response as an attachment. We are pleased with the actions being taken to address our recommendations.

As part of its operating responsibilities, the Office of Audit Services (OAS) is responsible for following up on its recommendations. Therefore, please submit a status report on the implementation of the recommendations to the OAS by May 25, 2018. The necessity of any further status reports will be determined at that time.

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

If you have any questions, please call me at (916) 376-5058, or Christine Pham, Management Auditor, at (916) 376-5060.



ANDY WON
Deputy Director, Office of Audit Services

Attachment

cc: Daniel C. Kim, Director
Jeffrey McGuire, Chief Deputy Director
Miles Burnett, Deputy Director, Administration Division
Susan Wong, Staff Services Manager II, Personnel Transactions Unit
Estella Ceja, Staff Services Manager I, Personnel Transactions Unit
Dorthia Lampley, Staff Services Manager I, Personnel Transactions Unit

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Subject: REVIEW OF THE SYSTEM 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 Auditing¹.

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.

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. 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.
- Personnel files are lacking evidence showing compliance with checkout procedures.
- Policies and procedures do not adequately 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.

¹ OAS is currently undergoing an Independent Quality Self-Assessment Validation by the Department of Finance.

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 October 2016. We also performed limited follow-up work in June 2017 related to the current status of salary overpayment and salary advance 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 the October 2016 audit exit conference, we discussed in detail the audit findings with management.

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 maintenance of the Separation Document Checklist, DGS OHR 71, form and Employee's Separation Clearance Checklist, DGS OHR 11, form, 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 ensure appropriate actions are taken 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 for both current and separating employees. Our recommendations are provided to aid management in improving systems of internal control. The two of 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 November 24, 2009.

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 during our audit fieldwork in October of 2016 and limited follow-up work in June 2017, we determined that the salary overpayment collection process does not provide for the: maintenance of comprehensive written policies and procedures governing the collection process; prioritizing 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. Monthly reviews of the accounts receivable reports should be performed to ensure there is ongoing collection activity. Further, OHR should review its accounts receivable no less than quarterly to identify receivables for processing for discharge from further collection activities. Due to the lack of systematic collection procedures, we did not perform in-depth testing of a large sample of individual transactions. However, we found that of 10 sampled employees, 5 had separated with an outstanding overpayment of \$19,764 and the remaining 5 currently employed had overpayments of \$12,363. Only 1 of 5 separated employee and 2 of 5 currently employed included in our sample tests had at least some documentation readily available of actions taken by the OHR to collect the long-outstanding receivable.

Based on information provided by OFS during our original audit fieldwork, as of May 31, 2016, outstanding salary overpayment receivables totaled over \$1.2 million, with \$800,845 (64%) dating over 3 years old.

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 procedures in place to 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 November 24, 2009. In a written response to that report, OHR indicated that it had taken actions to improve its salary overpayment policies and procedures. The response included such key activities as identifying a lead on reconciling and tracking the A/Rs and monitoring past-due reports. Our current audit disclosed that the activities presented to us in the response 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 – SEPARATION PROCESS

Operating policies and procedures do not ensure that prior to an employee separation, a check-out list to document that all outstanding advances, outstanding accounts receivables, and state-owned property is returned. Specifically, our review of the separation packages for a sample of 10 employees found that in 9 instances documentation was not available showing separation documents submitted. Further, in all 10 instances, samples did not have evidence in the file to show if the employee had state owned property returned.

Our in-depth review of the separation process identified that the separation package that includes the Separation Document Checklist (DGS OHR 71) and the Employee's Separation Clearance Checklist (DGS OHR 11) are not being maintained by the personnel specialist. Although the attendance clerks are initially responsible for preparing the separation package, OHR is overall responsible for ensuring that salary warrants will not be distributed to separating employees until the department has verified that all travel and salary advances have been paid (cleared) as contained in SAM Section 8580.4.

Further, because amounts owed by a separating employee, other than salary and travel advance will not be deducted from an employee's final separation pay, the verification of any outstanding accounts receivable would provide OHR with an opportunity to begin the collection process under SAM Section 8776.6.

Recommendation

2. Reinstigate current policies and procedures to attendance clerks to ensure a Separation Document Checklist, DGS OHR 71, form and Employee's Separation Clearance Checklist, DGS OHR 11, form are included in the separation package submitted to OHR.
3. Policies and procedures should ensure that the personnel specialist review and sign the separation package for separating employees to ensure that the separation process is adequately followed and collection efforts are initiated.

SALARY ADVANCES – COLLECTION AND DOCUMENTATION PROCESSES

The OHR has not implemented policies and procedures which ensure that salary advances are accurately prepared and recovered in a timely manner. Further, policies and procedures do not adequately address those employees with direct deposit that have an outstanding salary advance, or those that separate from DGS with an outstanding salary advance. Specifically, in its response to our November 2009 audit, OHR indicated that it 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 not actively being done and outstanding salary advances were not being effectively tracked. To ensure sufficient control of the salary advance and collection process, we believe the procedures for monthly monitoring of outstanding salary advances should be reinstated.

As of June 30, 2016, (74%) of the \$34,140 in salary advances was outstanding over 90 days, with the oldest dating to November 2006. Based on our review of the 27 advances comprising the \$18,745 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, GS 950. The GS 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 27 advance request forms found that 7 did not have sufficient information on the GS 950 form or the GS 950 form was not found in the file.

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.

The above finding is a repeat issue that was previously reported by us in an audit report issued on November 24, 2009. In a written response to that report, OHR indicated that it agreed with our finding and had taken actions to improve the salary advances policies and procedures.

Recommendations

4. Reinststitute the policies and procedures that require staff to submit and supervisors to review a monthly status report on outstanding salary advances.
5. Reemphasize to staff the necessity of completing the Reason for Request section of the salary advance revolving fund request form, GS 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 changes 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 Christine Pham, Management Auditor, at 376-5060.



ANDY WON
Deputy Director, Office of Audit Services

cc: Daniel C. Kim, Director
Jeffrey McGuire, Chief Deputy Director
Miles Burnett, Deputy Director, Administration Division
Susan Wong, Staff Services Manager II, Personnel Transactions Unit
Estella Ceja, Staff Services Manager I, Personnel Transactions Unit
Dorthia Lampley, Staff Services Manager I, Personnel Transactions Unit



MEMORANDUM

Date: November 9, 2017

To: Andy Won, Chief
Office of Audit Services
Department of General Services

From: 
Estela Gonzales, Chief
Office of Human Resources
Department of General Services

Subject: **RESPONSE TO AUGUST 2017 AUDIT FINDINGS**

This memo outlines the Office of Human Resources (OHR), Personnel Transactions Unit (PTU) response to the areas of concern raised in the review of the internal controls for Personnel and Payroll.

1. SALARY OVERPAYMENTS – COLLECTION PROCESS

Findings:

OHR has not established and implemented adequate and effective policies and procedures for the collection of employee salary overpayments. All overpayments are to be collected through an Accounts Receivable (AR). The AR collection process does not provide for the:

- maintenance of comprehensive written policies and procedures governing the collection process;
- prioritizing 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 OHR;
- monitoring of past-due aging reports;
- coordination of collection activities with the OFS; and,
- timely performance of discharge from accountability activities.

ARs owed by current employees should be collected in one year and ARs owed by separated employees should immediately be pursued for recovery.

OAS sampled 10 employees from the period of December 2006 through October 2015; five of whom have separated had outstanding ARs totaling \$19,764.31 and five active employees had outstanding ARs totaling \$12,363.20. As of May 31, 2016, OFS reported OHR's total outstanding ARs amount is \$1,254,349.69, with \$800,845 (64%) dating over three years old.

Recommendation:

OAS recommended OHR implement policies and procedures ensuring the prompt collection of accounts receivables (AR). 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 OFS; and, timely performance of discharge from accountability activities. In addition, OHR should consider assigning staff member(s) whose duties and responsibilities are primarily focused on the salary overpayment collection process.

OHR Response:

OHR acknowledges the need to implement strategies to reduce the number of ARs. OHR and OFS will be meeting monthly to develop a system that accurately captures all types of ARs and to resolve outstanding issues.

Additionally, as of February 8, 2017, the AR section of the Transactions Operations Manual was revised and updated to include step by step AR collection instructions. The new process requires tracking of ARs from inception to close. The PTU supervisors and subordinate staff have received training and understand their roles and responsibilities on existing control agency policies and procedures, as well as, PTU's internal process.

Finally, supervisors and managers are now required to monitor subordinate staff to ensure that collection activities are timely and documented appropriately. As a second avenue of oversight, a Senior Personnel Specialist has been appointed and assigned to closely monitor all ARs including the collection method (agency/payroll deduction), follow-up, and tracking of ARs. The Senior Personnel Specialist is also required to monitor AR reports to ensure aging issues are identified and resolved. PTU staff began the collection process on all collectable ARs and will continue until all outstanding ARs have been collected.

2. SEPARATING EMPLOYEES – SEPARATION PROCESS

Findings:

Operating policies and procedures do not ensure that prior to an employee separation, a check out list to document that all outstanding advances, outstanding ARs, and state owned property is returned. Specifically, the separation packages for a sample of 10 employees found that in 9 instances, documentation was not available showing separation documents submitted. Further, in all 10 instances, samples did not have evidence in the file to show if the employee had state owned property returned.

Recommendation:

Reinstitute current policies and procedures to attendance clerks to ensure the following separation forms are included in the separation package submitted to OHR; Separation Document Checklist form (DGS OHR 71) and Employee's Separation Clearance Checklist form (DGS OHR 11).

OHR Response:

PTU implemented a 2-day training for all ACs/PLs. This training is administered every two months and outlines the separation process including the DGS OHR 71 and DGS OHR 11 process. PTU works closely with program managers to ensure attendance clerks are enrolled

and attend scheduled training. This training provides guidance and training on the importance of timely notification of separating employees.

Additionally, an AC Manual was created to outline all relevant AC processes and is located on OHR's website. The manual has a section dedicated to the process of separating employees and the forms for which they are responsible to submit: the DGS OHR 71 and DGS OHR 11.

Once a separation has been entered in ABMS by the AC/PL, an alert is generated. Once the alert is received by the Personnel Specialist, the Personnel Specialists have been instructed to follow up with the AC/PL for the timely submittal of the DGS OHR 71 and DGS OHR 11. PTU supervisors and managers will monitor separation alerts to ensure all documentation, monies, and equipment has been received.

3. SALARY ADVANCES – COLLECTION AND DOCUMENTATION PROCESS

Findings:

OHR has not implemented policies and procedures to ensure salary advances (SAs) are prepared and recovered in a timely manner as noted in the November 2009 audit. In 2009, OAS indicated OHR had implemented a process requiring staff to submit their SAs to supervisors and for supervisors to review a monthly status report.

After sampling 27 SAs ranging from 2008 through 2016, the OAS found the SAs are not being cleared timely and copies of outstanding SAs aren't adequately kept; thus, unable to locate.

Recommendations:

Reinstitute the policies and procedures that require staff to submit SAs and for supervisors to review a monthly status report on outstanding SAs.

Reemphasize to staff the necessity of completing the *Reason for Request* section of the Request for Revolving Fund Check in Lieu of Salary form, GS 950.

OHR Response:

PTU is developing a comprehensive step by step process to ensure the timely collection and documentation of salary advances. The process will include how to process SAs for:

- employees who receive a paper warrant,
- employees who are on direct deposit, and
- employees who have separated from state service.

The Personnel Specialists have been trained to provide their assigned supervisors with copies of the SAs. The PTU supervisors are responsible for reviewing the accuracy of subordinate staff work to ensure that the SAs are cleared once the warrant has issued.

PTU has also created an excel spreadsheet to track and capture all issued SAs including comments on actions taken to clear the SAs. This report will be utilized in the monthly reconciliation meetings with OFS.

In closing, OHR will continue to identify process improvements and provide guidance and training to the department.

**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.