

FRANCHISE TAX BOARD

Audit Report

PAYROLL AUDIT

March 1, 2017, through February 29, 2020



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

January 2025



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

January 15, 2025

Ms. Selvi Stanislaus, Executive Officer
Franchise Tax Board
P.O. Box 1468, MS A162
Sacramento, CA 95812

Dear Ms. Stanislaus:

This is the final report on our audit of the Franchise Tax Board's payroll process and transactions for the period of March 1, 2017, through February 29, 2020. The audit was conducted pursuant to Government Code sections 12476 and 12410.

Franchise Tax Board 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.

If you have any questions regarding this report, please contact Roochel Espilla, Chief, State Agency Audits Bureau, by telephone at 916-323-5744. Thank you.

Sincerely,

Original signed by

Kimberly A. Tarvin, CPA
Chief, Division of Audits

KAT/ac

Ms. Selvi Stanislaus

January 15, 2025

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Copy: Douglas Winslow, Chief Deputy
Office of Chair Sally J. Lieber
California State Board of Equalization
John Thiella, Tax Counsel III
California State Board of Equalization
Malia M. Cohen, Chair
Franchise Tax Board
Sally J. Lieber, Member
Franchise Tax Board
Joe Stephenshaw, Member
Franchise Tax Board
Carol D. Williams, Chief
Administrative Services Division
Franchise Tax Board
Candie Malone, Director
Business and Human Resources Bureau
Franchise Tax Board
Kelly Heckman, Director
Internal Audit Bureau
Franchise Tax Board
Liliana Lopez, Manager
Internal Audit Bureau
Franchise Tax Board
Helen Fairchild, Chief, Administrative Services Division
California Department of Human Resources
Lisa Dean, Acting Chief
Personnel and Payroll Services Division
State Controller's Office
Veronica Encinas, Bureau Chief
Personnel and Payroll Services Division
State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited the Franchise Tax Board's (FTB) payroll process and transactions for the period of March 1, 2017, through February 29, 2020.

FTB 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 FTB did not:

- Maintain adequate and effective internal controls over certain aspects of its payroll process, as described in Findings 1 through 7;
- Process payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures in certain instances, as described in Findings 3 through 6; or
- Administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures, as described in Finding 7.

Background

In 1979, the State of California adopted collective bargaining for state employees. This created a significant workload increase for the SCO's Personnel and Payroll Services Division (PPSD), as 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

We conducted this audit in accordance with Government Code (GC) section 12476, which authorizes the SCO to audit the State's payroll system, the State Pay Roll Revolving Fund, and related records of state agencies within the State's payroll system. In addition, GC section 12410 provides the SCO with general authority to audit the disbursement of state money for correctness, legality, and sufficient provisions of law for payment.

Objectives, Scope, and Methodology

Our audit objectives were to determine whether FTB:

- 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, 2017, through February 29, 2020. The audit population consisted of payroll transactions totaling \$1,235,803,835, as quantified in the Schedule.

To achieve our audit objectives, we performed the following procedures:

- We reviewed state and FTB policies and procedures related to the payroll process to understand FTB's methodology for processing various payroll and payroll-related transactions.
- We interviewed FTB payroll personnel to understand FTB's methodology for processing various payroll and payroll-related transactions, determine the 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.
- We 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.
- We 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.
- We reviewed salary advances to determine whether FTB administered and recorded them in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.
- We assessed the reliability of computer-processed data for payroll and payroll-related transactions by interviewing FTB officials knowledgeable about the data; reviewing existing information about the data and the system that produced it; and tracing data to source documents, based on statistical sampling and targeted selection. We determined that the data was sufficiently reliable for the purposes of this report.

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 FTB did not maintain adequate and effective internal controls over its payroll process;¹ did not process payroll or payroll-related disbursements and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures; and did not administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

We found deficiencies in internal control over the payroll process that we consider to be material weaknesses; and instances of noncompliance with the requirements of collective bargaining agreements and state laws, regulations, policies, and procedures. The material weaknesses and instances of noncompliance are as follows:

- FTB had inadequate segregation of duties and a lack of compensating controls over payroll transactions (see Finding 1).
- Fifteen of 83 (18%) employees whose records we examined during our audit had inappropriate access to the State's payroll system (see Finding 2).
- FTB did not consistently maintain timesheets for regular pay. Based on our audit testing of 105 regular pay transactions, we estimated that 4% of the timesheets associated with regular pay during the audit period were not retained. We identified \$24,993 and projected an additional \$54,279,305 in unsupported payments (see Finding 3).
- FTB did not reduce employees' balances in the State's leave accounting system after separation lump-sum payments were made to 48 of 105 (46%) employees whose records we examined; we identified unreduced leave credits with a value of \$830,267 and we projected additional unreduced leave credits with a value of \$8,948,987. In addition, FTB overpaid three (3%) of the employees whose records we examined by \$777 and underpaid two (2%) employees by \$477. We projected an additional \$8,379 in overpayments and \$5,143 in

¹ In planning and performing our audit of compliance, we considered FTB'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, implementation, 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 on a timely basis. *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 a compliance requirement will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention from those charged with governance.

underpayments. Furthermore, FTB did not make separation lump-sum payments to 18 (or 17%) of the employees in a timely manner (see Finding 4).

- FTB overpaid one of 105 (1%) overtime transactions that we examined by approximately \$71 and underpaid five (5%) by approximately \$348. We projected additional underpayments with a net total of \$38,027 (see Finding 5).
- FTB had inadequate controls to ensure that holiday credits were granted to eligible employees; we identified two errors with a total value of \$681. Although the number of transactions and the dollar amount are small, there could be additional improper credits (see Finding 6).
- FTB had inadequate controls to ensure that salary advances were administered in accordance with requirements and collected in a timely manner. Seven salary advances, totaling \$11,723, remained outstanding for more than 90 days as of February 29, 2020 (see Finding 7).

Follow-up on Prior Audit Findings

We have not previously conducted an audit of FTB's payroll process and transactions.

Views of Responsible Officials

We issued a draft audit report on September 5, 2024. FTB's representative responded by letter dated September 13, 2024, agreeing with the audit results. This final audit report includes FTB's response as an attachment.

Restricted Use

This audit report is solely for the information and use of FTB 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 A. Tarvin, CPA
Chief, Division of Audits

January 15, 2025

**Schedule—
Summary of Audit Results
March 1, 2017, through February 29, 2020**

Audit Area Tested	Method of Selection	Number of Units of Population	Dollar Amount of Population	Number of Selections Examined	Dollar Amount of Selections Examined	Net Total Dollar Amount of Identified Improper Costs	Net Total Dollar Amount of Projected and Identified Unsupported Costs	Finding Number
Segregation of duties	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1
System access	Targeted	83	N/A	83 Employees	N/A	N/A	N/A	2
Regular pay	Statistical	222,785	\$1,201,843,391	105 Transactions	\$ 553,136	\$ -	\$ 54,304,298	3
Separation lump-sum pay	Statistical	1,237	11,495,248	105 Employees	975,956	830,567	8,952,223	4
Overtime pay	Statistical	15,081	10,273,586	105 Transactions	74,370	(277)	(38,027)	5
Excess vacation and annual leave	Statistical	408	3,619,302	105 Employees	919,423	-	-	
Holiday credit	Targeted	20,037	5,902,023	6 Transactions	3,187	681	-	6
Leave buy-back	Statistical	2,199	2,584,668	105 Transactions	123,653	-	-	
Salary advance	Targeted	45	85,617	45 Transactions	85,617	11,723	-	7
			\$1,235,803,835		\$ 2,735,342	\$ 842,694	\$ 63,218,494	

Findings and Recommendations

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

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

Our audit found that FTB 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. FTB failed to demonstrate that it 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 FTB 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 7, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that material noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

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

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

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

Recommendation

We recommend that FTB:

- Separate conflicting payroll functional 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, FTB 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

FTB lacked adequate controls to ensure that only appropriate staff members had keying access to the State’s payroll system. FTB inappropriately allowed 15 employees keying access to the State’s payroll system because FTB did not immediately remove or modify keying access for the employees after the employees’ separation from state service, transfer to another agency, or change in classification.

The SCO maintains the State’s payroll system. The system is decentralized, thereby allowing employees of state agencies to access it. All state agencies are required to comply with PPSD’s *Decentralized Security Program Manual* (DSP Manual) in order to access the payroll system. The DSP Manual describes how state agencies can secure and protect the confidentiality and integrity of payroll data against misuse, abuse, and unauthorized use.

We examined the records of 83 FTB employees who had keying access to the State’s payroll system at various times between March 2017 and February 2020. Of the 83 employees, 15 had inappropriate keying access to the State’s payroll system. Specifically, FTB did not immediately remove or modify keying access for the employees after the employees’ separation from state service, transfer to another agency, or change in classification. For example, a Staff Services Analyst left FTB on June 30, 2017; FTB did not request to remove the employee’s access until April 17, 2018—291 days later. FTB lacked periodic review of keying access granted to employees to ensure compliance with the DSP Manual.

If not mitigated, this control deficiency leaves payroll data at risk of misuse, abuse, and unauthorized use.

The December 2015 DSP Manual (“Access Requirements,” page 13) states, in part:

The [State’s payroll system] contains sensitive and confidential information. Access is restricted to persons with an authorized, legal, and legitimate business requirement to complete their duties. . . .

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.

The December 2015 DSP Manual (“Revocation and Deletion of User IDs,” page 17) states, in part:

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 [Security Authorization form] 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 FTB:

- Update keying access to the State’s payroll system immediately after employees leave FTB, transfer to another unit, or change classifications; and
- Periodically review access to the system to verify that access complies with the DSP Manual.

FINDING 3— Missing timesheets for regular pay

FTB lacked segregation of duties and compensating controls within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls to ensure that timesheets were maintained to support regular pay.

Payroll records show that FTB processed 222,785 regular pay transactions, totaling \$1,201,843,391, between March 1, 2017, and February 29, 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling \$553,136. Based on our examination of these transactions, we found that FTB lacked timesheets for four of 105(4%) transactions, totaling \$24,993. Without the required documentation, we could not determine the validity, accuracy, and propriety of the payments made to the employees; or the completeness and accuracy of the leave accounting records.

If not mitigated, the control deficiencies leave FTB at risk of making improper payments for regular pay.

Statistical sampling results

The identified value of unsupported payments was \$24,993.

We used a statistical sampling method to select the regular pay transactions that we examined. We projected an additional \$54,279,305 in

unsupported payments. Therefore, the identified and projected unsupported payments totaled approximately \$54,304,298.

The following table summarizes the results of our statistical sampling (amounts are rounded to the nearest dollar):

Identified unsupported payments	\$ 24,993
Divide by: Sample	553,136
Error rate for projection (differences due to rounding)	<u>4.52%</u>
Population that was statistically sampled	1,201,843,391
Multiply by: Error rate for projection	4.52%
Identified and projected unsupported payments (differences due to rounding)	<u>54,304,298</u>
Less: Identified unsupported payments	24,993
Projected unsupported payments	<u>\$ 54,279,305</u>

Criteria

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.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding regular pay.

FTB's General Retention Schedule for Payroll/Personnel Records specifies a four-year retention period for timesheets.

Recommendation

We recommend that FTB maintain supporting documentation for regular pay, pursuant to its retention policies.

FINDING 4— Inaccurate leave accounting; improper and late separation lump- sum payments

FTB lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls to ensure that paid credits were reduced in the State's leave accounting system, and that separation lump-sum payments were accurate and made in a timely manner.

Payroll records show that FTB processed separation lump-sum payments, totaling \$11,495,248, for 1,237 employees between March 2017 and February 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 employees who received separation lump-sum payments, totaling \$975,956. Based on our examination of these employees' records, we found the following errors:

- FTB did not appropriately reduce employees' balances in the State's leave accounting system for 48 of the 105 (46%) employees to reflect the number of leave credits—with a value of \$830,267—that had been paid. Unreduced leave balances pose a risk to the State because they

overstate the State's liabilities for leave balances and allow the possibility of improper and duplicative payments for leave credits. FTB stated that the employees' balances were corrected in the leave accounting system after we discussed this issue with FTB representatives. We projected additional unreduced leave credits with a value of \$8,948,987.

- FTB overpaid three of 105 (3%) employees—including two whose balances were not reduced to reflect the number of leave credits that had been paid—by a total of \$777. and underpaid two (2%) employees—whose balances were also not reduced to reflect the number of leave credits that had been paid—by a total of \$477. The errors occurred because payroll transactions unit staff members miscalculated the number of leave credits paid. We projected the value of additional overpayments to be \$8,379 and the additional underpayments to be \$5,143.
- FTB did not make separation lump-sum payments to 18 of 105 (17%) employees in a timely manner.

If not mitigated, these control deficiencies leave FTB at risk of making additional improper and late separation lump-sum payments, noncompliance with agreements and laws, and liability for late payments.

Statistical sampling results

The identified value of improper payments and unreduced leave credits has a net total of \$830,567.

We used a statistical sampling method to select the employees whose separation lump-sum payments we examined. We projected additional unreduced leave credits with a value of \$8,948,987. We also projected an additional \$8,379 in overpayments and \$5,143 in underpayments. The projected value of improper payments and unreduced leave credits has a net total of \$8,952,223. Therefore, the total net value of identified and projected improper payments and unreduced leave credits is approximately \$9,782,790, consisting of \$9,156 in overpayments, \$5,620 in underpayments, and \$9,779,254 in unreduced leave credits.

The following table summarizes the results of our statistical sampling (amounts are rounded to the nearest dollar):

Identified value of unreduced leave credits and improper payments, net	\$ 830,567
Divide by: Sample	975,956
Error rate for projection (differences due to rounding)	<u>85.10%</u>
Population that was statistically sampled	11,495,248
Multiply by: Error rate for projection	<u>85.10%</u>
Identified and projected value of unreduced leave credits and improper payments, net (differences due to rounding)	9,782,790
Less: Identified value of unreduced leave credits and improper payments, net	<u>830,567</u>
Projected value of unreduced leave credits and improper payments, net	<u>\$ 8,952,223</u>

Criteria

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

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.

Collective bargaining agreements and state laws summarized in section 1703 of the California Department of Human Resources' Human Resources Manual establish the requirements for separation lump-sum pay.

Recommendation

We recommend that FTB:

- Conduct a review of separation lump-sum payments made during the past three years to ensure that the payments were accurate and in compliance with collective bargaining agreements and state law; and
- Recover any overpayments made to separated employees in accordance with GC section 19838 and State Administrative Manual (SAM) sections 8291, 8291.1, and 8293; and
- Properly compensate those employees who were underpaid.

We further recommend that, to prevent inaccurate and untimely processing of separation lump-sum pay from recurring, FTB establish adequate controls to ensure that:

- Employee leave balances are reduced in a timely manner after separation lump-sum payments are made;
- Separation lump-sum payments are calculated accurately; and
- Separation lump-sum payments are made in a timely manner.

FINDING 5— Improper overtime payments

FTB lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls over the processing of overtime pay and adequate supervisory review to ensure accurate processing of overtime pay.

Payroll records show that FTB processed 15,081 overtime pay transactions, totaling \$10,273,586, between March 2017 and February 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling \$74,370. Based on our examination of these transactions, we found that FTB had overpaid one by approximately \$71 and had underpaid five by approximately \$348. The errors occurred because payroll transactions unit staff members miscalculated overtime hours worked and incorrectly entered overtime hours into the payroll system. We projected additional underpayments with a net total of \$38,027.

If not mitigated, these control deficiencies leave FTB at risk of making additional improper overtime payments. Although we deemed the improper payments to be insignificant, the existence of control deficiencies related to the processing of overtime pay presents the risk that FTB will not prevent, or detect and correct, improper payments in a timely manner.

Statistical sampling results

The identified improper payments totaled a net underpayment of \$277.

We used a statistical sampling method to select the overtime pay transactions that we examined. We projected additional overpayments of \$9,777 and underpayments of \$47,804. The projected improper payments represent a net total underpayment of \$38,027. Therefore, the identified and projected improper payments result in a net underpayment of approximately \$38,304, consisting of \$9,848 in overpayments and \$48,152 in underpayments.

The following table summarizes the results of our statistical sampling (amounts are rounded to the nearest dollar):

Identified underpayments, net	\$ 277
Divide by: Sample	74,370
Error rate for projection (differences due to rounding)	<u>0.37%</u>
Population that was statistically sampled	10,273,586
Multiply by: Error rate for projection	<u>0.37%</u>
Identified and projected underpayments, net (differences due to rounding)	38,304
Less: Identified underpayments, net	277
Projected underpayments, net	<u><u>\$ 38,027</u></u>

Criteria

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.

Collective bargaining agreements, and state laws and policies, contain specific clauses regarding overtime pay.

Recommendation

We recommend that FTB:

- 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;
- Recover any 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 payments for overtime pay from recurring, FTB:

- Establish adequate internal controls to ensure that payments are accurate and entered correctly into the payroll system; 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 6—
Improper holiday
credit transactions**

FTB lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls over the processing of holiday credit transactions. We identified approximately \$681 in improper holiday credits.

Leave accounting records show that FTB processed 20,037 accrual transactions of holiday credit, with an estimated value of \$5,902,023. We examined six of these transactions, with an estimated value of \$3,187, because they involved unusual credits. Based on our examination, we found that two transactions, with an estimated value of \$681, involved improper credits. We tested only a targeted selection; there could be additional improper credits.

The improper holiday credit transactions were made because payroll transactions unit staff members granted holiday credits to employees during pay periods with no holidays. FTB also lacked adequate supervisory review to ensure proper and accurate processing of holiday credits.

If not mitigated, this control deficiency leaves FTB at risk of granting additional improper holiday credits.

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

GC section 19853 specifies the compensation that eligible employees are entitled to receive when required to work on a qualifying holiday. The collective bargaining agreement between the State and Bargaining Unit 1 includes similar provisions regarding holiday credit and holiday pay for represented employees.

Recommendation

We recommend that FTB:

- Conduct a review of holiday credits granted during the past three years to ensure that credits are properly supported with documentation, and complied with collective bargaining agreements and state law;
- Correct any improper holiday credits in the State's leave accounting system; and

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

**FINDING 7—
Failure to collect
outstanding
salary advances**

FTB lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1, and lacked adequate controls over salary advances to ensure that advances were collected in a timely manner in accordance with state law and policies. Seven salary advances, totaling \$11,723 remained outstanding for more than 90 days as of February 29, 2020.

At February 29, 2020, FTB's accounting records show 45 outstanding salary advances, totaling \$85,617. We examined all 45, and found that seven of them—with a value of \$11,723—had been outstanding for more than 90 days. The seven salary advances had been outstanding for an average of 132 days, and the oldest uncollected salary advance was outstanding for over eight months. We noted that FTB had not initiated timely collection efforts for any of the salary advances that we sampled. Salary advances are more difficult to collect after the employee leaves state service, and they may become uncollectable if not collected within three years.

If not mitigated, these control deficiencies leave FTB at risk of failing to collect further salary advances.

GC section 19838 and SAM sections 8291, 8291.1, 8293, and 8293.2 describe the State's collection policies and procedures, which require the collection of salary advances in a timely manner and maintenance of proper records of collection efforts. Specifically, GC section 19838(d) and SAM section 8293.2 require that actions to recover overpayments begin within three years of the date of overpayment.

Recommendation

We recommend that FTB ensure that it collects salary advances in a timely manner, pursuant to GC section 19838 and SAM sections 8291, 8291.1, 8293, and 8293.2.

Appendix— Audit Sampling Methodology

This Appendix outlines our audit sampling application for all audit areas in which statistical sampling was used.

We used attributes sampling for tests of compliance. We chose this sample design because:

- It follows the American Institute of Certified Public Accountants (AICPA) guidelines;
- It allowed us to achieve our objectives for tests of compliance in an efficient and effective manner;
- Audit areas included high volumes of transactions;
- We planned to project the results to the intended population; and
- We had the collective knowledge and skills to plan and perform the sampling plan and design.

We conducted compliance testing on samples chosen by computer-generated simple random selection. For populations of 250 items or more, we determined the sample size using a calculator with 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 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.

The confidence level was 90.00%, the tolerable error rate was 5.00%, and the expected error rate was 2 (1.75%). Pursuant to the AICPA's *Audit Guide: Audit Sampling* (December 1, 2019 edition), pages 131–132, the *expected error rate* 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 become 1.0 error. Results were projected to the intended (total) population.

Audit Area	Population (Unit)	Population (Dollar)	Sampling Unit	Sample Size	Finding Number
Regular pay	222,785	\$1,201,843,391	Transaction	105	3
Separation lump-sum pay	1,237	11,495,248	Employee	105	4
Overtime pay	15,081	10,273,586	Transaction	105	5
Leave buy-back	2,199	2,584,668	Transaction	105	
Excess vacation and annual leave	408	3,619,302	Employee	105	

**Attachment—
Franchise Tax Board's Response to Draft Audit Report**



DATE: September 13, 2024
TO: Kimberly Tarvin, CPA
FROM: Amy Tong, Secretary
SUBJECT: State Controller's Office Draft Audit Report of the Franchise Tax Board's Payroll Process and Transactions

Pursuant to the above audit report, enclosed are the Franchise Tax Board's comments pertaining to the results of the audit.

The Government Operations Agency would like to thank the State Controller's Office for its comprehensive review. The results provide us with the opportunity to better serve our clients and protect the public.

Enclosures



09.13.2024

KIMBERLY A TARVIN, CPA
STATE CONTROLLER'S OFFICE
3301 C STREET, SUITE 700
SACRAMENTO, CA 95816

Re: Response to State Controller's Office Auditor Report of the Franchise Tax Board's Payroll Process and Transactions Audit

Thank you for the opportunity to respond to the State Controller's Office Report for the Franchise Tax Board's Payroll Process and Transactions Audit for the period of March 1, 2017, through February 29, 2020. The following response addresses the auditor's recommendation regarding FTB's payroll and transactions.

OVERVIEW OF THE REPORT

In summary the SCO Audit determined that FTB did not:

- Maintain adequate and effective internal controls over its payroll process.
- Process payroll and payroll-related disbursements accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.
- Administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures.

There were seven specific findings. FTB has reviewed the draft report and agrees with all findings presented. FTB is committed to taking the necessary steps to ensure compliance. See findings, recommendations, and corrective actions taken below:

Finding Number	Recommendation	Corrective Actions
Finding 1 – Inadequate segregation of duties and lack of compensating controls over payroll transactions	<ul style="list-style-type: none">• Separate conflicting payroll functional duties to the greatest extent possible.• Develop formal procedures for performing and documenting compensating controls	<ul style="list-style-type: none">• Personnel Transaction Unit duties were separated, and additional levels of review were inserted into the processes.• Developed formal procedures and a checklist for reviewing the accuracy of work completed.
Finding 2- Inappropriate keying access to the State's payroll system.	<ul style="list-style-type: none">• Update keying access to the State's payroll system immediately after employees leave FTB, transfer to another unit, or change classifications; and• Periodically review access to the system to verify that access complies with the DSP Manual.	<ul style="list-style-type: none">• Updated procedures to include a monthly review of accesses to ensure users are removed timely.

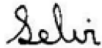
<p>Finding 3- Inadequate controls over regular pay, resulting in questioned payments. (unsigned 634's)</p>	<ul style="list-style-type: none"> We recommend that FTB maintain supporting documentation for regular pay pursuant to retention policies. 	<ul style="list-style-type: none"> 634's are now signed and stored electronically to decrease the potential for inaccurate filing. Timekeeper's track and follow up with the supervisors regarding missing signatures to ensure a 634's/682's with all signatures is received for every employee. In July of 2025 we will be implementing a new timekeeping system where the e-signature and approvals will occur and be stored within that system, there will no longer be a need to save a document and file it in a separate location electronically.
<p>Finding 4 – Inadequate controls over separation lump-sum pay, resulting in improper and payments</p>	<ul style="list-style-type: none"> Establish adequate controls to ensure accurate calculation and timely payment of separation lump-sum pay and proper adjustment in the leave accounting system to reflect the number of leave credits that were paid. 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 overpayment made to separated employees in accordance with GC section 19838 and State Administrative manual section 87606 and properly compensate those employees who were underpaid. 	<ul style="list-style-type: none"> Personnel Transaction Unit duties were separated, and additional levels of review were inserted into the processes. Developed formal procedures and a checklist for reviewing the accuracy of work completed. Updated our Lump Sum worksheet to require a quality review sign off FTB will conduct a review of separation lump sum payments made during the last 3 years and recover overpayments if identified.
<p>Finding 5 – Inadequate controls over overtime pay, resulting in improper payments</p>	<ul style="list-style-type: none"> 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 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 Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreement and state laws and policies. Provide adequate oversight to ensure that payroll transaction unit staff process only valid and authorized payments that comply with collective bargaining agreements and state laws and policies. 	<ul style="list-style-type: none"> Personnel Transaction Unit duties were separated, and additional levels of review were inserted into the processes. Developed formal procedures and a checklist for reviewing the accuracy of work completed. FTB will conduct a review of overtime payments made during the last 3 years and recover overpayments if identified.

<p>Finding 6 – Inadequate controls over holiday credit transactions resulting in improper credits</p>	<ul style="list-style-type: none"> • Conduct a review of holiday credits granted during the past three years to ensure that credits are properly supported with documentation, and complied with collective bargaining agreements and state law • Correct any improper holiday credits in the State's leave accounting system. • Establish adequate controls to ensure that holiday credits granted are valid, and comply with collective bargaining agreements and state law. 	<ul style="list-style-type: none"> • FTB conducted a review of Holiday credits granted in August of 2019 and corrected any improper holiday credits. • Personnel Transaction Unit duties were separated, and additional levels of review were inserted into the processes. • Developed formal procedures and a checklist for reviewing the accuracy of work completed. • FTB leverages the Holiday Guidance Charts provided in the HR Manual Section 1712 – Holiday Guidance
<p>Finding 7 – Inadequate controls over salary advances, resulting in failure to recover outstanding amounts</p>	<ul style="list-style-type: none"> • We recommend that FTB ensure that it recovers salary advances in a timely manner, pursuant to GC section 19838 and State Administrative Manual sections 8291, 8291.1, 8293, and 8293.2. 	<ul style="list-style-type: none"> • Fiscal Accounting and Personnel Transactions Unit have implemented a monthly reconciliation process to ensure salary advances are recovered in a timely manner.

CONCLUSION

In closing, we constantly strive to improve our processes and want to ensure payroll and leave accounting is processed accurately. FTB appreciates the efforts of the auditor, and the opportunity to partner with you to complete this review.

Sincerely,



Selvi Stanislaus Executive Officer

cc: Amy Tong

Tel 916.845.4543

Fax 916.845.3191

ftb.ca.gov

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250**

www.sco.ca.gov