

Internal Audit Department

O R A N G E C O U N T Y
 6th Largest County in the USA

PAYROLL AUDIT USING COMPUTER-ASSISTED AUDIT TECHNIQUES (CAATS):

AUDITOR-CONTROLLER AND SELECTED DEPARTMENTS/AGENCIES

(Cited as a Best Practice by the Institute of Internal Auditors)

For the Quarter Ended:
 September 30, 2013

Payroll: We analyzed 129,413 paychecks for the quarter ended September 30, 2013, totaling \$220 million to determine whether the CAPS+ Payroll system is accurately processing and reporting payroll data. Our analysis was intended to identify unusual trends, outliers and exceptions for further investigation, including comparing payroll data with human resource data; recalculating selected pay components; accumulating data for quarterly reporting; comparing selected pay components to prior pay periods; and comparing hours and dollars in selected payroll registers.

Our CAAT routines identified several exceptions that required further research by Internal Audit, the Auditor-Controller and selected County departments (Health Care Agency, Social Services Agency, and Sheriff-Coroner) to determine whether exceptions exist that could indicate inaccuracies with the CAPS+ Payroll system reporting. *Based on our testing and the Auditor-Controller's research of the exceptions found in our CAAT analysis, we found that satisfactory explanations were provided in all instances, including the sample of payroll transactions we tested. As such, we have no findings or recommendations from this audit.*

AUDIT NO: 1350-B
 REPORT DATE: June 20, 2014

Director: Dr. Peter Hughes, MBA, CPA, CIA
 Senior Audit Manager: Michael Goodwin, CPA, CIA
 IT Audit Manager: Wilson Crider, CPA, CISA*

(*Certified Information System Auditor)

RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010, 2013
 American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



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

 ORANGE COUNTY BOARD OF SUPERVISORS'
Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010, 2013

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

Dr. Peter Hughes

Director

Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE, CFF, CGMA

Certified Compliance & Ethics Professional (CCEP)

Certified Information Technology Professional (CITP)

Certified Internal Auditor (CIA)

Certified Fraud Examiner (CFE)

Certified in Financial Forensics (CFF)

Chartered Global Management Accountant (CGMA)

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



Michael J. Goodwin

CPA, CIA

Senior Audit Manager

Alan Marcum

MBA, CPA, CIA, CFE

Senior Audit Manager

Hall of Finance & Records

12 Civic Center Plaza, Room 232
Santa Ana, CA 92701

Phone: (714) 834-5475

Fax: (714) 834-2880

To access and view audit reports or obtain additional information about the
OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA



Transmittal Letter



Audit No. 1350-B June 20, 2014

TO: Jan Grimes
Auditor-Controller

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Payroll Audit Using Computer-Assisted Audit
Techniques (CAATS): Auditor-Controller and
Selected Departments/Agencies

We have completed a Payroll Audit using Computer-Assisted Audit Techniques (CAATS) for the quarter ended September 30, 2013. We performed this audit in accordance with our *FY 2013-14 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. The final report is attached for your information.

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). Our **First Follow-Up Audit**, if necessary, will begin at six months 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**, if necessary, will begin at six months from the release of the first Follow-Up Audit 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.

Note: Because there are no findings or recommendations from this audit, a **Follow-Up Audit** is not necessary, and we have not attached a **Follow-up Audit Report Form**.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit issues 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.

As always, the Internal Audit Department is available to partner with your staff. Please feel free to call me should you wish to discuss any aspect of our audit report. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 5.

Table of Contents



***Payroll Audit Using Computer-Assisted Audit techniques (CAATS):
Auditor-Controller and Selected Departments/Agencies
Audit No. 1350-B***

***For the Quarter Ended:
September 30, 2013***

Transmittal Letter	i
OC Internal Auditor's Report	
OBJECTIVES	1
RESULTS	2
BACKGROUND	4
SCOPE	4

OC Internal Auditor's Report



Audit No. 1350-B

June 20, 2014

TO: Jan Grimes
Auditor-Controller

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Payroll Audit Using Computer-Assisted Audit Techniques
(CAATs): Auditor-Controller and Selected
Departments/Agencies

Audit Highlight

We analyzed 129,413 paychecks issued for the quarter ended September 30, 2013, amounting to about \$220 million to determine whether the CAPS+ Payroll system is accurately processing and reporting payroll data.

Based on our testing of payroll transactions in selected County departments (HCA, SSA, and Sheriff-Coroner) and the Auditor-Controller's research of the exceptions, we found that **satisfactory explanations for the exceptions were provided**. Nothing came to our attention indicating any errors in CAPS+ payroll system processing or reporting.

As such, we have no findings or recommendations.

OBJECTIVES

In accordance with our *FY 2013-2014 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and Board of Supervisors, the Internal Audit Department conducted an audit of Payroll. We performed a variety of audit tests of Payroll transaction activity utilizing Computer-Assisted Audit Techniques (CAATs). This audit was conducted in conformance with the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors. Our objective was to determine whether the CAPS+ HR/Payroll system was accurately processing and reporting payroll data. To accomplish this, we performed the following:

1. **Stratified payroll data to identify and investigate unusual trends and exceptions:** Reviewed Payroll and Human Resources data to identify:
 - Total Gross Pay for the period in excess of \$10,000,
 - Total Hours Worked for the period in excess of 80 hours,
 - Hourly Rates in excess of \$100 per hour, and
 - Paychecks issued to separated/non-active employees.
2. **Recalculated paycheck data for accuracy:** Reviewed Payroll data to verify:
 - Summed pay components agrees with paycheck gross pay amount,
 - Summed deduction components agrees with paycheck total deductions,
 - Net pay was calculated accurately,
 - Paycheck components were calculated accurately, and
 - Quarterly data on State Quarterly Unemployment report was accurate.
3. **Compared paycheck data to the prior pay periods' data to identify and investigate differences:** Reviewed Payroll data in the following areas:
 - Total Gross Pay
 - Total Deductions
 - Pay Components
4. **Compared Payroll Register with Hours to Gross Register report to identify and investigate any differences:**
 - Compared hours reported on the *Hours to Gross Register* to the *Payroll Register* to verify consistency between the two reports.



RESULTS

■ Objective #1 – Payroll Data Stratification:

We reviewed all **129,413 paychecks issued totaling \$220 million** during the quarter ended September 30, 2013, to identify unusual trends and exceptions. Our CAAT analysis found the following types of exceptions:

- Paychecks with a gross pay greater than \$10,000,
- Paychecks with hours paid greater than 80 hours.
- Paychecks with a regular hours pay rate greater than \$100 per hour.
- Paychecks for employees with a status code other than "A – Active."

Research conducted by Internal Audit, the Auditor-Controller and department payroll personnel found the above exceptions were attributed to overtime pay, annual leave payouts, payoffs of final leave balances in final separation checks, and individuals with pay rates over \$100/hr. There are 19 employee status codes used other than "A – Active" that are valid pay codes

As indicated above, this analysis was intended to identify unusual trends and outliers that would require further research to determine if they are indicative of a CAPS+ payroll system reporting error. The above thresholds (e.g., gross pay exceeding \$10,000, pay rate greater than \$100/hr.) were judgmentally determined by Internal Audit for this analysis only, **and are not indicative of non-compliance with County policy.**

Based on our limited testing of payroll transactions in selected County departments (HCA, SSA, and Sheriff-Coroner) and the Auditor-Controller's research of the exceptions, we found that **satisfactory explanations for the exceptions were provided.** Our testing found that the pay components such as overtime and annual leave payouts were authorized by the respective departments/agencies. We also matched up all paychecks to valid County employees with no exceptions. Finally, nothing came to our attention that would indicate any errors in CAPS+ payroll system reporting. **As such, we have no findings or recommendations under this objective.**

■ Objective #2 – Recalculation of Selected Payroll Components:

We recalculated gross pay, total deductions and net pay on the **129,413 paychecks (comprised of 1,700,683 pay components)** for the quarter ended September 30, 2013, and found the following types of exceptions:

- Paychecks where the summed pay components did not agree to the total gross pay.
- Paychecks where the deduction components did not agree to the total deductions.
- Paychecks where the component amount did not equal hours times the pay rate.
- Instances where the recalculated accumulated gross pay for the quarter did not agree to what was reported in the State Quarterly Unemployment report.

Research conducted by Internal Audit, the Auditor-Controller and department payroll personnel found the above exceptions were attributed to pay components differing between paychecks for different hours worked, pay increases, overtime pay, mileage reimbursements, shift differential pay, work furloughs and worker's compensation benefits.

This analysis was intended to identify exceptions that require further research to determine if they are indicative of a CAPS+ payroll system reporting error concerning the calculation and reporting of gross pay, net pay and related pay components. Nothing came to our attention that indicated any errors in the calculation and reporting of gross pay and pay components.

OC Internal Auditor's Report



Based on our limited testing of payroll transactions in selected County departments (HCA, SSA, and Sheriff-Coroner) and the Auditor-Controller's research of the exceptions, we found that **satisfactory explanations were provided**. Nothing came to our attention that would indicate any errors in CAPS+ payroll system reporting.

As such, we have no findings or recommendations under this objective.

■ Objective #3 – Comparison to Prior Pay Periods:

We compared select payroll data to the prior pay period's data to identify variances in pay components between pay periods for all **129,413 paychecks** during the quarter ended September 30, 2013 and found the following types of exceptions:

- Paychecks with a different total gross amount from the prior pay periods.
- Paychecks with a different total deductions amount from the prior pay periods.
- Paycheck components with a different amount from the prior pay periods.

Research conducted by Internal Audit, the Auditor-Controller and department payroll personnel found the above exceptions were attributed to pay differences primarily due to Federal and State tax withholdings, retirement deduction rate changes, child support garnishments, and changes to gross pay.

This analysis was intended to identify exceptions that require further research to determine if they are indicative of a CAPS+ payroll system reporting error concerning the calculation and reporting of pay components between pay periods.

Based on our limited testing of transactions in selected County departments (HCA, SSA, and Sheriff-Coroner) and the Auditor-Controller's research of the exceptions, we found that **satisfactory explanations were provided**. Nothing came to our attention that would indicate any errors in CAPS+ payroll system reporting.

As such, we have no findings and recommendations under this objective.

■ Objective #4 – Comparison of Payroll Reports:

Two of the main reports that are critical in payroll processing and reporting are the *Payroll Register* and *Hours to Gross Register*. We compared the *Payroll Register* data to the *Hours to Gross Register* data and initially found exceptions where the hours reported did not agree between the two payroll registers.

Upon further research by the Auditor-Controller, we determined our CAAT routine did not account for certain multiple pay components resulting in false exceptions. Once we refined our CAAT routine, the exceptions did not appear and the hours agreed between the two payroll registers. Nothing else came to our attention that is indicative of a CAPS+ payroll system reporting error in these two payroll registers.

As such, we have no findings and recommendations under this objective.

OC Internal Auditor's Report



BACKGROUND

The County processes approximately **\$2 billion annually for payroll**. The CAPS+ HR/Payroll system was implemented in February 2011. There are 26 pay periods annually. Each pay period, departments/agencies utilize the VTI timekeeping system to record payroll hours (except for the Sheriff-Coroner that uses an in-house developed payroll system). VTI interfaces with CAPS+ HR/Payroll, which contains the employee personnel and payroll data, to process the reported hours with the employee payroll data.

Continuous auditing using CAATs is a change to the traditional audit approach. CAATs differ from our traditional audits in that CAATs can query **100%** of a data universe whereas the traditional audits typically test but a **sample** of transactions from the population. CAATs are automated queries applied to large amounts of electronic data searching for specified characteristics. We use a proprietary, best practice and industry recognized software product (ACL) to help us in this process.

Often there is additional research needed to validate exceptions that is only known at the department level. Internal Audit attempts to validate and resolve exceptions; however, most of the exceptions are forwarded to the appropriate department for validation and/or resolution. Depending on the department's review, **the exceptions may or may not be a finding**. For the exceptions noted in this report, we either forwarded them to the **Auditor-Controller (A-C)** for further research, or we contacted the departments/agencies (**Health Care Agency, Social Services Agency, and Sheriff-Coroner**) and obtained documentation explaining the exceptions. In this report, we are keeping the details of our exceptions to a general discussion and do not identify specific paychecks. The A-C was provided with the specific details in order to conduct their research on the exceptions.

SCOPE

Our analysis was intended to identify unusual trends, outliers and exceptions for further investigation to determine whether the CAPS+ HR/Payroll system is accurately processing and reporting payroll data. This report details the CAAT work we performed on the payroll data for the quarter ended September 30, 2013. Specifically, our data included seven (7) pay periods (pay period 15 through pay period 21). Our analysis included a review in the following areas:

1. **Data Stratification:** We stratified payroll data for all 129,413 paychecks by total gross pay amount, hours worked, and regular hours pay rate to identify unusual trends and exceptions. In addition, we compared pay data with Human Resources data to identify inappropriate payments.
2. **Recalculation of Selected Payroll Components:** We recalculated for all 129,413 paychecks the following: total gross pay amount, total deductions, net paycheck amount, and component pay amount (component pay rate times hourly rate) to verify the payroll data reported was accurate. In addition, we recalculated Wages QTD reported on the *State Quarterly Unemployment* report to verify the payroll data was reported accurately.
3. **Comparison to Prior Pay Periods:** We compared for all 129,413 paychecks and 1,700,683 pay components with the prior pay periods payroll data the following: total gross pay amount, total deductions, and paycheck components to identify and investigate any differences.
4. **Comparison of Payroll Reports:** We compared the hours reported on the *Hours to Gross Register* with the *Payroll Register* to verify the hours were consistent between the reports.

To accomplish the above, we worked with **Auditor-Controller/Information Technology** and the team managing **CAPS+ HR/Payroll**. The CAPS+ HR/Payroll Manager assisted us in researching our exceptions and helping refine our CAAT routines used in the audit. For our limited testing and research of the exceptions generated from our CAAT, we selected the **Health Care Agency (HCA)**, **Social Services Agency (SSA)** and **Sheriff-Coroner** because together they account for over 50% of County payroll. We issued audit entrance letters to the three departments and worked with their respective Payroll Managers to obtain support documentation for our test items.

OC Internal Auditor's Report



SCOPE EXCLUSION

This audit did not evaluate internal controls over payroll processing in County departments/agencies, and was intended to primarily determine if the CAPS+ payroll system processing and reporting is effective. Our test work in HCA, SSA, and the Sheriff-Coroner was limited to a sample of payroll transactions that we judgmentally selected and a review of supporting payroll documents.

Acknowledgment

We appreciate the courtesy extended to us by the Auditor-Controller, Health Care Agency, Social Services Agency and Sheriff-Coroner personnel during our audit. If we can be of further assistance, please contact me directly at 834-5475 or Michael Goodwin, Senior Audit Manager, at 834-6066.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Sandra Hutchens, Sheriff-Coroner
Mark Refowitz, Director, Health Care Agency
Mike Ryan, Director, Social Services Agency
Frank Kim, Chief Financial Officer
Mark Denny, Chief Operating Officer
Denise Steckler, Chief Deputy Auditor-Controller
Phillip Daigneau, Director, Information Technology, Auditor-Controller
Teresa White, Manager, CAPS+ HR/Payroll, Auditor-Controller
Victoria Ross, Director, Central Accounting Operations, Auditor-Controller
Lisa Poma, Senior Manager, Claims and Disbursing, Auditor-Controller
Nasrin Soliman, Audit Manager, Financial/Administrative Svcs., Sheriff-Coroner
Diane Ramos, Payroll Manager, Payroll Operations, Sheriff-Coroner
Jeff Nagel, Dept. Agency Director, Financial/Administrative Svcs., HCA
Kimberly Engelby, Manager, Accounting Services, HCA
Chi Vu, Manager, Accounts Payable and Payroll, HCA
Carol Wiseman, Division Director, Administrative Services, SSA
Moses Hernandez, Manager, Accounting Services, SSA
Lien Mai, Manager, General Accounting & Payroll, SSA
Foreperson, Grand Jury
Susan Novak, Clerk of the Board of Supervisors
Macias Gini & O'Connell LLP, County External Auditor



ATTACHMENT A: Report Item Classifications

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

▶ **Critical Control Weaknesses:**

Audit findings or a combination of Significant Control Weaknesses that represent serious exceptions to the audit objective(s), policy and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

▶ **Control Findings:**

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