CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

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 23, 2024

Ms. Danyal Noel, Deputy Director of Human Resources
California Department of Corrections and Rehabilitation
1515 S Street, Suite 201 South
Sacramento, CA 95815

Dear Ms. Noel:

The State Controller's Office audited the California Department of Corrections and Rehabilitation'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 Corrections and Rehabilitation 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

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Contents

Audit Report

Summary

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

CDCR 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 CDCR did not:

- Maintain adequate and effective internal controls over certain aspects of its payroll process, as described in Findings 1 through 8;
- 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, 5, 7 and 8; or
- Administer salary advances in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures, as described in Finding 6.

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 CDCR:

- 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 $1,818,065,129, as quantified in the Schedule.

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

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

- CDCR had inadequate segregation of duties and compensating controls over payroll transactions (see Finding 1).
- Fifty-two of 224 (23%) employees whose records we examined during our audit had inappropriate keying access to the State's payroll system (see Finding 2).
- Timesheets were not consistently maintained for regular pay. Based on audit testing of 105 regular pay transactions, we identified 25 transactions—with an approximate value of $251,051—for which timesheets were not retained. As a result, we estimate that 24% of the timesheets—with a projected value of approximately $412 million—associated with regular pay during the audit period were not retained (see Finding 3).
- Overtime payments were frequently miscalculated and timesheets were not consistently maintained. Based on audit testing, we found that 38 of 105 (36%) overtime pay transactions that we examined had

[1] In planning and performing our audit of compliance, we considered CDCR'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.

a net total of $38,511 in improper payments; and we projected an additional $17,593,711 in improper payments. We also noted that timesheets for 13 of 105 (12%) of the transactions had not been retained; we identified and projected a total of $4,716,316 in unsupported overtime payments. Furthermore, CDCR lacked the required prior written approval of overtime hours for 44 of the 105 (42%) transactions (see Finding 4).

- CDCR had inadequate controls to ensure that it adhered to requirements limiting the accumulation of vacation and annual leave credits. As of February 29, 2020, CDCR employed 1,047 employees who exceeded the limits on vacation and annual leave balances set by collective bargaining agreements and state regulations. The value of CDCR's excess leave balance was at least $40,265,164 as of February 29, 2020. Our audit determined that for about 30% of the excess leave balances, with a value of $12,359,591, CDCR had failed to implement controls to ensure that it adhered to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits (see Finding 5).

- CDCR had inadequate controls to ensure that salary advances were collected in a timely manner and administered in accordance with requirements. Twenty-seven salary advances, totaling $115,294, remained outstanding for more than 90 days as of February 29, 2020 (see Finding 6).

- Leave credits with a value of $2,862,073 were not properly reduced in the leave accounting system after separation lump-sum payments were made to 42 of 105 (40%) employees whose records we examined; we projected an additional $27,512,228 in unreduced leave credits. CDCR also made a net total of $1,235 in improper payments to four of the 105 (4%) of the employees; we projected an additional $11,875 in improper payments. Furthermore, CDCR did not make separation lump-sum payments to eight (or 8%) of the 105 (8%) employees in a timely manner (see Finding 7).

- CDCR had inadequate controls to ensure that holiday credits were granted to eligible employees; we identified seven improper transactions with an approximate value of $2,266. Although the number of transactions and the dollar amount are small, there could be additional improper credits (see Finding 8).

Follow-up on Prior Audit Findings

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

Views of Responsible Officials

We issued a draft audit report on October 4, 2024. CDCR's representative responded by letter dated October 11, 2024, agreeing with the audit results. This final audit report includes CDCR's response as an attachment.

Restricted Use

This audit report is solely for the information and use of CDCR 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 23, 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	224	N/A	224 Employees	N/A	N/A	N/A	2
Regular pay	Statistical	221,804	$ 1,652,978,591	105 Transactions	$ 870,864	$ -	$411,982,949	3
Overtime pay	Statistical	36,958	46,509,041	105 Transactions	101,582	38,511	22,310,027	4
Excess vacation and annual leave	Statistical	1,047	40,265,164	105 Employees	4,293,285	1,317,845	11,041,746	5
Salary advance	Targeted	34	136,778	34 Transactions	136,778	115,294	-	6
Separation lump-sum pay	Statistical	1,233	60,680,135	105 Employees	5,717,695	2,863,308	27,524,103	7
Leave buy-back	Statistical	2,378	10,428,203	105 Transactions	460,566	-	-	
Uniform allowance	Statistical	4,254	1,485,871	105 Transactions	35,467	-	-	
Holiday credit	Targeted	14,259	5,581,346	7 Transactions	2,266	2,266	-	8
			$ 1,818,065,129		$ 11,618,503	$ 4,337,224	$472,858,825	

Findings and Recommendations

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

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

Our audit found that CDCR 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. CDCR 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 CDCR 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 8, represent a material weakness in internal control over the payroll process such that there is a reasonable possibility that a material noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected, on a timely basis.

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

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

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 CDCR:

- 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, CDCR 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

CDCR lacked adequate controls to ensure that only appropriate staff members had keying access to the State's payroll system. CDCR inappropriately allowed 52 employees keying access to the State's payroll system. If not mitigated, this control deficiency leaves payroll data at risk of misuse, abuse, and unauthorized use.

The SCO maintains the State's payroll system. The system is decentralized, thereby allowing employees of state agencies to access it. All state agencies are required to follow the *Decentralized Security Program Manual* (DSP Manual) in order to access the payroll system. The 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 224 CDCR employees who had keying access to the State's payroll system at various times between March 2017 and February 2020. Of the 224 employees, 52 had inappropriate keying access to the State's payroll system. Specifically, CDCR did not immediately remove or modify keying access for the 52 employees after their separation from state service, transfer to another agency, or change in classification. CDCR lacked periodic review of keying access granted to employees to ensure compliance with the DSP Manual.

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 June 2020 DSP Manual ("Access Requirements," page 7) 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 regular daily 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 via 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. . . .

The June 2020 DSP Manual ("Revocation and Deletion of User IDs," page 10) 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 signed by both Security Monitor and Authorizing Manager to delete the user's system access. Using an old User ID increases the risk of a security breach, which is a serious security violation. Sharing a User ID is strictly prohibited. . . .

<u>Recommendation</u>

We recommend that CDCR:

- Update keying access to the State's payroll system immediately after employees leave CDCR, 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

Payroll records show that CDCR processed 221,804 regular pay transactions, totaling $1,652,978,591, between March 2017 and February 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling $870,864. Based on our examination, we questioned 25 transactions with an approximate value of $217,051 because CDCR lacked timesheets associated with regular pay. 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.

Statistical sampling results

The identified unsupported payments totaled $217,051.

Based on number of missing timesheets identified in our statistical sample, we projected an additional $411,765,898 in unsupported payments.

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

Identified unsupported payments	$ 217,051
Divide by: Sample	870,864
Error rate for projection (differences due to rounding)	24.92%
Population that was statistically sampled	1,652,978,591
Multiply by: Error rate for projection	24.92%
Identified and projected unsupported payments (differences due to rounding)	411,982,949
Less: Identified unsupported payments	217,051
Projected unsupported payments	$ 411,765,898

<u>Criteria</u>

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

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

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.

<u>Recommendation</u>

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

FINDING 4— Improper overtime payments

CDCR 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. CDCR also lacked adequate supervisory review to ensure accurate processing of overtime pay.

Payroll records show that CDCR processed 36,958 overtime pay transactions, totaling $46,509,041, between March 2017 and February 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling $101,582. Based on our examination of the selected transactions, we found that:

- CDCR overpaid 32 of 105 (30%) of the transactions by $41,282 and underpaid six of 105 (6%) of the transactions by $2,771. The errors occurred because payroll transactions unit staff members miscalculated overtime hours worked; paid employees for overtime hours worked at the straight-time rate instead of the time-and-a-half rate, or vice-versa; failed to verify that employees were eligible for overtime pay; and incorrectly entered overtime hours worked into the payroll system. We projected an additional $18,859,595 in overpayments and an additional $1,265,884 in underpayments.

- CDCR lacked timesheets associated with 13 of 105 (12%) of the transactions; the 13 timesheets totaled $10,301. 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. We projected an additional $4,706,015 in unsupported transactions.
- CDCR lacked the required prior written approval of overtime hours for 44 of 105 (42%) of the transactions, including 23 that were overpaid and 13 that were unsupported.

If not mitigated, these control deficiencies leave CDCR at risk of making additional improper overtime payments.

Statistical sampling results

The identified improper and unsupported payments totaled $48,812.

We used a statistical sampling method to select the overtime pay transactions that we examined. We projected an additional $18,859,595 in overpayments, an additional $1,265,884 in underpayments, and an additional $4,706,015 in unsupported payments. The projected improper and unsupported payments totaled a net of $22,299,726.

The identified and projected improper and unsupported payments totaled a net of approximately $22,348,538, consisting of $18,900,877 in overpayments, $1,268,655 in underpayments, and $4,716,316 in unsupported payments.

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

Identified improper and unsupported payments, net	$ 48,812
Divide by: Sample	101,582
Error rate for projection (differences due to rounding)	48.05%
Population that was statistically sampled	46,509,041
Multiply by: Error rate for projection	48.05%
Identified and projected improper and unsupported payments, net (differences due to rounding)	22,348,538
Less: Identified improper and unsupported payments, net	48,812
Projected improper and unsupported payments, net	$ 22,299,726

<u>Criteria</u>

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

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

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including a system of policies and procedures adequate to ensure compliance with applicable laws and other requirements, and an effective system of internal review.

Recommendation

We recommend that CDCR:

- Conduct a review of overtime payments made during the past three years to ensure that the payments complied with collective bargaining agreements and state laws and policies; and
- Recover 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, CDCR:

- Establish adequate internal controls to ensure that payments are accurate and entered correctly into the payroll system, and that employees are eligible for overtime pay;
- Provide adequate oversight to ensure that payroll transactions unit staff process only valid and authorized payments that comply with collective bargaining agreements and state laws and policies; and
- Maintain supporting documentation for overtime pay, pursuant to its retention policies.

FINDING 5— Excessive vacation and annual leave balances

As of February 29, 2020, CDCR employed 1,047 employees who exceeded the limits on vacation and annual leave balances set by collective bargaining agreements and state regulations. The value of CDCR's excess leave balances was at least $40,265,164 as of February 29, 2020. Our audit determined that for about 30% of the excess leave balances, with a value of $12,359,591, CDCR failed to implement controls to ensure that it adhered to the requirements of collective bargaining agreements and state regulations to limit the accumulation of vacation and annual leave credits. 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.

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

[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.

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 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 1,047 employees with excess vacation and annual leave, we randomly selected a statistical sample (as described in the Appendix) of 105 employees who accumulated 69,073 hours of excess vacation and annual leave balances, with a value of at least $4,293,285. We examined the records of these selected employees to determine whether CDCR complied with collective bargaining agreements and state regulations.

Of the 105 employees whose records we examined, 29 did not comply with collective bargaining agreements and state regulations for the following reasons:

- CDCR 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 balances because of the extenuating circumstances specified in the agreements and regulations.
- CDCR had no plans in place during the audit period for the employees to reduce leave balances below the limit.

The 29 employees accumulated 19,789 hours of excess vacation and annual leave balances, with a value of at least $1,317,845.

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 $1,317,845.

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 $11,041,746. Therefore, the identified and projected value of excess vacation and annual leave balances totaled $12,359,591.

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

Identified excess vacation and annual leave balances	$ 1,317,845
Divide by: Sample	4,293,285
Error rate for projection (differences due to rounding)	30.70%
Population that was statistically sampled	40,265,164
Multiply by: Error rate for projection	30.70%
Identified and projected excess vacation and annual leave balances (differences due to rounding)	12,359,591
Less: Identified excess vacation and annual leave balances	1,317,845
Projected excess vacation and annual leave balances	$ 11,041,746

If CDCR 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.

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 CDCR:

- 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 6—Failure to collect outstanding salary advances

CDCR lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls over salary advances to ensure that they were recovered in a timely manner in accordance with state law and policies. Twenty-seven salary advances, totaling \$115,294, remained outstanding for more than 90 days as of February 29, 2020.

As of February 29, 2020, CDCR's accounting records showed 34 outstanding salary advances, totaling \$136,778. We examined all 34, and found 27 balances—with a value of \$115,294—that had been outstanding for more than 90 days. The 27 salary advances had been outstanding for an average of 286 days, and the oldest unrecovered salary advance was outstanding for over three years. We noted that CDCR had not initiated timely collection efforts for the 27 balances that were over 90 days old. For example, CDCR issued a salary advance to an employee in February 2018 and sent the first collection letter in February 2019, approximately a year later. Salary advances are more difficult to collect after an employee leaves state service, and they may become uncollectable if not collected within three years.

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

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 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 CDCR 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 7—Inaccurate leave accounting; improper and late separation lump-sum payments

CDCR lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls over the processing of employee separation lump-sum pay, and adequate supervisory review to ensure accurate and timely processing of separation lump-sum pay.

Payroll records show that CDCR processed separation lump-sum payments, totaling $60,680,135, for 1,233 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 $5,717,695. Based on our examination of these selected records, we found that:

- CDCR did not appropriately reduce the leave balances in the State's leave accounting system for 42 of 105 (40%) employees to reflect the number of leave credits—with a value of $2,862,073—that had been paid. Unreduced leave balances pose a risk to the State because they overstate the State's liability for leave balances and allow the possibility of improper and duplicative payments for leave credits. However, CDCR stated that the employees' leave balances were corrected in the leave accounting system after we discussed this issue with CDCR representatives. We projected the value of additional unreduced leave credits to be $27,512,228.

- CDCR made improper payments, with a net total of $1,235, to four of 105 (4%) employees whose leave balances had not been reduced because payroll transactions unit staff members miscalculated leave credits paid. We projected an additional $11,875 in improper payments.

- CDCR also did not make separation lump-sum payments to eight of 105 (8%) employees in a timely manner.

If not mitigated, these control deficiencies leave CDCR 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 unreduced leave credits and improper payments have a net value of $2,863,308.

We used a statistical sampling method to select the employees whose payments for separation lump-sum pay were examined. We projected an additional $27,512,228 in unreduced leave credits; and we projected an additional $15,658 in overpayments and an additional $3,783 in underpayments. The projected improper costs have a net total of $27,524,103. Therefore, the identified and projected improper costs totaled a net of approximately $30,387,411, consisting of $17,287 in overpayments, $4,177 in underpayments, and $30,374,301 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	$ 2,863,308
Divide by: Sample	5,717,695
Error rate for projection (differences due to rounding)	50.08%
Population that was statistically sampled	60,680,135
Multiply by: Error rate for projection	50.08%
Identified and projected value of unreduced leave credits and improper payments, net (differences due to rounding)	30,387,411
Less: Identified value of unreduced leave credits and improper payments, net	2,863,308
Projected value of unreduced leave credits and improper payments, net	$ 27,524,103

Criteria

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

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.

Recommendation

We recommend that CDCR:

- 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 any overpayments made to separated employees in accordance with GC section 19838 and SAM sections 8291, 8291.1, 8293, and 8293.2; and
- Properly compensate those employees who were underpaid

We further recommend that, to prevent inaccurate leave balances and improper payments from recurring, CDCR 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 8— Improper holiday credit transactions

CDCR 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. We identified approximately $2,266 in improper holiday credits. If not mitigated, this control deficiency leaves CDCR at risk of granting additional improper holiday credits.

Leave accounting records show that CDCR processed 14,259 accrual transactions of holiday credit, with an estimated value of $5,581,346. We examined seven of these transactions, with an estimated value of $2,266, because they involved unusual credits. We found that all seven 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. CDCR also lacked adequate supervisory review to ensure proper and accurate processing of holiday credits.

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 1, 6 and 9 include similar provisions regarding holiday credit and holiday pay for represented employees.

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

Recommendation

We recommend that CDCR:

- 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.

Appendix— Audit Sampling Methodology

This Appendix outlines our audit sampling application for all audit areas where 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	221,804	$ 1,652,978,591	Transaction	105	3
Overtime pay	36,958	46,509,041	Transaction	105	4
Excess vacation and annual leave	1,047	40,265,164	Employee	105	5
Separation lump-sum pay	1,233	60,680,135	Employee	105	7
Leave buy-back	2,378	10,428,203	Transaction	105	
Uniform allowance	4,254	1,485,871	Transaction	105	

Attachment— California Department of Corrections and Rehabilitation's Response to Draft Audit Report

DIVISION OF HUMAN RESOURCES
PAYROLL & BENEFITS OPERATIONS
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October 11, 2024

Kimberly A. Travin, CPA
State Controller's Office
Chief, Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Ms. Travin:

This letter is in response to the draft report issued by the State Controller's Office (SCO) on October 4, 2023, regarding the Payroll Process Review of the California Department of Corrections and Rehabilitation (CDCR), Payroll & Benefit Operations (PBO) for the period of March 1, 2017 through February 29, 2020. PBO takes its responsibility seriously to ensure that effective payroll processes are in place and is committed to continually improving these processes as the entire management team has turned over since this audit was conducted.

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

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

Response: PBO agrees with the audit finding. Adjustments have been made and PBO will continue its efforts to segregate duties while also balancing the ongoing challenge of shifting workloads resulting from staff turnover and vacancies. The Personnel Specialist (PS) duties and responsibilities consist of processing various personnel/payroll transactions, including: data entry, reconciliation, and processing adjustments and corrections. Over the years, these duties have increased significantly, which has caused our Personnel Supervisor I/II (PS I/II) to assist with completing the job duties of the PS and Senior PS. In May 2022, PBO changed its organizational structure, and began utilizing analysts to assist with auditing, reconciling, and providing a peer review of items such as reconciled leave, audited appointments and separations and audited pay differentials that are applied to employees' pay.

In April 2020, CDCR implemented the Electronic Personnel Operation Manual (ePOM) Section 730, Accurate and Timely Leave Accounting Procedures, to ensure a designated reviewer performs monthly reviews of timesheets to reconcile pay and leave. Policy is currently being updated to account for the new virtual work environment to ensure PBO completes the required timesheet and leave audits. We have this projected to be released by January 2025. In April 2024, PBO developed internal procedures for performing and documenting compensating controls, as well as conducting monthly reviews of leave keyed into the payroll system by our personnel staff.

Additionally, in 2023, a PS academy was developed for all new PSs to attend upon appointment. The academy assists with training and educating new staff and consists of in-person and/or virtual instructor-led onboarding, training, hands on experience, and eLearning courses.

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

Response: PBO agrees with the audit finding and has confirmed that all employees have appropriate access to avoid inappropriate keying access to the State's payroll system. PBO follows the SCO Decentralized Security Program Manual procedures for removing or adding SCO access for staff. PBO implemented internal controls to ensure employees are removed when changing classifications, transferring to another agency, or separating from CDCR. PBO has also implemented a monthly review of SCO access to ensure we are in compliance. PBO ensures that the SCO Security Monitor is notified of all staff being appointed and separated from positions with SCO access.

Finding #3 — Missing timesheets for regular pay.

Response: PBO agrees with the audit finding and has created a policy to ensure all timesheets (998s) are received for each unit. If a 998 is not received from an employee by the 3rd business day after pay day, the PS is to inform the employee as well as the employee's manager. This process has been reiterated to PBO staff, and as stated in the response to Finding 1, PBO is currently updating ePOM Section 730 to account for the required timesheet and leave audits. Part of this audit process is updating the method of how PBO tracks whether a timesheet was received from each employee, including those on extended leave. The "known" overpayment amounts listed in this finding were due to 25 timesheets being unavailable for the audit, resulting in the employees' full gross monthly pay being counted as questionable payments. Improving our timesheet tracking will reduce the errors listed in this finding. CDCR currently maintains supporting documentation for regular pay, pursuant to its records retention policy.

Finding #4 — Improper overtime payments.

Response: PBO acknowledges there may be errors within the overtime calculations; however, since SCO's sampled records are outside of CDCRs retention period, PBO cannot verify why the errors occurred. As such, PBO is unable to verify if the records provided to SCO included carryover overtime hours from the prior pay period. Most months have carryover hours which would have impacted the pay history that was compared to the timesheet. Additionally, if leave was taken during a work week that splits between two pay periods that would impact whether the overtime was paid at the straight or premium rate. PBO is unable to determine if either of these factors were considered in the audit findings.

Due to the recent budget impacts, PBO has lost numerous positions and is operating with limited staff; therefore, we are unable to execute your recommendation to review all overtime payments made during the past three years. PBO is currently completing sample 998 audits of units within our agency to ensure leave was taken correctly and overtime was paid out accordingly. CDCR developed a training module, Reviewing CDCR 998-A for Overtime and in March 2023, all PBO staff attended. This training is also provided to all new staff appointed within PBO and can be accessed anytime on the Learning Management System. As an added measure to ensure overtime is being processed accurately, our PSs are required to send their 998s and STD. 672s to their assigned analyst to review all overtime prior to it being keyed into SCO. In response to 998s missing for auditing overtime, we have developed a share drive where all 998s are placed after being processed into the employee's assigned folder. This has created a centralized location for 998s to be easily accessible. CDCR currently maintains supporting documentation for regular pay, pursuant to its records retention policy.

Finding #5 — Excessive vacation and annual leave balances.

Response: PBO agrees with the audit finding and implemented the leave reduction plan requirements effective July 2019 to comply with the applicable leave reduction effort policies. The requirements state that employees with leave balances over the cap must have leave reduction plans that are approved by their respective supervisors. On June 4, 2019, the "Leave Reduction Plan Requirements-Action Due by July 5, 2019" memorandum was distributed to all staff from the CDCR HR Mailbox, which requires the completion and documentation of leave reduction plans for all employees in excess of or approaching leave credit balance limitations. However, effective October 26, 2020, the California Department of Human Resources suspended leave reduction plan requirements for the duration of the 2020 Personal Leave Program (PLP), until July 1, 2022 or until PLP 2020 ended. The PLP 2020 ended June 30, 2021 for all employees. This resulted in leave balances continuing to rise. Although the leave reduction plan requirements were suspended, when operationally feasible and when the budget permits, managers and supervisors were encouraged to work with employees to reduce leave balances, utilizing PLP and vacation/annual leave for scheduled time off. CDCR has resumed Annual Leave Reduction Plans starting in April 2024.

Finding #6 — Failure to collect outstanding salary advances.

Response: PBO agrees with the audit finding. Since the audit, PBO is more efficiently tracking records of outstanding salary advances and documents sent to SCO to request pay. PBO holds monthly meetings with our Accounts Receivable/Salary Advance (AR/SA) unit to review outstanding items and look for patterns of concern. The AR/SA unit is tracking which PS are not actively working the monthly AR/SA report. Additionally, in October 2022, PBO developed and implemented a new process with CDCR's Accounting Services Branch (ASB) that requires all warrants be held by ASB until cleared by PBO to ensure warrants are being applied to open salary advances and are not inadvertently released to employees. Training was provided to all PBO staff on Salary Advances in October 2021 and February 2022. In December 2023, CDCR's policy incorporated these changes within ePOM Section 713, Disposition of Payroll Warrants.

Finding #7 — Inaccurate leave accounting; improper and late separation lump-sum payments.

Response: PBO agrees with the audit finding and has adjusted our process since this audit. PBO is utilizing the Lump Sum memorandum, Personnel Information Bulletin (PIB), and the October 2020 Election to defer Lump Sum Separation Pay into the Next Calendar Year Form (CDCR 3062) to ensure all lump sum calculations are correct and timely. This PIB provides processing instructions to each PS for deferring lump sum separation pay into the next calendar year, as well as deferrals into a Savings Plus Plan. PBO also utilizes the SCO's Lump Sum Separation Toolkit. The toolkit includes the Guide for Avoiding Common Errors: Lump Sum Documentation and Processing, Lump Sum Worksheet, and Lump Sum Pre-Tax Calculator. These tools aid PBO to ensure all lump sum calculations are correct and timely. Additionally, PBO implemented a checklist for use by all PSs to ensure leave balances are cleared when cashed out as part of a lump sum. Furthermore, to ensure calculations are accurate, we follow the policy requiring two levels of approval for a lump sum leave runout and its corresponding salary advance. Currently, this consists of a peer review by an analyst and a manager.

Due to the recent budget impacts, PBO has reduced positions and is operating with limited staff; therefore, we are unable to execute your recommendation to review lump sum payments for headquarters staff, which includes compensating underpaid employees and recovering payments during the past three years. As our internal resources allow, we will revisit an internal audit for proof of practice in the coming year.

Finding #8 — Improper holiday credit transactions.

Response: PBO agrees with the audit finding. As stated in Findings 1 and 3, PBO has implemented a monthly audit to ensure accuracy in leave credit transactions. This monthly audit is designed to identify errors like holiday credits listed in Finding 8. In the interim, the analysts are conducting a peer review of the 998s to ensure holidays are being credited accordingly. The HR Manual for Holiday Credit was updated and PBO staff were trained on this in December 2022. This manual is being presented and trained to each new PS, Senior PS, analyst, and manager appointed to PBO.

Due to the recent budget impacts, PBO has reduced positions and is operating with limited staff; therefore, we are unable to execute your recommendation to review holiday credits and ensure they were credited accordingly during the past three years. Additionally, our process has changed since this audit and clear direction has been presented to our staff regarding holiday credit transactions. As our internal resources allow, we will revisit an internal audit for proof of practice in the coming year.

PBO welcomes insights provided by the auditors and would like to thank SCO for its work on this report. PBO continues to place importance on the quality of work of the Personnel Office and is looking forward to continued improvement. We will take corrective action as necessary to address the issues identified in this report. Should you have any questions, please contact Brandi Probst, Staff Services Manager III, Payroll and Benefits Operations, at [redacted] or via email at [redacted]

Sincerely,

DocuSigned by:
Danyal Noel
F3A5331552B4465...

DANYAL NOEL
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