DEPARTMENT OF DEVELOPMENTAL SERVICES

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 27, 2024

Mr. Pete Cervinka, Acting Director
Department of Development Services
P.O. Box 944202
Sacramento, CA 94244

Dear Mr. Cervinka:

The State Controller's Office audited the Department of Developmental Services' 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.

Department of Developmental Services 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

Copy: Carla Castaneda, Chief Deputy Director, Operations
Department of Developmental Services
Jim Knight, Deputy Director
Administration Division
Department of Developmental Services
Courtney Filkill, Manager
Human Resources Branch
Department of Developmental Services
Carlos Mendoza, Personnel Supervisor II
Human Resources Branch
Department of Developmental Services
Helen Fairchild, Chief
Administrative Services Division
California Department of Human Resources
Lisa Dean, Acting Chief
Personnel and Payroll Services Division
State Controller's Office
Veronica Encinas, Bureau Chief
Personnel and Payroll Services Division
State Controller's Office

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Audit Report

Summary

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

DDS 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 DDS 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 and leave balances accurately and in accordance with collective bargaining agreements and state laws, regulations, policies, and procedures in certain instances, as described in Findings 3, 4, 6, 7 and 8; 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 DDS:

- 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 $118,969,688, as quantified in the Schedule.

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

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

- DDS had inadequate segregation of duties and a lack of compensating controls over payroll transactions (see Finding 1).
- Six of 19 (32%) employees whose records were examined during our audit had inappropriate keying access to the State's payroll system (see Finding 2).
- DDS did not reduce employees' balances in the State's leave accounting system after three of 105 (3%) regular-pay transactions that we examined, and did not record earned credits in the State's leave accounting system for two of 105 (or 2%) of the transactions. The identified and projected unreduced leave credits totaled $196,318, and the identified and projected unrecorded leave credits totaled $82,787. In addition, DDS did not consistently maintain timesheets for regular pay. Based on our audit testing, we estimated that 9% of the timesheets associated with regular pay during the audit period were not retained. We identified $48,665 and projected an additional $8,143,645 in unsupported regular pay transactions (see Finding 3).

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

- DDS had inadequate controls to ensure that it adhered to requirements limiting the accumulation of vacation and annual leave credits. As of February 29, 2020, DDS's leave accounting records show 77 employees whose balances exceed the limits set by collective bargaining agreements and state regulations. The value of DDS's excess leave balances was at least $2,003,753 as of February 29, 2020. Based on our audit testing, we determined that for all 77 employees, DDS had failed to implement controls to ensure that it adhered to the requirements (see Finding 4).
- DDS had inadequate controls to ensure that salary advances were properly issued, administered in accordance with requirements, and collected in a timely manner. Specifically, DDS was unable to provide supporting documentation for 15 salary advances totaling $326,959 (see Finding 5).
- DDS overpaid 10 of 105 (10%) overtime transactions that we examined and underpaid four of 105 (4%) transactions. The identified and projected overpayments and underpayments total $27,106 and $13,138, respectively. In addition, DDS did not consistently maintain timesheets for overtime pay. Based on our audit testing, we estimated that 14% of the timesheets associated with overtime payments during the audit period were not retained; we identified $11,061 and projected an additional $175,477 in unsupported overtime payments (see Finding 6).
- DDS did not reduce employees' balances in the State's leave accounting system for seven of 64 (11%) leave buy-back transactions that we examined; the unreduced leave credits had a value of $21,627. In addition, DDS did not consistently maintain supporting documentation for 10 of the 64 (16%) leave buy-back transactions that we examined; we identified $34,612 in unsupported leave buy-back transactions (see Finding 7).
- DDS overpaid seven of 58 (12%) employees whose separation lump-sum payments we examined and underpaid 14 of 58 (24%) of the employees. The identified and projected overpayments and underpayments totaled $7,017 and $48,750, respectively. In addition, DDS did not make separation lump-sum payments to 18 of 58 (31%) of the employees in a timely manner. Furthermore, DDS did not consistently maintain supporting documentation for separation lump-sum pay. Based on our audit testing, we estimated that 10% of the supporting documentation associated with separation lump-sum payments during the audit period was not retained; we identified $14,059 and projected an additional $19,377 in unsupported payments (see Finding 8).

Follow-up on Prior Audit Findings

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

Views of Responsible Officials

We issued a draft audit report on September 12, 2024. A representative from DDS responded by letter dated September 23, 2024, agreeing with the audit results. This final audit report includes DDS's response as an attachment.

Restricted Use

This audit report is solely for the information and use of DDS 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 27, 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	19	N/A	19 Employees	N/A	N/A	N/A	2
Regular pay	Statistical	18,403	$ 112,828,482	105 Transactions	$ 670,237	$ 674	$ 8,305,167	3
Excess vacation and annual leave	Targeted	77	2,003,753	77 Employees	2,003,753	2,003,753	-	4
Salary advance	Targeted	233	570,628	15 Transactions	326,959	-	326,959	5
Overtime pay	Statistical	1,698	1,606,819	105 Transactions	95,273	828	199,678	6
Leave buy-back	Targeted	64	187,037	64 Transactions	187,037	21,627	34,612	7
Separation lump-sum pay	Statistical and targeted	97	1,772,969	58 Employees	949,410	(17,839)	9,292	8
			$ 118,969,688		$ 4,232,669	$ 2,009,043	$ 8,875,708	

Findings and Recommendations

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

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

Our audit found that DDS 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. DDS 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 DDS payroll process, and impairs the effectiveness of other controls by rendering their design ineffective or by preventing 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 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 DDS:

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

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

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

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

We examined the records of 19 DDS employees who had keying access to the State's payroll system at various times between March 2017 and February 2020. Of the 19 employees, six had inappropriate keying access to the State's payroll system. Specifically, DDS did not immediately remove or modify keying access for the employees after the employees' separation from state service, transfer to another agency, or change in classification. For example, a Senior Personnel Specialist left DDS on February 28, 2018, but DDS did not request to remove the employee's access until June 7, 2018—99 days later. DDS 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. . . .

<u>Recommendation</u>

We recommend that DDS:

- Update keying access to the State's payroll system immediately after employees leave DDS, 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 and missing timesheets for regular pay

DDS lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1. It also lacked adequate controls to ensure that paid credits were reduced and earned credits were recorded in the State's leave accounting system, and that timesheets were maintained to support regular pay.

Payroll records show that DDS processed 18,403 regular pay transactions, totaling $112,828,482, between March 1, 2017, and February 29, 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling $670,237. Based on our examination of these transactions, we found the following errors:

- DDS did not appropriately reduce employees' balances in the State's leave accounting system for three of 105 (3%) transactions to reflect the number of leave credits—with a value of $1,166—that had been used or 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. We projected additional unreduced leave credits with a value of $195,152.
- DDS did not increase employees' balances in the State's leave accounting system for two of 105 (2%) transactions to reflect the number of leave credits—with a value of $492—that the employees

had earned. Unrecorded leave credits understate employees' balances in the State's leave accounting system, and prevent the employees from using or receiving cash compensation for credits that they have earned. We projected additional unrecorded leave credits with a value of $82,295.

- DDS lacked timesheets associated with nine of 105 (9%) regular pay transactions totaling $48,665. 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 the additional unsupported payments to be $8,143,645.

If not mitigated, these control deficiencies leave DDS at risk of making additional improper payments for regular pay.

Statistical sampling results

The identified value of unreduced leave credits, unrecorded leave credits, and unsupported payments totaled $49,339.

We used a statistical sampling method to select the regular pay transactions examined. We projected an additional $195,152 in unreduced leave credits and an additional $82,295 in unrecorded leave credits. We also projected additional unsupported payments of $8,143,645. The projected improper and unsupported costs have a net total of $8,256,502. Therefore, the identified and projected improper and unsupported costs totaled approximately $8,305,841, consisting of $196,318 in unreduced leave credits, $82,787 in unrecorded leave credits, and $8,192,310 in unsupported payments.

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, net	$ 49,339
Divide by: Sample	670,237
Error rate for projection (differences due to rounding)	7.36%
Population that was statistically sampled	112,828,482
Multiply by: Error rate for projection	7.36%
Identified and projected value of unreduced leave credits and unsupported payments, net (differences due to rounding)	8,305,841
Less: Identified value of unreduced leave credits and unsupported payments, net	49,339
Projected value of unreduced leave credits and unsupported payments, net	$ 8,256,502

Criteria

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

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

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

Recommendation

We recommend that DDS:

- Establish adequate controls to ensure that employee leave balances are adjusted in a timely manner after payments for regular pay are made; and
- Maintain supporting documentation for regular pay pursuant to its retention policies.

FINDING 4—Excessive vacation and annual leave balances

DDS's leave accounting records show 575 employees with unused vacation or annual leave credits at February 29, 2020. Of those employees, 77 exceeded the limits set by collective bargaining agreements and state regulations. These employees accumulated 36,407 hours of excess vacation and annual leave, with a value of at least $2,003,753 as of February 29, 2020. DDS 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.

Collective bargaining agreements and state regulations limit the amount of vacation and annual leave that 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 (CalHR) 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.

We examined the records of the 77 employees with excess vacation and annual leave to determine whether DDS had complied with collective bargaining agreements and state regulations. None of the 77 employees

[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.

complied with collective bargaining agreements and state regulations for the following reasons:

- DDS 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.
- DDS had no plans in place during the audit period for the employees to reduce leave balances below the limit.

These 77 employees accumulated 36,407 hours of excess vacation and annual leave, with a value of at least $2,003,753 as of February 29, 2020.

If DDS 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.

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).

<u>Recommendation</u>

We recommend that DDS:

- 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 and maintain related documentation

DDS 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 advances were issued properly and collected in a timely manner, and that adequate records were maintained in accordance with state laws, regulations, policies, and procedures. Fifteen salary advances, totaling $326,959, lacked required documentation.

DDS was not able to provide accounting records with information about outstanding salary advances as of February 29, 2020, or as of any given time during the audit period. This was because DDS began using a new accounting system in July 2018; data from before that date was unavailable, and the system was unable to generate an outstanding salary advance aging report because it lacked necessary information such as issuance dates and ages of salary advances.

For our audit purposes, we used DDS's list of 233 salary advances, totaling $570,628, issued between July 2018 and February 2020. The list did not include issuance dates or ages of salary advances. We examined the 15 largest salary advances, totaling $326,959. DDS was unable to provide the required documentation for these advances; therefore, we were unable to determine whether the 15 advances had been properly issued and collected in a timely manner, or whether DDS attempted to recover the advanced funds if overpayments had occurred.

The lack of adequate records, such as monthly reports, for salary advances prevents DDS from performing adequate review and reconciliation of salary advances. If not mitigated, these control deficiencies leave DDS at risk of failing to collect future salary advances.

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.

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 DDS:

- Establish adequate controls to ensure that salary advances are issued, administered, and collected in compliance with state laws and policies;
- Conduct monthly review and reconciliation of salary advances; and
- Maintain adequate records of salary advances, collection efforts and payments.

FINDING 6—Improper payments and missing timesheets for overtime pay

DDS 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, adequate supervisory review to ensure accurate processing of overtime pay, and adequate controls to ensure that timesheets were maintained for overtime payments.

Payroll records show that DDS processed 1,698 overtime pay transactions, totaling $1,606,819, between March 2017 and February 2020. We randomly selected a statistical sample (as described in the Appendix) of 105 transactions, totaling $95,273. Based on our examination of these transactions, we found the following errors:

- DDS overpaid 10 of 105 (10%) transactions by $1,607 and underpaid four of 105 (4%) transactions by $779. The error occurred because payroll transactions unit staff members miscalculated overtime hours worked; paid for overtime hours worked at the straight-time rate instead of the time-and-a-half rate, or vice-versa; and failed to verify that employees were eligible for overtime pay. DDS also lacked adequate supervisory review to ensure accurate and timely processing of overtime pay. We projected the additional overpayments to be $25,499 and the additional underpayments to be $12,359.

- DDS lacked timesheets and supporting calculations for 15 of 105 (14%) overtime pay transactions, with a value of $11,061. 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 the additional unsupported payments to be $175,477.

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

Statistical sampling results

The identified improper and unsupported payments have a net total of $11,889.

We used a statistical sampling method to select the overtime pay transactions that we examined. We projected an additional $25,499 in overpayments and $12,359 in underpayments; we also projected an additional $175,477 in unsupported payments. The projected improper and unsupported payments have a net total of $188,617. Therefore, the identified and projected improper and unsupported payments totaled a net of approximately $200,506, consisting of $27,106 in overpayments, $13,138 in underpayments, and $186,538 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	$ 11,889
Divide by: Sample	95,273
Error rate for projection (differences due to rounding)	12.48%
Population that was statistically sampled	1,606,819
Multiply by: Error rate for projection	12.48%
Identified and projected improper and unsupported payments, net (differences due to rounding)	200,506
Less: Identified improper and unsupported payments, net	11,889
Projected improper and unsupported payments, net	$ 188,617

Criteria

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

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

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

Recommendation

We recommend that DDS:

- Conduct a review of overtime payments made during the past three years to ensure that the payments complied with collective bargaining agreements and state laws and policies;
- Recover any overpayments made to employees through an agreed-upon collection method in accordance with GC section 19838 and SAM sections 8291, 8291.1, and 8293; and
- Properly compensate those employees who were underpaid.

We further recommend that, to prevent improper payments for overtime pay from recurring, DDS:

- Establish adequate internal controls to ensure that payments are accurate and comply with collective bargaining agreements and state laws and policies;
- 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 7— Inaccurate leave accounting and missing documentation for leave buy-back

DDS lacked adequate segregation of duties within its payroll transactions unit, as noted in Finding 1; it also lacked adequate controls to ensure that credits that had been bought back were properly reduced in the State's leave accounting system, and that supporting documentation was maintained to support leave buy-back payments.

A leave-buy back occurs when an employee receives payment at the regular salary rate in exchange for accrued vacation, annual leave, personal leave, personal holiday, and/or holiday credits. CalHR authorized leave buy-backs for excluded employees from fiscal year 2016-17 through fiscal year 2018-19. It also provided the State's policies and procedures regarding cash-out of vacation and annual leave.

Payroll records show that DDS processed 64 leave buy-back transactions, totaling $187,037, between March 2017 and February 2020. We examined all 64 transactions to determine whether DDS complied with collective bargaining agreements and state regulations, and found the following errors:

- DDS did not reduce employees' balances in the State's leave accounting system for seven of 64 (11%) transactions to reflect the number of leave credits—with a value of $21,627—that had been bought back. 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.

- DDS lacked supporting leave buy-back forms and calculations associated with 10 of 64 (10%) leave buy-back transactions totaling $34,612. Without the required documentation, we could not determine the validity, accuracy, and propriety of the payments made to the employees or the completeness and accuracy of the leave accounting records.

If not mitigated, these control deficiencies leave DDS at risk of making additional improper leave buy-back payments.

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.

Title 2, California Code of Regulations, section 599.744 provides that CalHR may also authorize a leave buy-back program for employees excluded from collective bargaining.

Collective bargaining agreements between the State and various bargaining units allow for the annual cash-out of a certain number of hours of accumulated vacation and annual leave if funds are available.

DDS's General Retention Schedule for Payroll/Personnel Records specifies a four-year retention period for leave buy-back documentation.

Recommendation

We recommend that DDS:

- Establish adequate internal controls to ensure that the employee leave balances are reduced in a timely manner after leave buy-back payments are made; and

- Maintain supporting documentation for leave buy-back payments pursuant to DDS retention policies.

FINDING 8— Improper and late payments, and missing documentation for separation lump-sum pay

DDS 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; adequate supervisory review to ensure accurate and timely processing of separation lump-sum pay; and adequate controls to ensure that documentation was maintained to support separation lump-sum payments.

Payroll records show that DDS processed separation lump-sum payments, totaling $1,772,969, for 97 employees between March 2017 and February 2020, as follows.

Separation Lump-Sum Pay Group	Unit	Amount
Employees who were paid at least $100,000 (examined 100%)	3	$ 351,828
Employees who were paid less than $100,000 (statistically sampled)	94	1,421,141
Total population	97	$1,772,969

We examined the payments for all three employees who were paid at least $100,000 each in separation lump-sum payments. Of the 94 employees who were paid less than $100,000 each in separation lump-sum payments, we randomly selected a statistical sample (as described in the Appendix) of 55 employees who received separation lump-sum payments, totaling $597,582.

Based on our examination of the payments made to these 58 employees, we found the following errors:

- DDS overpaid seven of 58 (12%) employees by $3,530 and underpaid 14 of 58 (24%) employees by $21,369 because payroll transactions unit staff members miscalculated leave credits paid. DDS also lacked adequate supervisory review to ensure accurate and timely processing of separation lump-sum pay. We projected the additional overpayments to be $3,237 and underpayments to be $27,381.
- DDS did not make separation lump-sum payments to 18 of 58 (31%) employees in a timely manner.
- DDS could not locate supporting documents (lump-sum calculation worksheets, leave balance statements, state calendars, and timesheets) for payments, totaling $14,059, made to six of 58 (or 10%) 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 additional unsupported payments to be $19,377.

If not mitigated, these control deficiencies leave DDS 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 improper and unsupported payments resulted in a net total underpayment of $3,460.

We used a statistical sampling method to select the employees whose separation lump-sum payments were examined. We projected an additional $3,237 in overpayments and $27,381 in underpayments. We also projected an additional $19,377 in unsupported payments. The projected improper and unsupported payments resulted in a net total underpayment of $4,767. Therefore, the identified and projected improper and unsupported payments resulted in a net total underpayment of approximately $8,227, consisting of $5,586 in overpayments, $47,249 in underpayments, and $33,436 in unsupported payments.

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

Identified underpayments and unsupported payments, net	$ 3,460
Divide by: Sample	597,582
Error rate for projection (differences due to rounding)	0.58%
Population that was statistically sampled	1,421,141
Multiply by: Error rate for projection	0.58%
Identified and projected underpayments and unsupported payments, net (differences due to rounding)	8,227
Less: Identified underpayments and unsupported payments, net	3,460
Projected underpayments and unsupported payments, net	$ 4,767

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 CalHR's Human Resources Manual establish the requirements for separation lump-sum pay.

DDS's General Retention Schedule for Payroll/Personnel Records specifies a four-year retention period for separation lump-sum pay documentation.

Recommendation

We recommend that DDS:

- 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, and 8293; and
- Properly compensate those employees who were underpaid.

We further recommend that, to prevent improper payments from recurring, DDS establish adequate controls to ensure that:

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

Appendix— Audit Sampling Methodology

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

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

- It follows the American Institute of Certified Public Accountants (AICPA) guidelines;
- It allowed us to achieve our objectives for tests of compliance in an efficient and effective manner;
- Audit areas included high and low 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 fewer than 250 items, we determined the sample size using a calculator with a hypergeometric distribution. 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 rates were 2 (1.75%) for regular and overtime pay and 2 (2.00%) for separation lump-sum pay. 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. The rate 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	18,403	$112,828,482	Transaction	105	3
Overtime pay	1,698	1,606,819	Transaction	105	6
Separation lump-sum pay	94	1,421,141	Employee	55	8

Attachment—
Department of Developmental Services' Response to Draft Audit Report

State of California—Health and Human Services Agency
Department of Developmental Services
1215 O Street, Sacramento, CA 95814
www.dds.ca.gov

PETE CERVINKA
ACTING DIRECTOR

GAVIN NEWSOM
GOVERNOR

September 23, 2024

Roochel Espilla
Chief, State Agency Audits Bureau
Division of Audits
California State Controller's Office
P.O. Box 942850
Sacramento, CA 94250

SUBJECT: DEPARTMENT OF DEVLEOPMENT SERVICES PAYROLL PROCESS

Dear Roochel Espilla:

Thank you for the opportunity to review the findings from the California State Controller's Office (SCO) audit of the payroll process at the Department of Developmental Services (Department), for the period of March 1, 2017, through February 29, 2020.

The Department concurs with the findings and has fully implemented, or is in the process of implementing, corrective actions and DDS would like to note that during the audit's review period, the Department was going through a headquarters building relocation and the closure of two Developmental Centers, which were significant disruptions accompanied by employee turnover. During this period, many human resources records were being scanned, boxed and purged. Below are our responses describing corrective actions for each of the findings.

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

Due to the organizational structure at the time of the review, there was a lack of oversight in the Payroll Transactions area. Specifically, there were only two Senior Personnel Specialists and one Staff Services Manager I to provide oversight and review, making it a challenge to maintain adequate separation of duties. Since the review, the Department has hired a Transactions Staff Services Manager I and three additional Personnel Specialists. There now are formal procedures for performing and documenting compensating controls over payroll transactions:

- A Senior Personnel Specialist and the Transactions Staff Services Manager I conduct monthly audits.
- The Transactions Staff Services Manager I reviews all separation documentation, including but not limited to timesheets, lump sum payment calculations, leave balances and personnel action request documentation.
- The Transactions Staff Services Manager I reviews and approves personnel action request documents prepared by the Personnel Specialists prior to keying.

- On a periodic basis, employee payroll rosters rotate among the Personnel Specialists to give them experience with different types of pay, such as overtime and semi-monthly payroll.

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

During the review period, the Senior Personnel Specialist held responsibility for maintaining the decentralized security program, making it difficult to monitor and ensure timely follow up due to competing priorities. Since 2021, the Department has implemented the following corrective actions:

- The Transactions Staff Services Manager I updates keying access to the State's payroll system immediately after employees leave the department, transfer to another unit, or change classifications.
- The Personnel Officer will perform a quarterly review of all access to the system to verify that access complies with the *Decentralized Security Program Manual*.

Finding #3 - Inaccurate leave accounting and missing timesheets for regular pay

As mentioned previously, there were disruptive factors that contributed to the availability of records for the audit's review period. The Department has implemented the following corrective actions:

- Timesheets and supporting documentation (overtime slips, etc.) now are received electronically. The Personnel Specialist keeps records on a shared drive, as well as prints and files in a centralized filing location.
- Timekeepers are required to post all hours worked (for semi-monthly payroll), leave taken, and overtime monthly on the Time and Attendance Report (STD 672).
- The Personnel Specialist reconciles STD 672 in the California Leave Accounting System (CLAS) to verify available leave for every employee.
- The Department now has a procedure for reconciliation of leave accounting.
- The Senior Personnel Specialist conducts monthly audits of timesheets and supporting documentation as well as verify leave usage taken from CLAS.
- The Department is drafting a policy on Time and Attendance Reporting, which will be disseminated to all staff this Fall.

Finding # 4 - Inadequate controls over vacation and annual leave balances, resulting in liability for excessive balances.

- The Department anticipates releasing a Leave Management policy in October 2024, which outlines the process and responsibility of leave balance management for employees who are over the established leave balance caps. DDS also participated in the leave buy-back program in 2022 and 2023 to reduce leave balances.

Finding #5 - Failure to collect outstanding salary advances and maintain related documentation.

As noted in the audit findings, the Department was not able to provide accounting records of outstanding salary advances because the Department began using a new accounting system (Fi$Cal) in July 2018. Data from before that date was unavailable, and the new system was unable to generate an outstanding salary advance aging report because it lacked necessary information such as issuance dates and ages of salary advances. The Department has implemented the following corrective actions to assure salary advances are issued and collected properly.

- The Transactions Staff Services Manager I reviews and approves all requests for salary advances prepared by Personnel Specialist staff. The Manager also creates a tracking log for all issued salary advances and follows up on the clearance of salary advances.
- A monthly outstanding salary advance report from Accounting is reconciled with payroll records.

Finding #6 - Improper payments and missing timesheets for overtime pay.

The Department has implemented the following corrective actions:

- Timesheets and supporting documentation (overtime slips, etc.) now are received electronically. The Personnel Specialist keeps records on a shared drive, as well as prints and files records in a centralized filing location.
- Timekeepers are required to post all hours worked (for semi-monthly payroll), leave taken, and overtime monthly on the Time and Attendance Report (STD 672).
- The Personnel Specialist reconciles STD 672 in the California Leave Accounting System (CLAS) to verify available leave for every employee.
- A procedure for reconciliation of leave accounting has been established.
- The Senior Personnel Specialist conducts monthly audits of timesheets and supporting documentation as well as verifies leave usage taken from CLAS.
- The Department is drafting a policy on Time and Attendance Reporting, which will be disseminated to all staff in the Fall.
- The Department will be conducting a review of overtime payments made during the past three years, as recommended by the auditors, to validate that the payments complied with collective bargaining agreements and state laws and policies. Overpayments made to employees will be recovered through a collection method in accordance with Government Code section 19838, and the Department will compensate those employees who may have been underpaid.
- The Department conducts quarterly reviews of overtime payment transactions to ensure proper controls are being met.

Finding #7 - Inaccurate leave accounting and missing documentation for leave buy-back.

Since the audit, the Department has participated in the leave buy-back for 2022, 2023 and has implemented the following corrective actions:

- The Transactions Staff Services Manger I logs and tracks all forms received in the HRB.
- All necessary forms are saved both electronically and hard copy.
- The Personnel Officer conducts a review of all leave buy-back participants.

Finding #8 - Improper and late payments, and missing documentation for separation lump sum pay.

The Department has implemented the following corrective actions:

- Implemented a Separation/Retirement Checklist utilized by the Personnel Specialist which includes a listing of all required documents needed to correctly calculate lump sum separation pay and to document supervisor approval before issuance of final pay.
- The Transactions Staff Services Manger I maintains a separation log which tracks each employee's separation status.
- The separation package is saved in the employee's OPF upon separation.
- The Department will be conducting a review of all separation payments made during the past three years, as recommended by the auditors, to validate that the payments complied with collective bargaining agreements and state laws and policies. Overpayments made to employees will be recovered through a collection method in accordance with Government Code section 19838, and the Department will compensate those employees who may have been underpaid.
- The Department conducts quarterly reviews of overtime payment transactions to validate that proper controls are in place.

Thank you again for the opportunity to review and respond to the audit's recommendations. If you have any questions or require additional information, please contact Courtney Filkill, Branch Manager, Human Resources Branch at (916) 322-7860.

Sincerely,

Carla Castaneda

CARLA CASTANEDA
Chief Deputy Director, Operations

Enclosures

cc: Jim Knight, Deputy Director, Administrative Division, DDS
Courtney Filkill, Branch Manager, Human Resources, DDS

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

www.sco.ca.gov