

Internal Audit Department

O R A N G E C O U N T Y

INTERNAL CONTROL AUDIT:

OC PUBLIC WORKS PAYROLL PROCESS

For the Year Ending
June 30, 2009

We audited internal controls over OC Public Works' payroll process where approximately \$80 million was paid to employees between July 1, 2008 and June 30, 2009. We also reviewed for efficiency and effectiveness of the payroll process.

We found that controls are in place to ensure: (1) payroll is processed completely, accurately, timely, with appropriate supporting documentation and management approval; and (2) payroll is processed in an efficient and effective manner. We identified (2) Control Findings to enhance controls over payroll processing.

AUDIT NO: 2925

REPORT DATE: OCTOBER 28, 2009

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Deputy Director: Eli Littner, CPA, CIA

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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007



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RISK BASED AUDITING

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Transmittal Letter



Audit No. 2925 October 28, 2009

TO: Jess Carbajal, Interim Director
OC Public Works

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

SUBJECT: Internal Control Audit:
OC Public Works Payroll Process

We have completed an Internal Control Audit of OC Public Works' Payroll Process for the year ending June 30, 2009, in which OC Public Works paid approximately **\$80 million** in payroll. We performed this audit in accordance with our *FY 2009-10 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our 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 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** 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.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are 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.

Letter from Dr. Peter Hughes, CPA



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.

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 recommendations.

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 4.

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OC Public Works Payroll Process
Audit No. 2925***

**For the Year Ending
June 30, 2009**

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Audit No. 2925

October 28, 2009

TO: Jess Carbajal, Interim Director
OC Public Works

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

A handwritten signature in blue ink that reads "Peter Hughes".

SUBJECT: Internal Control Audit: OC Public Works Payroll Process

Audit Highlight

We audited internal controls over Public Works' bi-weekly payroll process where approximately \$80 million was paid to employees between July 1, 2008 and June 30, 2009. We also reviewed for efficiency and effectiveness of the payroll process.

We found that controls are in place to ensure: (1) payroll is processed completely, accurately, timely, with proper supporting documentation and management approval; and (2) payroll is processed in an efficient and effective manner.

OBJECTIVES

The Internal Audit Department conducted an Internal Control Audit of OC Public Works payroll process, which included an evaluation of the adequacy and integrity of internal controls; compliance with department and County policies; and evidence of process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of our audit were to:

- 1. Accuracy and Propriety of Payroll Process:** Evaluate internal controls, processes and systems to ensure payroll is processed accurately, completely, timely, and has appropriate supporting documentation and management approval. Included is an assessment of segregation of duties, supervisory reviews and approvals, changes to payroll for errors and corrections, and key reconciliations to ensure accuracy and completeness of payroll.
- 2. Efficiency/Effectiveness of Payroll Process:** Evaluate the efficiency and effectiveness of OC Public Works payroll process to determine if there are backlogs, duplication of work, or manual processes that could benefit from automation.

BACKGROUND

The OC Public Works Department employs approximately 975 employees. Payroll Operations within the Finance and Department Services Division is responsible for processing payroll. Payroll Operations consists of a Payroll Supervisor and two Payroll Specialists who process payroll on a bi-weekly basis using *Virtual Timesheet Interface (VTI)*.

VTI is an automated timekeeping and reporting system supported by Auditor-Controller/Information Technology and used by nearly all County departments/agencies. VTI records hours and interfaces with CAPS in Auditor-Controller Central Payroll every two weeks to compute actual payroll amounts and for issuance of payroll.



OC Public Works Payroll Process

On a bi-weekly basis, OC Public Works employees input their time into a VTI electronic timecard, which requires employees to certify their information as true and correct before submitting it to their designated supervisor. Supervisors review and approve employee timecards, certify the hours as true and correct, and submit them to Payroll Operations. The two Payroll Specialists review submitted timecards; adjust employees' timecards for errors or corrections as necessary, maintain documentation to support payroll corrections and changes; and upload the approved timecards to CAPS in the Auditor-Controller's Claim and Disbursing Unit (Central Payroll) for payroll processing and issuance of paychecks. There are various reports generated by VTI to ensure accuracy and completeness of payroll before and after uploading VTI to CAPS.

During the audit period, total gross pay for Public Works employees was approximately **\$80 million**. Of the total 975 employees, about 30 employees have actual paychecks issued to them bi-weekly, while the remaining payroll is issued through direct deposit.

SCOPE

Our audit evaluated internal controls over OC Public Works' payroll process for the period from July 1, 2008 through June 30, 2009. We evaluated the payroll process starting with the receipt of VTI timecards in Payroll Operations to the uploading of payroll information to Central Payroll. Specifically, we evaluated for proper segregation of duties; supervisory or management authorization of employee hours and premium pay/overtime; existence of supporting documentation for changes to payroll after being submitted to Payroll Operations; and key reconciliations between VTI and CAPS to ensure completeness of payroll. We also evaluated the efficiency and effectiveness of the payroll process by observing for backlogs, duplication of work, and manual processes that could benefit from automation.

SCOPE EXCLUSIONS

Our audit did not include payroll processes and calculations pertaining to withholdings or retro-pay, check printing, or payroll distribution. We also did not audit controls in Central Payroll, which was addressed in a prior Internal Control Audit.

RESULTS

We found that: (1) controls and are in place to ensure payroll is processed accurately, completely, timely, with appropriate supporting documentation and management approval; and (2) payroll is processed in an efficient and effective manner.

We identified **two (2) Control Findings** resulting in **two (2) recommendations** 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. Based upon the objectives of our audit, we noted:



- ▶ **Objective #1 – Accuracy and Propriety of Payroll Process:** *Evaluate internal controls, processes and systems to ensure payroll is processed accurately, completely, timely, and has appropriate supporting documentation and management approval.*
- ▶ **Results:** We found internal controls, processes and systems in place to ensure payroll is processed accurately, completely, timely, with proper supporting documentation and management approval. We noted **one (1) Control Finding** to enhance controls in the area of supervisory review and document retention of various payroll processing reports. (See Observation No. 1)

- ▶ **Objective #2 – Efficiency/Effectiveness of Payroll Process:** *Evaluate the efficiency and effectiveness of OC Public Works payroll process to determine if there are backlogs, duplication of work, or manual processes that could benefit from automation.*
- ▶ **Results:** OC Public Works payroll is processed in an efficient and effective manner. We noted **one (1) Control Finding** for utilizing the VTI *Timecard Audit Report* to monitor for unauthorized changes to payroll. (See Observation No. 2)

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. Our Internal Control Audit enhances and complements, but does not substitute for OC Public Works' 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. 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 audit would not necessarily disclose all weaknesses in OC Public Works' operating procedures, accounting practices and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by OC Public Works Payroll Operations and Finance/Department Services. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899, 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
Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO, OC Infrastructure
Carlos Bustamante, Director, OCPW Administration
Liz Jewell, Chief, OCPW Department & Finance Services
Susan Umali, Payroll Supervisor, OCPW Payroll Operations
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



Audit Objective #1 – Accuracy and Propriety of Payroll Process

Our objective was to evaluate internal controls, processes and systems to ensure payroll is processed accurately, completely, timely, and has appropriate supporting documentation and management approval. Included is an assessment of segregation of duties, supervisory reviews and approvals, changes to payroll, and key reconciliations.

We audited the payroll process from when OC Public Works Payroll Operations receives VTI Timecards from the pay locations to the processing of payroll by Auditor-Controller Central Payroll (Central Payroll). Our audit sample consisted of **45 employees** selected from three different pay periods from five pay locations: Facilities Operations, Purchasing and Contracts, Traffic Engineering, General Maintenance, and Transportation Fleet Management.

Payroll Process and Control Strengths

Based on our testing of 45 employees, we found payroll was processed completely, accurately, timely and in accordance with department procedures and management's authorization. No errors or exceptions to payroll were noted in our sample. Process and control strengths noted during our audit include:

- ✓ Payroll Operations staff is knowledgeable of the payroll process.
- ✓ Additions, deletions and changes to payroll are approved and supported.
- ✓ Supplemental/premium pay is properly authorized per department procedures.
- ✓ Authorized individuals (supervisors) from each pay location electronically approve VTI Timecards.
- ✓ Payroll exceptions (hours input into VTI less than or exceed 80 hrs) are identified.
- ✓ Central Payroll validates employee payroll information received from VTI to ensure completeness and accuracy of payroll.

The following is our observation where we believe payroll processes and controls should be enhanced in the areas of supervisory review and document retention.

Observation No. 1 – Supervisory Review and Retention of Payroll Documents

(Control Finding) Payroll Operations has procedures in place to identify and review all employee timecards and ensure all errors are cleared before upload/delivery to Central Payroll. However, we noted that supervisory review of payroll processing and exception reports was not documented and the reports were not retained to show payroll had been reviewed and approved in Payroll Operations as discussed below.

Prior to delivery of VTI timecards to Central Payroll, Payroll Operations staff review the final *Missing Timecards Report* and final *Errored Timecard Report* online to account for all missing timecards and to ensure all errors are cleared before uploaded to Central Payroll. After delivery of VTI timecards to Central Payroll, Payroll Operations reviews the *Upload Summary* to verify successful upload to Central Payroll. We noted the Payroll Operations Supervisor does not review and sign the last *Missing Timecards Report*, the last *Errored Timecard Report*, and *Upload Summary* to document the supervisory review.



We also noted that Payroll Operations maintains documentation to support the bi-weekly payroll process; however, they did not retain copies of the VTI generated final *Missing Timecards Report* and *Errored Timecard Report*. Retention of these documents will provide accountability of work performed.

Recommendation No. 1

OC Public Works ensure payroll reports are reviewed and signed by the Payroll Operations supervisor and copies of the payroll documents are retained.

OC Public Works Management Response:

We concur. This recommendation was implemented for Pay Period 17, which ended August 13, 2009. These documents will be retained for six years (current fiscal year plus five years).

Audit Objective #2 – Efficiency and Effectiveness of Payroll Process

Our objective was to evaluate the efficiency and effectiveness of OC Public Works payroll process to determine if there are backlogs, duplication of work, or manual processes that could benefit from automation.

We did not observe any backlogs, duplication of work or manual processes that could benefit from automation. VTI is highly automated and enables Payroll Operations, consisting of two Payroll Specialists and a Payroll Supervisor, to efficiently and effectively process bi-weekly payroll for OC Public Works employees. We did note one area that could increase Payroll Operations' effectiveness in reviewing for changes to payroll as discussed below.

Observation No. 2 – Use of *Timecard Audit Report* to Monitor Payroll Changes (Control Finding) Payroll Operations was not aware of a VTI generated *Timecard Audit Report* that was created to help departments/agencies monitor for unauthorized changes to payroll after the designated supervisor has authorized and submitted the timecards to Payroll Operations.

The *Timecard Audit Report* is important because the VTI system has eight different user roles. Each role has different rights, with different levels of access. Payroll staff are generally assigned "Payroll Clerk" access. "Payroll Clerk" access enables Payroll staff to complete and/or update employee timecards, including the ability to change pay codes (e.g., from Regular Hours to Annual Leave) for absent employees. Also, this access also allows Payroll staff to make changes and corrections after the designated supervisor has reviewed and authorized the employee's timecard. Because of this access, these subsequent changes do not require management review or final approval prior to upload to Central Payroll. As a result, a risk of processing unauthorized changes exists with this user role.

VTI generates a *Timecard Audit Report* that can assist management in reviewing all subsequent changes to timecards after submitted by the employee and supervisor. This tool is a comprehensive report displaying the actions taken, the changes made, the person who made the changes, and the date and time of the changes. This report can be modified to show specific payroll changes to make the report more manageable, such as changes in regular and annual leave hours. We made Payroll Operations aware of this report, and they started utilizing it during our fieldwork. Payroll Operations should continue to generate this report and evaluate how it can be incorporated into their process.



Recommendation No. 2

OC Public Works utilize the VTI *Timecard Audit Report* as a tool to monitor unauthorized changes to pay codes, such as modifying annual leave hours to regular hours. Payroll Operations can determine the frequency and extent of using this report after evaluating results.

OC Public Works Management Response:

We concur. This recommendation was implemented for Pay Period 17, which ended August 13, 2009. This report is reviewed each pay period.



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:**

Audit findings concerning internal controls, compliance, 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.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



ATTACHMENT B: OC Public Works Management Responses



Jess A. Carbajal, Interim Director
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Santa Ana, CA
P.O. Box 4048
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Telephone: (714) 834-2300
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memo

DATE: October 22, 2009
TO: Dr. Peter Hughes, CPA, Director, Internal Audit Department
FROM: Jess Carbajal, Interim Director, OC Public Works
SUBJECT: Response to Draft Audit Report 2925 on Internal Control of OC Public Works Payroll Process

We have reviewed the draft report for Audit 2925 on Internal Control of the OC Public Works Payroll Process. Our responses to the two recommendations are below.

Recommendation No. 1

OC Public Works ensure payroll reports are reviewed and signed by the Payroll Operations supervisor and copies of the payroll documents are retained.

OC Public Works Management Response:

We concur. This recommendation was implemented for Pay Period 17, which ended August 13, 2009. These documents will be retained for six years (current fiscal year plus five years).

Recommendation No. 2

OC Public Works utilize the VTI *Timecard Audit Report* as a tool to monitor unauthorized changes to pay codes, such as modifying annual leave hours to regular hours. Payroll Operations can determine the frequency and extent of using this report after evaluating results.

OC Public Works Management Response:

We concur. This recommendation was implemented for Pay Period 17, which ended August 13, 2009. This report is reviewed each pay period.

If you need additional information, please contact Carlos Bustamante at 834-7512 or Liz Jewell at 834-5906.

cc: Michael Goodwin
Carlos Bustamante
Liz Jewell
Susan Umali