

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Audit Report

PAYROLL AUDIT

March 1, 2017, through February 29, 2020



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

December 2024



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CALIFORNIA STATE CONTROLLER

December 20, 2024

Mr. Tony Tavares, Director
California Department of Transportation
P.O. Box 168038
Sacramento, CA 95816

Dear Director Tavares:

The State Controller's Office audited the California Department of Transportation'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.

California Department of Transportation 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/rs

Mr. Tony Tavares
December 20, 2024
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Audit Report

Summary

The State Controller's Office (SCO) audited the California Department of Transportation's (Caltrans) payroll process and transactions for the period of March 1, 2017, through February 29, 2020.

Caltrans 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 Caltrans did not:

- Maintain adequate and effective internal controls over certain aspects of its payroll process, as described in Findings 1 through 6;
- 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, 4, and 6; or
- Administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures, as described in Finding 5.

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 Caltrans:

- 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 \$5,295,582,564, as quantified in the Schedule.

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

- We reviewed state and Caltrans policies and procedures related to the payroll process to understand Caltrans' methodology for processing various payroll and payroll-related transactions.
- We interviewed Caltrans payroll personnel to understand Caltrans' 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 Caltrans 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 Caltrans 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 Caltrans 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:

- Caltrans had inadequate segregation of duties and a lack of compensating controls over payroll transactions (see Finding 1).
- Forty-three of 233 (18%) employees whose records we examined during our audit had inappropriate access to the State's payroll system (see Finding 2).
- Caltrans did not reduce employees' balances in the State's leave accounting system after separation lump-sum payments were made to 87 of 105 (83%) employees whose records we examined; we identified unreduced leave credits with a value of \$1,333,894 and projected additional unreduced leave credits with a value of \$49,869,966. In addition, Caltrans did not make separation lump-sum payments to 76 of 105 (72%) of the employees in a timely manner. Furthermore, Caltrans did not consistently maintain supporting documentation for separation lump-sum payments. Based on our audit testing, we estimated that 62% of the supporting documentation associated with separation lump-sum payments during the audit period was not retained. We identified \$1,184,923 and projected an additional \$44,300,413 in unsupported separation lump-sum payments (see Finding 3).
- Caltrans had inadequate controls to ensure that it adhered to requirements limiting the accumulation of vacation and annual leave.

¹ In planning and performing our audit of compliance, we considered Caltrans' 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.

As of February 29, 2020, Caltrans' leave accounting records show 1,917 employees whose vacation and annual leave balances exceeded the limits set by collective bargaining agreements and state regulations. The value of Caltrans' excess leave balances was at least \$10,646,224 as of February 29, 2020. Based on our audit testing, we determined that for 58% of the employees whose records we examined, Caltrans had failed to implement controls to ensure that it adhered to the requirements. We identified excess vacation and annual leave credits with a value of \$326,721 and projected additional leave credits with a value of \$4,223,450 (see Finding 4).

- Caltrans had inadequate controls to ensure that salary advances were administered in accordance with requirements and collected in a timely manner. Over 1,000 salary advances, totaling \$1,619,338, remained outstanding for more than 90 days as of February 29, 2020 (see Finding 5).
- Caltrans had inadequate controls to ensure that holiday credits were granted to eligible employees; we identified 11 improper transactions with a total value of \$3,176 (see Finding 6).

Follow-up on Prior Audit Findings

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

Views of Responsible Officials

We issued a draft audit report on September 5, 2024. Caltrans' representative responded by letter dated September 16, 2024, acknowledging the audit results. This final audit report includes Caltrans' response as an attachment.

Restricted Use

This audit report is solely for the information and use of Caltrans 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

December 20, 2024

**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 Improper Costs and Identified and Projected 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	233	N/A	233 Employees	N/A	N/A	N/A	2
Regular pay	Statistical	743,308	\$ 4,941,039,485	105 Transactions	\$ 737,942	\$ -	\$ -	
Separation lump-sum pay	Statistical	4,485	60,656,713	105 Employees	1,580,147	-	96,689,196	3
Overtime pay	Statistical	223,899	223,889,169	105 Transactions	104,363	-	-	
Excess vacation and annual leave	Statistical	1,917	10,646,224	105 Employees	764,444	326,721	4,223,450	4
Salary advance	Statistical	1,459	1,619,338	105 Transactions	578,983	578,983	1,040,355	5
Leave buy-back	Statistical	11,747	22,109,457	105 Employees	194,778	-	-	
Uniform allowance	Statistical	860	457,045	105 Transactions	56,500	-	-	
Holiday credit	Targeted	106,302	35,165,133	11 Transactions	3,176	3,176	-	6
			\$ 5,295,582,564		\$ 4,020,333	\$ 908,880	\$ 101,953,001	

Findings and Recommendations

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

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

Our audit found that 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. Caltrans 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 Caltrans payroll process, and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively. These control deficiencies, in combination with other deficiencies discussed in Findings 2 through 6, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that 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 Caltrans:

- Separate conflicting payroll function duties to the greatest extent possible. Adequate segregation of duties will provide a stronger system of internal control whereby the functions of each employee are subject to the review of another.

If it is not possible to segregate payroll functions fully and appropriately, Caltrans 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

Caltrans lacked adequate controls to ensure that only appropriate staff members had keying access to the State’s payroll system. Caltrans inappropriately allowed 43 employees keying access to the State’s payroll system because Caltrans did not immediately remove or modify keying access for the employees after their 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 233 Caltrans employees who had keying access to the State’s payroll system at various times between March 2017 and February 2020. Of the 233 employees, 43 had inappropriate keying access to the State’s payroll system. Specifically, Caltrans did not immediately remove or modify keying access for the 43 employees after the employees’ separation from state service, transfer to another agency, or change in classification. For example, a Personnel Specialist left Caltrans on August 31, 2017, but Caltrans did not request to remove the employee’s access until October 3, 2018—398 days later. Caltrans 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 Caltrans:

- Update keying access to the State’s payroll system immediately after employees leave Caltrans, 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— Inaccurate leave accounting, late payments, and missing documentation for separation lump- sum pay

Caltrans 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 properly reduced in the State’s leave accounting system; adequate controls over the processing of separation lump-sum pay; adequate supervisory review to ensure timely processing of separation lump-sum pay; and adequate controls to ensure that supporting documentation was maintained for separation lump-sum payments.

Payroll records show that Caltrans processed separation lump-sum payments, totaling \$60,656,713, for 4,485 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 \$1,580,147. Based on our examination of the employees’ records, we found the following errors:

- Caltrans did not appropriately reduce employees’ balances in the State’s leave accounting system after payments to 87 of 105 (83%) employees to reflect the number of leave credits—with a value of \$1,333,894—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. However, Caltrans representatives stated that the employees’ balances were corrected in the leave accounting

system after we discussed this issue with the representatives. We projected the value of additional unreduced leave credits to be \$49,869,966.

- Caltrans did not make separation lump-sum payments to 76 of 105 (72%) employees in a timely manner.
- Caltrans could not locate supporting documents (lump-sum calculation worksheets, leave balance statements, state calendars, and timesheets) for payments, totaling \$1,184,923, made to 65 of 105 (62%) employees. We could not determine the validity, accuracy, and propriety of the payments made to these employees; or the completeness and accuracy of the leave accounting records. We projected the value of additional unsupported payments to be \$44,300,413.

If not mitigated, this control deficiency leaves Caltrans 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 unreduced leave credits and unsupported payments totaled \$2,518,817.

We used a statistical sampling method to select the employees whose payments for separation lump-sum payments were examined. We projected additional unreduced leave credits with a value of \$49,869,966, and an additional \$44,300,413 in unsupported payments. The projected value of unreduced leave credits and unsupported payments totaled approximately \$94,170,379. Therefore, the identified and projected value of unreduced leave credits and unsupported payments totaled approximately \$96,689,196.

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

Identified value of unreduced leave credits and unsupported payments	\$ 2,518,817
Divide by: Sample	<u>1,580,147</u>
Error rate for projection (differences due to rounding)	<u>159.40%</u>
Population that was statistically sampled	60,656,713
Multiply by: Error rate for projection	<u>159.40%</u>
Identified and projected value of unreduced leave credits and unsupported payments (differences due to rounding)	96,689,196
Less: Identified value of unreduced leave credits and unsupported payments	<u>2,518,817</u>
Projected value of unreduced leave credits and unsupported payments	<u>\$ 94,170,379</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.

Caltrans' General Retention Schedule for Payroll/Personnel Records specifies a five-year retention period for separation lump-sum supported documentation.

Recommendation

We recommend that Caltrans:

- 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
- Correct any unreduced leave credits in the State's leave accounting system in a timely manner.

We further recommend that, to prevent improper payments from occurring, Caltrans establish adequate controls to ensure that:

- Separation lump-sum payments are made in a timely manner; and
- Supporting documentation for payments are maintained pursuant to Caltrans retention policies.

**FINDING 4—
Excessive vacation
and annual leave
balances**

Caltrans' leave accounting records show 19,995 employees with unused vacation or annual leave credits at February 29, 2020. Of those employees, 1,917 exceeded the limits set by collective bargaining agreements and state regulations. The employees accumulated 200,187 hours of excess vacation and annual leave, with a value of at least \$10,646,224 as of February 29, 2020. Our audit determined that for about 58% of the employees whose records we examined, Caltrans had failed to implement controls to ensure that it adhered to the requirements. This estimated liability does not adjust for salary rate increases and additional leave credits.² Accordingly, we expect that the amount needed to pay for this liability will be higher.

² Most state employees receive pay rate increases every year pursuant to state laws and/or collective bargaining agreements until they reach the top of their pay scale, or promote into a higher-paying position. In addition, when an employee's accumulated leave balances upon separation are calculated for lump-sum pay, the employee is credited with additional leave credits equal to the amount that the employee would have earned had the employee taken time off and not separated from state service.

Collective bargaining agreements and state regulations limit the amount of vacation and annual leave that most state employees may accumulate. The limit on leave balances helps state agencies to manage leave balances and control the State's liability for accrued leave credits. State agencies may allow employees to carry a higher leave balance only under limited circumstances. For example, an employee may not be able to reduce accrued vacation or annual leave hours below the limit due to business needs. When an employee's leave accumulation exceeds or is projected to exceed the limit, state agencies should work with the employee to develop a written plan to reduce leave balances below the applicable limit.

On October 20, 2020, the California Department of Human Resources directed departments to immediately suspend policies that require leave balances to be reduced below the limit and those that require employees to implement leave-reduction plans. This suspension was in effect until the 2020 Personal Leave Program ended on June 30, 2021.

Of the 1,917 employees with excess vacation or annual leave balances, we randomly selected a statistical sample (as described in the Appendix) of 105 employees who accumulated 12,982 hours of excess vacation and annual leave balances, with a value of at least \$764,444. We examined the records of these employees to determine whether Caltrans had complied with collective bargaining agreements and state regulations.

Of the 105 employees whose records we examined, 61 did not comply with collective bargaining agreements and state regulations for the following reasons:

- Caltrans could not demonstrate that, if the employees were unable to reduce their vacation and annual leave balances, it had allowed the employees to maintain excess vacation or annual leave balances because of the extenuating circumstances specified in the agreements and regulations.
- Caltrans had no plans in place during the audit period for the employees to reduce leave balances below the limit.

These 61 employees accumulated 6,067 hours of excess vacation and annual leave, with a value of at least \$326,721 as of February 29, 2020.

If Caltrans does not take action to reduce the excessive leave balances, the liability for accrued vacation and annual leave will likely increase because most employees will receive salary increases or use other non-compensable leave credits instead of vacation or annual leave, thus increasing their vacation or annual leave balances.

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

Statistical sampling results

The identified value of excess vacation and annual leave balances that did not comply with collective bargaining agreements and state regulations totaled at least \$326,721.

We used a statistical sampling method to select the employees whose records we examined. We projected additional excess vacation and annual leave balances with a value of at least \$4,223,450. Therefore, the value of identified and projected excess vacation and annual leave balances totaled \$4,550,171.

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

Identified excess vacation and annual leave balances	\$ 326,721
Divide by: Sample	764,444
Error rate for projection (differences due to rounding)	<u>42.74%</u>
Population that was statistically sampled	10,646,224
Multiply by: Error rate for projection	<u>42.74%</u>
Identified and projected excess vacation and annual leave balances (differences due to rounding)	4,550,171
Less: Identified excess vacation and annual leave balances	326,721
Projected excess vacation and annual leave balances	<u>\$ 4,223,450</u>

Criteria

Collective bargaining agreements and state regulations limit the amount of vacation and annual leave that most state employees may accumulate to no more than 80 days (640 hours).

Recommendation

We recommend that Caltrans:

- Implement controls, including existing policies and procedures, to ensure that its employees' vacation and annual leave balances are maintained within levels allowed by collective bargaining agreements and state regulations;
- Conduct ongoing monitoring of controls to ensure that they are implemented and operating effectively; and
- Participate in leave buy-back programs if the State offers such programs and funds are available.

FINDING 5— Failure to collect outstanding salary advances

Caltrans 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. Over 1,000 salary advances, totaling \$1,619,338, remained outstanding for more than 90 days as of

February 29, 2020. Furthermore, Caltrans did not initiate timely collection efforts for any of them.

At February 29, 2020, Caltrans' accounting records show 1,459 outstanding salary advances, totaling \$1,619,338. We randomly selected a statistical sample (as described in the Appendix) of 105 salary advances, totaling \$578,983. Based on our examination, we found that 1,326 (or 91%) salary advances, totaling \$1,496,162, had been outstanding for more than 90 days. The 105 salary advances had been outstanding for an average of 513 days, and the oldest unrecovered salary advance was outstanding for over three years. We noted that Caltrans had not initiated timely collection efforts for any of the sampled salary advances. For example, Caltrans issued a salary advance to an employee in March 2017. Caltrans sent the first collection letter in February 2021, approximately three years and 10 months later.

We also noted that 528 salary advances, totaling \$620,256, were issued to 198 employees who had at least two outstanding salary advances. We found that one employee with an outstanding salary advance received another 12 salary advances. Issuing multiple salary advances to the same employee, especially when the employee already carries a large advance balance, increases the risk that the advanced funds will not be recovered prior to the employees' separation from state service. Salary advances are more difficult to collect after employees leave state service, and they may become uncollectable if not collected within three years.

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

Statistical sampling results

The identified value of unrecovered salary advances totaled \$578,983.

We used a statistical sampling method to select the salary advances that we examined. We projected additional unrecovered salary advances with a value of \$1,040,355. Therefore, the value of identified and projected unrecovered salary advances totaled \$1,619,338.

The table on the next page summarizes the results of our statistical sampling (amounts in this table are rounded to the nearest dollar).

Identified unrecovered salary advances	\$ 578,983
Divide by: Sample	578,983
Error rate for projection	<u>100.00%</u>
Population that was statistically sampled	1,619,338
Multiply by: Error rate for projection	<u>100.00%</u>
Projected unrecovered salary advances	1,619,338
Less: Identified unrecovered salary advances	578,983
Projected unrecovered salary advances	<u>\$ 1,040,355</u>

Criteria

GC section 19838 and State Administrative Manual (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 the 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 Caltrans 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.

FINDING 6— Improper holiday credit transactions

Caltrans lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls over the processing of holiday credit transactions, and adequate supervisory review to ensure proper and accurate processing of holiday credits. We identified approximately \$3,176 in improper holiday credits.

Leave accounting records show that Caltrans processed 106,302 accrual transactions of holiday credit, with an estimated value of \$35,165,133. We examined 11 of these transactions, with an estimated value of \$3,176, because they involved unusual credits. Based on our examination, we found that all 11 transactions 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. Caltrans also lacked adequate supervisory review to ensure proper and accurate processing of holiday credits.

If not mitigated, this control deficiency leaves Caltrans 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 an eligible employee is entitled to receive when required to work on a qualifying holiday. Collective bargaining agreements between the State and Bargaining Units 9 and 12 include similar provisions regarding holiday credit and holiday pay for represented employees.

Recommendation

We recommend that Caltrans:

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

We further recommend that, to prevent improper holiday credit compensation from recurring, Caltrans:

- Establish adequate controls to ensure that holiday credits granted are valid, and comply with collective bargaining agreements and state law; and
- Conduct periodic reviews of holiday credits to identify unusual credits and make necessary corrections in the State's leave accounting system.

Appendix— Audit Sampling Methodology

This Appendix outlines our audit sampling application for all audit areas for 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 2.00 (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	743,308	\$4,941,039,485	Transaction	105	
Overtime pay	223,899	223,889,169	Transaction	105	
Separation lump-sum pay	4,485	60,656,713	Employee	105	3
Excess vacation and annual leave	1,917	10,646,224	Employee	105	4
Salary advance	1,459	1,619,338	Transaction	105	5
Leave buy-back	11,747	22,109,457	Transaction	105	
Uniform allowance	860	457,045	Transaction	105	

**Attachment—
California Department of Transportation’s
Response to Draft Audit Report**

California Department of Transportation

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September 16, 2024

Roochel Espilla
Chief, State Agency Audits Bureau
Division of Audits
State Controller's Office
Post Office Box 942850
Sacramento, CA 94250

Dear Bureau Chief Roochel Espilla:

The California Department of Transportation (Caltrans) submits this letter in response to the State Controller's Office (SCO) audit on payroll processes and transactions from March 1, 2017, to February 29, 2020. Caltrans acknowledges the findings and offers the following responses to each of the findings and recommendations from SCO below.

FINDING NO. 1: INADEQUATE SEGREGATION OF DUTIES AND LACK OF COMPENSATING CONTROLS OVER PAYROLL TRANSACTIONS

Due to the size and diversity of Caltrans, in addition to the broad scope of the Personnel Specialist duties outlined by CalHR, we are unable to separate payroll function duties any further. All Personnel Specialists are required to take SCO trainings related to payroll processing, and they are aware that they are required to apply the applicable State laws, rules, regulations, and bargaining unit contracts, also known as Memorandums of Understanding (MOU) when completing their work. Additionally, our new Personnel Specialists receive training from their supervisors, as well as concentrated training from the specialized Transactions Operations Unit that Caltrans has established. Caltrans has dual authorization requirements and documented reviews of payroll system transactions for all processes for Personnel Specialists with less than 12 months experience. The specialized Transactions Operations Unit documents reviews of payroll system input and output with monthly, quarterly, and yearly processes, and they have also created formal procedures for documenting compensation controls to ensure that the department is processing transactions in alignment with control agency requirements and compliance with applicable MOU.

FINDING NO. 2: INAPPROPRIATE KEYING ACCESS TO THE STATE'S PAYROLL SYSTEM

Caltrans acknowledges the above finding from the SCO audit and has reviewed and adjusted our internal processes to ensure that access to the State's payroll system is up-to-date and accurate. We currently have a policy to quickly notify the Division of Human

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Resources State Payroll System Security Monitor of any classification changes, transfers, and separations. The department will also implement a quarterly review of all Caltrans employees with access to the system as a safeguard to ensure further security measures are in place so that only the appropriate employees maintain their access to the State's payroll system.

FINDING NO. 3: INACCURATE LEAVE ACCOUNTING, LATE PAYMENTS, AND MISSING DOCUMENTATION FOR SEPARATION LUMP-SUM PAY

Caltrans follows the SCO Class Workbook (page 86) Accrued Leaves, Vacation, Annual Leave, and Personal Holiday section. In addition, we have already made changes to address this finding. To promote separation of duties, we have restructured separation tracking and review of lump-sum payments. The specialized Transactions Operations Unit runs a quarterly report of separations to verify leave credits in the State Controller's system have been reduced. Internal training and support materials have also been provided to personnel. To ensure that lump-sum payments are paid in a timely manner, the Department sends out a Management Information Bulletin to promote the timely submission of the Employee Separation Checklist so that we are aware of anyone who is leaving the Department. Since this audit, Caltrans established, and has been utilizing, an email inbox dedicated to the notification and submission of information related to employees who are separating from the Department to simplify the process for supervisors. Caltrans has also created digital and hard copy lump-sum documentation retention processes.

FINDING NO. 4: EXCESSIVE VACATION AND ANNUAL LEAVE BALANCES

Caltrans continues to make an effort to ensure that employees do not carry excessive vacation and annual leave balances. Each year, the Department sends a Personnel Information Bulletin to all staff indicating the appropriate vacation and annual leave levels and outlines the requirements to complete and follow a leave reduction plan when an employee is over the leave cap. In addition, the Caltrans Director's Office forwards communication to staff related to the importance of leave reduction plans and the expectation that these plans are completed.

FINDING NO. 5: FAILURE TO COLLECT OUTSTANDING SALARY ADVANCES

Caltrans understands the importance of collecting outstanding salary advances and has continued to improve processes over the years to ensure collection in accordance with applicable Government Codes. The payroll database is checked daily to capture warrants and apply them to the corresponding salary advance. If an outstanding balance remains, collection efforts are made in accordance with Government Code 19838.

FINDING NO. 6: IMPROPER HOLIDAY CREDIT TRANSACTIONS

Caltrans uses an automated time tracking system called Staff Central Online Time Reporting. Staff Central is programmed to ensure that an employee's Holiday Credit is

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Roochel Espilla, Chief
September 16, 2024
Page 3

reported accurately based on each employee's time base, tenure, work week group, and MOU in alignment with State laws and control agency recommendations. Our Transactions Operations Unit will also be conducting quarterly audits to ensure accuracy and address any errors that may occur.

We appreciate the opportunity to provide a response to the draft report.

Sincerely,


Michael Kuever (Sep 16, 2024 13:44 PDT)

for

TONY TAVARES
Director

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