

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

2005 Recipient of the Institute of Internal Auditors Award for Recognition of Commitment to Professional Excellence, Quality and Outreach

Integrity • Objectivity • Independence

INTERNAL CONTROL REVIEW OF AUDITOR-CONTROLLER'S

CENTRAL PAYROLL PROCESSES

For the Period January 1, 2006 through December 31, 2006

Corporate Controls: Centralized Core Business System Audit

AUDIT NUMBER: 2631-1 REPORT DATE: August 30, 2007

Audit Director: Peter Hughes, Ph.D., CPA
Deputy Director: Eli Littner, CPA, CIA

Senior Audit Manager: Michael Goodwin, CPA, CIA

Audit Manager: Winnie Keung, CPA, CIA

Internal Control Review of Auditor-Controller's Central Payroll Processes

For the Period January 1, 2006 through December 31, 2006

TABLE OF CONTENTS

Transmittal Letter	i
INTERNAL AUDITOR'S REPORT	1
EXECUTIVE SUMMARY	3
OBJECTIVES	3
BACKGROUND	3
SCOPE	4
RESULTS	4
DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES	5
Payroll Correction Process	
ATTACHMENT A: Report Item Classifications	6
ATTACHMENT B: Auditor-Controller Management Responses	7

Independence Objectivity Integrity



Providing Facts and Perspectives Countywide

OFFICE OF THE DIRECTOR

DR. PETER HUGHES

PH.D., MBA, CPA,

Certified Compliance & Ethics Professional (CCEP) Certified Information Technology Professional (CITP) Certified Internal Auditor (CIA) Certified Fraud Examiner (CFE)

E-MAIL: peter.hughes@iad.ocgov.com

ELI LITTNER

DEPUTY DIRECTOR

CPA, CIA, CFE,

Cartified Fraud Specialist (CFS)

Certified Fraud Specialist (CFS), Certified Information Systems Auditor (CISA)

> MICHAEL J. GOODWIN SENIOR AUDIT MANAGER CPA, CIA

ALAN MARCUM SENIOR AUDIT MANAGER MBA, CPA, CIA, CFE

AUTUMN MCKINNEY
SENIOR AUDIT MANAGER
CPA, CIA, CISA
Certified Government Financial Manager
(CGFM)

HALL OF FINANCE & RECORDS 12 CIVIC CENTER PLAZA, ROOM 232 SANTA ANA, CA 92701

www.ocgov.com/audit

(714) 834-5475 (714) 834-2880 Fax

OC FRAUD HOTLINE (714) 834-3608

COUNTY OF ORANGE BOARD OF SUPERVISORS'

INTERNAL AUDIT DEPARTMENT

Transmittal Letter

Audit No. 2631-1

e Sugkes

August 30, 2007

TO: David E. Sundstrom, Auditor-Controller

FROM: Peter Hughes, Ph.D., CPA, Dir

Internal Audit Department

SUBJECT: Internal Control Review of Auditor-Controller's

Central Payroll Processes

We have completed our Internal Control Review of the Auditor-Controller's central payroll processes for the period January 1, 2006 through December 31, 2006. The final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will <u>now</u> begin at <u>six months</u> from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will now begin at 12 months from the release of the original report, by which time *all* audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a <u>Follow-Up Audit Report Form.</u> Your department should complete this template as our audit recommendation is implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

David E. Sundstrom, Auditor-Controller August 30, 2007 Page ii

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendation.

Additionally, we will request your department complete a <u>Customer Survey of Audit Services</u>. You will receive the survey shortly after the distribution of our final report.

Attachments

Other recipients of this report:

Members, Board of Supervisors
Members, Audit Oversight Committee
Shaun Skelly, Senior Director, A-C/Accounting and Technology
Jan Grimes, Director, A-C/Central Accounting Operations
Robert Leblow, Senior Manager, A-C/Claims and Disbursing
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

Independence Objectivity Integrity



Providing Facts and Perspectives Countywide

OFFICE OF THE DIRECTOR

DR. PETER HUGHES

PH.D., MBA, CPA,

Certified Compliance & Ethics Professional (CCEP) Certified Information Technology Professional (CITP) Certified Internal Auditor (CIA) Certified Fraud Examiner (CFE)

E-MAIL: peter.hughes@iad.ocgov.com

ELI LITTNER
DEPUTY DIRECTOR
CPA, CIA, CFE,
Certified Fraud Specialist (CFS),
Certified Information Systems Auditor (CISA)

MICHAEL J. GOODWIN SENIOR AUDIT MANAGER CPA, CIA

ALAN MARCUM SENIOR AUDIT MANAGER MBA, CPA, CIA, CFE

AUTUMN MCKINNEY
SENIOR AUDIT MANAGER
CPA, CIA, CISA
Certified Government Financial Manager
(CGFM)

HALL OF FINANCE & RECORDS 12 CIVIC CENTER PLAZA, ROOM 232 SANTA ANA, CA 92701

www.ocgov.com/audit

(714) 834-5475 (714) 834-2880 Fax

OC FRAUD HOTLINE (714) 834-3608

COUNTY OF ORANGE BOARD OF SUPERVISORS'

INTERNAL AUDIT DEPARTMENT

INTERNAL AUDITOR'S REPORT

Audit No. 2631-1

August 30, 2007

TO: David E. Sundstrom

Auditor-Controller

SUBJECT: Internal Control Review of Auditor-Controller's

Central Payroll Processes

Scope of Review

We have completed our Internal Control Review of the Auditor-Controller's central payroll processes for the period from January 1, 2006 through December 31, 2006. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

Results

Based on our audit, **no material weaknesses, significant issues or control findings were identified.** However, we did identify **one Efficiency/Effectiveness Issue** and recommendation to enhance controls and processes as discussed in the Detailed Observations, Recommendations and Management Responses section of this report. See *Attachment A* for a description of Report Item Classifications.

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because *management has primary responsibility* for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Internal Audit's review enhances and complements, but does not substitute for the Auditor-Controller's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment.

David E. Sundstrom, Auditor-Controller August 30, 2007 Page 2

Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our review made for the purpose described above would not necessarily disclose all weaknesses in the Auditor-Controller's operating procedures, accounting practices and compliance with County policy.

Acknowledgment

We appreciate the courtesy and cooperation extended to us during the audit by the personnel of the Auditor-Controller's Claims and Disbursing, and Information Technology Units. If we can be of further assistance, please contact me or Eli Littner, Deputy Director, at (714) 834-5899 or Michael Goodwin, Senior Audit Manager, at (714) 834-6066.

Respectfully Submitted,

Peter Hughes Pn.D., CPA Director, Internal Audit

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors

Members, Audit Oversight Committee

Shaun Skelly, Senior Director, A-C/Accounting and Technology

Jan Grimes, Director, A-C/Central Accounting Operations

Robert Leblow, Senior Manager, A-C/Claims and Disbursing

Foreperson, Grand Jury

Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted an Internal Control Review of the Auditor-Controller's central payroll processes, which includes an evaluation of the adequacy and integrity of internal controls; compliance with applicable rules, regulations and department policies, and evidence of process efficiencies and effectiveness. The objectives of our audit were to evaluate bi-weekly payroll processes and controls at the Auditor-Controller's Claims and Disbursing Unit (Central Payroll) and determine if they are in place to ensure:

- ➤ Bi-weekly payroll is processed completely, accurately, timely, and in accordance with department/agency procedures and management's authorization.
- ➤ Changes made to bi-weekly payroll (e.g., exceptions and corrections) are appropriate, approved and adequately supported.
- ➤ Peace Officer Standards and Training (POST) premium pay adjustments are properly supported, approved and calculated.
- ➤ Business processes are efficient and effective as related to Central Payroll's processing of biweekly payroll.

BACKGROUND

The mission of the Auditor-Controller (A-C) is to promote public oversight, provide accountability, and support financial decision-making for the County. The A-C is comprised of three divisions: Central Operations, Satellite Accounting and Information Technology. The Claims & Disbursing Unit (Central Payroll) within Central Operations provides payroll services for all County agencies/departments and some governmental non-County entities.

Central Payroll processes county payroll in accordance with various union contracts on a bi-weekly basis using the County Accounting and Personnel System (CAPS). Payroll is calculated based on hours worked during the pay period, which is a two-week period beginning on Friday and ending on a Thursday. Employees' time is recorded on an electronically and/or manually prepared timecard. County agencies are responsible to approve their employees' time and to ensure all timecards are accounted for prior to submitting them to Central Payroll. Agencies may use Virtual Timesheet Interface (VTI) or another payroll system referred as "Feeder" to record employees' time electronically. The approved timecards are uploaded to CAPS for payroll processing. Also, an employee's time may be recorded on a manual timecard, which is input into a database, and subsequently uploads to CAPS. Once the timesheets are successfully uploaded into CAPS, the system will automatically convert hours to gross dollars and then gross to net dollars.

During 2006, Central Payroll processed payroll for approximately 19,700 employees in twenty-four (24) County agencies/departments and seven (7) other governmental non-County agencies, totaling \$1,136,302,255 in gross pay.

The table below provides a summary of County Payroll information:

Methodology	# of Agencies	# of Employees	Gross Pay (\$)	Net Pay (\$)
VTI	21	13,539	\$ 713,741,368	\$ 488,512,727
Feeder	3	3,785	277,276,530	188,870,526
Manual	5	138	7,010,880	4,759,667
Mix (VTI & Manual)	2	2,189	138,273,478	91,436,283
Total	31	19,651	\$1,136,302,255	\$773,579,202

POST pay is a premium pay for employees who complete Peace Officer Standards and Training (POST) and receive a certificate. There are Intermediate, Advanced and Supervisory POST Certificates; and employees can receive premium pay ranging from \$150 to \$390 per month depending on the certificate received and the associated Memorandum of Understanding. Agency personnel review and approve the eligibility of the employee, and request Central Payroll to establish POST pay for the qualified employee.

SCOPE

Our audit was limited to evaluating controls and processes over bi-weekly payroll processes starting from Central Payroll's receipt of department/agency uploaded VTI timecards and manual timecards through the issuance of payroll for the period from January 1, 2006 to December 31, 2006. We did not review in detail processes pertaining to withholdings; disbursements to other agencies; retro pay calculations; check printing and information system controls. Further, we did not review the payroll approval process at the agency, which has been reviewed at a separate audit. Our methodology included inquiry, auditor observation and examination and testing of relevant documentation.

RESULTS

No material weaknesses, significant issues or control findings were noted. Based upon the objectives of our audit, we noted the following:

Objective: Bi-weekly payroll is processed completely, accurately, timely, and in accordance with department/agency procedures and management's authorization.

Results: Controls and processes are in place to ensure bi-weekly payroll is processed completely, accurately, timely, and in accordance with central payroll procedures and management's authorization.

Objective: Changes made to bi-weekly payroll (e.g., exceptions and corrections) are appropriate, approved and adequately supported.

Results: Controls and processes are in place to ensure payroll changes, such as payroll exceptions and corrections, are appropriate, approved and supported.

Objective: POST premium pay adjustments are properly supported, approved and accurately calculated.

Results: POST pay is properly supported, approved and calculated.

Objective: Business processes are efficient and effective as related to Central Payroll's bi-weekly payroll processing.

Results: No inefficient or ineffective procedures concerning backlogs or duplication of work in bi-weekly payroll processing were noted or came to our attention. However, we note in our report one observation where business process effectiveness can be enhanced in the areas of payroll corrections. This is discussed in the Detailed Observations, Recommendations and Management Responses section of this report.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

EFFICIENCY/EFFECTIVENESS OBSERVATION

One of our audit objectives was to identify areas where efficiencies and effectiveness can be enhanced in the bi-weekly payroll process. Our audit noted the following observation that has been discussed with Central Payroll management:

Payroll Correction Process

Employees' timecards are reviewed and approved by designated department/agency supervisors, and Agency Payroll is responsible for ensuring all timecards are complete and accurate. Central Payroll begins its payroll process once all timecards (electronic and manual) are received in the CAPS system.

CAPS generates two reports with specific error messages of exceptions identified after interface. The two reports are: *Time and Leave Rejected Transaction Report*, which lists all entries that the CAPS system is unable to identify; and *Timecard Audit Report*, which lists all time entries that are over or under the employee's regular standard hours. According to Central Payroll's procedures, they are to review each exception and make any necessary adjustments. For exceptions that require department/agency clarification (e.g., time reported for an employee that is not in CAPS), Central Payroll contacts the department/agency Payroll Administrator and may request a correction memo from the department/agency authorizing the correction. Central Payroll maintains an Authorized Signature List that includes the authorized signatures for issuing Payroll Correction Memos and/or Payroll Adjustment Forms from departments/agencies.

Observation

We noted that Central Payroll contacts department/agency Payroll Administrators for all entries that require clarifications. Because Payroll Administrators are responsible for a number of payroll functions, which include receiving timecards from employees, ensuring all timecards are accounted for, uploading/submitting timecards for payroll processing, and modifying employee timecards; there is a risk associated with having them be the contact person for exception inquiries and for coordinating Correction Memos. Central Payroll cites tight processing deadlines as the reason they do not contact other individuals such as Human Resources personnel for resolving exceptions.

Recommendation

We recommend Claims & Disbursing Unit (Central Payroll) consider contacting department/agency Human Resources personnel when there are payroll exceptions that are identified as higher risk.

Auditor-Controller Management Response:

Concur. We will notify departmental HR sections when there are exceptions noted during the correction cycle that are considered higher risk. These include but may not be limited to items such as invalid employee I.D. no., ineligible premium pays, and incorrect pay codes for status type. While we will notify HR staff when we encounter these conditions, we will continue to work with departmental staff to correct these errors so that we can complete the correction cycle on time and not delay payroll processing for the affected individuals. There will still normally be 48 hours after the corrections cycle is completed for HR to request us to cancel a payment to an employee in the event that they do not want the payment to go forward.

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

Material Weaknesses:

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

Significant Issues:

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

Control Findings and/or Efficiency/Effectiveness Issues:

Audit findings that require management's corrective action to implement or enhance processes and internal controls. Control Findings and Efficiency/Effectiveness issues are expected to be addressed within our follow-up process of six months, but no later than twelve months.



DAVID E. SUNDSTROM, CPA AUDITOR-CONTROLLER

AUDITOR-CONTROLLER **COUNTY OF ORANGE**

SHAUN M. SKELLY SENIOR DIRECTOR ACCOUNTING & TECHNOLOGY

RECEIVED HALL OF FINANCE AND RECORDS
12 CIVIC CENTER PLAZA, ROOM 20 TERNAL AUDIT DEPARTMENT POST OFFICE BOX 567

JAN E. GRIMES CENTRAL ACCOUNTING OPERATIONS

SANTA ANA, CALIFORNIA 92702-0567 2007 AUG 30 AM 7: 53

WILLIAM A. CASTRO

(714) 834-2450 FAX: (714) 834-2569

www.ac.ocgov.com

SATELLITE ACCOUNTING OPERATIONS

PHILLIP T. DAIGNEAU DIRECTOR INFORMATION TECHNOLOGY

August 28, 2007

TO: Peter Hughes, Director

Internal Audit Department

Pre-Draft Report on Internal Control Review of the Auditor-Controller's SUBJECT:

Central Payroll Processes (Audit Number: 2631-1)

Following is our response to the recommendation contained in the Pre-Draft Report on Internal Control Review of the Auditor-Controller's Central Payroll Processes (Audit Number: 2631-1).

Recommendation

We recommend Central Payroll consider contacting department/agency Human Resources personnel when there are payroll exceptions that are identified as higher risk.

Auditor-Controller Response

Concur. We will notify departmental HR sections when there are exceptions noted during the correction cycle that are considered higher risk. These include but may not be limited to items such as invalid employee I.D. no., ineligible premium pays, and incorrect pay codes for status type. While we will notify HR staff when we encounter these conditions, we will continue to work with departmental staff to correct these errors so that we can complete the correction cycle on time and not delay payroll processing for the affected individuals. There will still normally be 48 hours after the corrections cycle is completed for HR to request us to cancel a payment to an employee in the event that they do not want the payment to go forward.

Thank you for the opportunity to respond to the pre-draft report. Please contact Bob Leblow at 834-2466 if you have any questions on our response.

> David E. Sundstiom Auditor-Controller