

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

Internal Audit: Sonoma County Payroll Process

For the Period:
July 1, 2011 to June 30, 2015

Engagement No: 4050
Report Date: May 31, 2016



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Significant Subsequent Event

Subsequent to the completion of audit procedures, but prior to the issuance of this audit report, the Auditor-Controller-Treasurer-Tax Collector (ACTTC) received important information from the Internal Revenue Service (IRS). The information is related to Finding 4 on page 11 of the audit report (\$1.8 million in penalties and interest assessed by the IRS). The ACTTC received a letter dated November 17, 2016 from the IRS stating that the County of Sonoma, Community Development Commission (CDC) and Sonoma Marin Area Transit (SMART) collectively owe approximately \$4 million in back payroll taxes, interest and penalties. The IRS communications state that if payment is not received by December 14, 2016, a \$4.3 million Notice of Federal Lien will be filed against any and all unpaid liabilities of the County of Sonoma, CDC, and SMART.

The differences between the \$1.8 million mentioned in the audit report and the \$4 million and the \$4.3 million discussed above will be investigated by the Audit Division of the ACTTC. As warranted, the Audit Division of the ACTTC will provide support to dispute IRS's assessments of taxes penalties and interest.

Executive Summary

As a part of the 2015/2016 Annual Audit Plan, the Internal Audit Division (Internal Audit) of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (ACTTC) conducted the audit of the Sonoma County (County) payroll process, reviewing payment and reporting activities and identified opportunities for improvement. The following observations are noted as a result of this audit:

- The ACTTC Payroll Division (Payroll) issues approximately 125,000 checks, valued at over \$500 million, to approximately 4,700 employees annually. Virtually all of these checks were issued without employees raising concerns about the accuracy of the payment amount.
- Although it is a business function that extends to all County departments, no single department is responsible or accountable for establishing and maintaining uniform County-wide payroll policies and procedures. Presently, Payroll and the Human Resources Department, with support from each County department, share responsibility for payroll processing.
- The current internal controls for accurate processing of payroll transactions need further development, updating, and uniform execution. We found significant differences in payroll procedures followed by the six departments included in our review because the County does not have comprehensive countywide policies and procedures. As a result, Payroll administers a substantial amount of work, some of it redundant and unnecessary, to accurately process payroll. In 2015, Payroll re-opened and reviewed 4,232 department certified time and labor reports, or about 3.6% of all timecards processed.
- Payroll staff spends a substantial amount of time checking the accuracy of time and labor reporting, leaving insufficient time to perform key internal controls. Payroll management has been splitting their time among multiple priorities and have not been able to identify, implement and/or perform certain key internal control procedures, needed to mitigate risks identified in our report.
- By making improvements recommended in this audit, the County can prevent incurring material amounts in penalties and interest, non-compliance with State and Federal payroll reporting requirements and reduce fraud risk to a low level.
- TimeSaver and ePersonality (HRMS) are key information systems that support the processing and reporting of payroll transactions. We noted a number of instances where appropriate system controls were not implemented or properly operated. To ensure that these systems continue to function as designed and calculate payroll accurately, appropriate system controls need to be implemented and reviewed periodically.

This report provides 10 recommendations to assist ACTTC Payroll in improving the processing and reporting of payroll transactions. The recommendations cover County-wide payroll policies and

Executive Summary

procedures, training of department payroll staff, and the restructuring of payroll processing. Our recommendations also cover ways to improve payroll processing administered by department employees, and the implementation of quality assurance activities for ensuring compliance with State and Federal payroll reporting requirements.

Summary of Recommendations

- Payroll should assume responsibility for developing, evaluating and enforcing organization wide payroll policies and procedures that focus on the accuracy of payroll.
- Payroll should develop a County-wide training program and conduct related training for all staff that perform payroll-related activities.
- Payroll should coordinate with the Information Systems Department (ISD) to improve controls over application access, change management and disaster recovery to ensure payroll information continues to be available, is safeguarded and the integrity of the payroll systems are maintained.
- ISD should ensure County departments are aware of and adhere to Information Security, Account Management, and Change Management policies and standards as systems are added or updated on the County's network. ISD should develop a compliance program to ensure County Departments are following ISD guidance to safeguard the County's network and integrity and confidentiality of data. Policies and standards should be evaluated and reviewed on a regular basis.
- ISD, working with Payroll, should test the HRMS and TimeSaver systems to ensure the systems and data can be recovered in a timely manner after a natural or man-made disaster. Testing should be scheduled periodically with findings from the tests incorporated into the disaster recovery procedures.
- The Payroll Manager should restructure and streamline processes performed by Payroll.
- ACTTC management should conduct an internal risk assessment over the biweekly payroll process and develop policies and procedures for fund reconciliations, request and approval of payments, and monitoring of IRS and State account activities to reduce the risk of non-compliance with the State and IRS Requirements resulting in penalty and interest assessment.
- Payroll and the Human Resources Department (and applicable sub-divisions) should work to improve coordination and communication with ISD for HRMS and TimeSaver support.
- Payroll should develop and adopt a set of performance metrics to assist with continuous process improvement over the County-wide payroll process.
- The Payroll Manager should, in collaboration with the Human Resources Department, develop a program to eliminate manual check issuance for new employees and encourage existing employees to convert to electronic deposit.

Introduction and Background

Introduction

The Internal Audit Division of the ACTTC completed the audit of the County payroll process for the period July 1, 2011 thru June 30, 2015, reviewing payment and reporting activities and identified opportunities for improvement. We conducted the audit in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that sufficient information and evidence to achieve audit objectives are identified, evaluated and documented. The evidence obtained provides a reasonable basis for the results, observations, and recommendations contained in our report.

The purpose of this audit report is to furnish management independent and objective analyses and recommendations and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

Background

Payroll and the Sonoma County Human Resources Department (HR) are primarily responsible for:

- The accurate and timely payment of wages and salaries to County employees.
- Timely remittance of withholdings and deductions to the appropriate State and Federal agencies or other third parties.

Payroll employs a total of 12 full time equivalent (FTE) employees and is one of nine divisions of the ACTTC Office. In FY 2014-15, Payroll processed approximately 125,000 pay checks (direct deposits and physical checks), disbursed bi-weekly to approximately 4,700 unionized and non-represented County employees, totaling approximately \$500 million in employee gross earnings for the fiscal year.

The County's payroll process is complex, requiring the involvement of Payroll, each County department, HR, ISD, and the Treasury and General Accounting Divisions of the ACTTC Office. The process, as shown in Appendix A, begins when employees record their time worked and leave taken each pay period. The process ends when 1) the employees receive their pay either through direct deposit at their financial institution or through hand delivery by department staff and 2) the County submits tax and other liability payments to the State and Federal agencies or other third parties.

Payroll relies on three main information systems; TimeSaver, HRMS, and the Enterprise Financial System (EFS). TimeSaver is used by County departments to capture time and attendance data. HRMS is an integrated system utilized primarily by HR and other departments to manage employee benefits and personnel functions and by Payroll to process payroll transactions. EFS is the County's financial accounting system in which the aggregate pay data is recorded and is used to support the preparation of the County's Comprehensive Annual Financial Report (CAFR).

Objectives, Scope & Methodology

Objectives

In 2014, ACTTC conducted a county wide risk assessment that identified Payroll processing as having inherently high potential risk, primarily due to the large dollar value of payments (approximately \$500 million annually) and its impact on all 26 County departments. Our objectives were to determine if: (1) controls were in place to ensure accurate processing of payroll, and (2) systems and processes to recognize, process, remit, and report payroll transactions can be improved.

Scope

The scope of our audit covered the fiscal year (FY) 2015 and included the examination of the payroll processing and reporting activities during that period. During the audit we expanded our scope to cover State and Federal payments made in FY 2011 through FY 2015.

Methodology

To address our audit objectives, Internal Audit conducted the following activities:

- Identified and obtained payroll requirements subject to compliance.
- Selected six County departments and assessed their internal controls over time and labor reporting. We also evaluated payroll processing activities for opportunities to improve efficiency.
- Interviewed the County Payroll Manager and staff about payroll processes and related activities.
- Reviewed payroll reports, payroll audit reports, reconciliation documents, and system generated exception reports.
- Conducted a general controls review of the County's TimeSaver and HRMS applications to assess potential risks to the accuracy, integrity, and reliability of the payroll information. The review addressed application controls, system edit checks, information security, and change management controls.
- Compared County payroll information systems activities to leading practices obtained from published standards.

Internal Audit conducted the audit from July 2015 to February 2016.

Results

Finding 1: Countywide Policies and Procedures can Enhance Coordination and Implementation of Payroll Processing (Risk Classification C)

County Departments Implement Different Procedures

To minimize the risk of errors in payroll transactions, payroll processing should be administered organization-wide through a uniform set of policies and procedures. These policies and procedures provide guidance to all employees involved with payroll processing on a number of activities, such as time and attendance processing, leave processing, and employee set up in the payroll system. However, our review found that although each of the various County departments perform key payroll functions, the County does not have a comprehensive set of policies and procedures to govern the payroll process. As a result, the implementation of payroll processing activities varies across the County, which leads to multiple instances of errors and other discrepancies, requiring excessive reviews and edits by Payroll staff. Specifically, we found the following:

- **Departments differ on supervisory review and approval procedures.** Supervisory review of employee timesheets provide assurance that the time and attendance reported by employees are accurate. Among the departments included in our review, supervisors reported reviewing and approving timesheets of employees that are not under their direct supervision. Some supervisors reviewed timesheets for only the employees they supervise while other supervisors reviewed the timesheets of up to 80 employees, a number of whom worked for other supervisors. Uniform timesheet review procedures facilitate timely identification of time and labor reporting errors.
- **Departments do not utilize uniform procedures for timesheet audits.** Prior to submitting timesheets to Payroll, departments must perform a series of quality assurance activities to certify the accuracy of time and attendance data. A uniform set of such activities have not been established for all departments to follow. Some departments follow outdated Payroll guidelines for timesheet audits and other departments have added other procedures to follow. Uniform timesheet audit procedures will improve timely identification of errors and reduce the need for detailed reviews and corrections to minimize process errors and risks.
- **Departments do not submit leave requests in a timely manner.** Leave processing requirements vary by department and are governed by County policy and collective bargaining agreements. Historically, Payroll has found material errors in time cards of individuals on leave. The Payroll Manager has dedicated one individual to perform review of time cards received from departments and make corrections to time cards as necessary.

Results

- **Departments train staff differently on payroll procedures.** Some departments do not provide formal training to their payroll staff at all while others do so routinely. None of the departments routinely train staff on changes to payroll requirements. While Payroll has conducted payroll clerk training in the past, including holding monthly payroll roundtables, they do not cover a number of key areas such as processing of garnishments, leave without pay, and family leave. Payroll's annual training budget of \$7,000 is not sufficient to provide the type of countywide training discussed above.

Due to the lack of uniform payroll procedures, Payroll is not able to place sufficient reliance on the department certification of the payroll data submitted. As a result, over a 12 month period in 2014 and 2015, Payroll re-opened and reviewed 4,232 department certified time and labor reports, or about 3.6 percent of all timecards processed. A number of errors were identified, some by individual departments and others by Payroll staff. Due to the number of errors in time and labor reports previously certified by departments as being accurate, Payroll continues to perform several redundant payroll processing activities.

Even with the redundant payroll audits and reviews conducted by Payroll staff, the County overpaid employees 156 times, made 21 check corrections after issuance, and reversed payroll transactions 41 times during FY 2014-15. These errors comprise approximately 0.2 percent of all payroll transactions.

Although Payroll is primarily responsible for processing countywide payroll, policies and procedures have not been fully developed. Payroll should develop and administer countywide payroll processes and procedures.

Finding 2: Information system controls need better execution (Risk Classification C)

Information systems provide controls to ensure the accuracy, integrity, and completeness of electronic payroll processing. These controls include system edit checks to identify payroll amounts that may not be correct, enforcement of password changes, configuration to prevent unauthorized access, and documentation of changes to the payroll system.

These controls are a shared responsibility between Payroll, HR, and ISD. ISD provides data center, network server, application, and database hosting and support functions. Payroll and HR provide TimeSaver and HRMS applications administration (code tables, security tables, etc....), user account administration, and end user support.

In certain areas of payroll processing, some system controls need to be changed for improved implementation and others to be added to reduce risks of errors and irregularities as discussed below:

- a. **System edits checks have not been properly adjusted.** System edit checks are the first line of electronic defense to identify potential errors. These are generally used to identify unusual transactions for further review. Presently, the payroll system edit check is set to identify pay amounts computed at or above \$10,000 as a potential error in computation. Based on a pay analysis conducted by Payroll, only 86 payroll checks are subject to additional scrutiny for potential calculation errors. About 97 percent of all County employee are issued payroll checks of \$6,000 or less. As a result, 867 payroll checks are not subject to additional system edits to

Results

ensure payroll computation accuracy. In response to this audit, Payroll took action to update the system edit check.

- b. **Password settings are outdated.** The password settings for the HRMS and Timesaver applications are not sufficiently complex given the critical nature of functions they support. Although industry guidance calls for the change of passwords at least every 90 days, there are no current County policies and procedures to change application related passwords. Many Payroll staff have not changed their application password since the system was implemented in 2009. Network access administered by ISD does comply with these standards but should not be considered a substitute for application level access.
- c. **User access reviews are not routinely performed.** Periodic application user access review provides assurance that active employees have the correct set of access rights to critical information based on business need, and ensures terminated employees no longer have access to the system. Generally, a log is maintained by position that shows the access rights to be granted to employees. Payroll does not have standard logs nor have they performed annual audits to insure access rights have been properly assigned. At the time of our audit, the Payroll Manager recognized the importance of this control and plans to address the need. Network access rights are currently reviewed by ISD / all departments annually and ISD deletes network access from terminated employees based upon reports received from HR.
- d. **Change notification procedures do not occur.** While changes to pay codes do not happen frequently, when they do occur in the HRMS system, these changes are not communicated to ISD timely. As a result, ISD does not use the most current codes when transferring data from HRMS to EFS, resulting in corrections and reworks causing delays.
- e. **Application changes are not properly documented.** Presently, Payroll does not systematically record changes made to pay tables, the extent of system testing performed, and the results of the testing. Proper management of application changes is critical to ensuring integrity and availability of systems. A number of standards and best practices are available as guidance over the performance and documentation of change management procedures. ISD has a change control process in place for network, server, and database updates. ISD is taking a lead role in introducing change management processes to Payroll and HR.
- f. **Documented Communication and Coordination protocols between Technical and Functional subject matter experts is needed:** HRMS and TimeSaver applications could benefit from better communication and coordination between technical and functional subject matter experts and ongoing governance. During the audit we noted that upgrades to TimeSaver and HRMS experienced delays due to constrained resources and other competing priorities for both teams. We also noted that there are not clear

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policies related to payroll data ownership that caused confusion amongst team members.

- g. **A tested disaster recovery plan is not in place.** A standard activity to assure continuity of service in issuing payroll checks in the event of a disaster is to perform disaster recovery testing. The County has not performed this type of testing for the full scope of the payroll systems. Disaster recovery testing is a component of ISD's information security programs, but County departments are allowed to develop their own security policies and procedures, as long as they provide greater security governance than the basic ISD requirements. We noted, however, that the ISD information security policies and standards were last updated in calendar year 2011. Best practices in internal controls requires that policies, procedures and standards be reviewed at least annually to remain current and relevant.

Without improved implementation of information system controls, current risks include: unauthorized user access, system calculation errors, data corruption, errors or delays in the upload process, a lack of timely data recovery, and unavailability of the system.

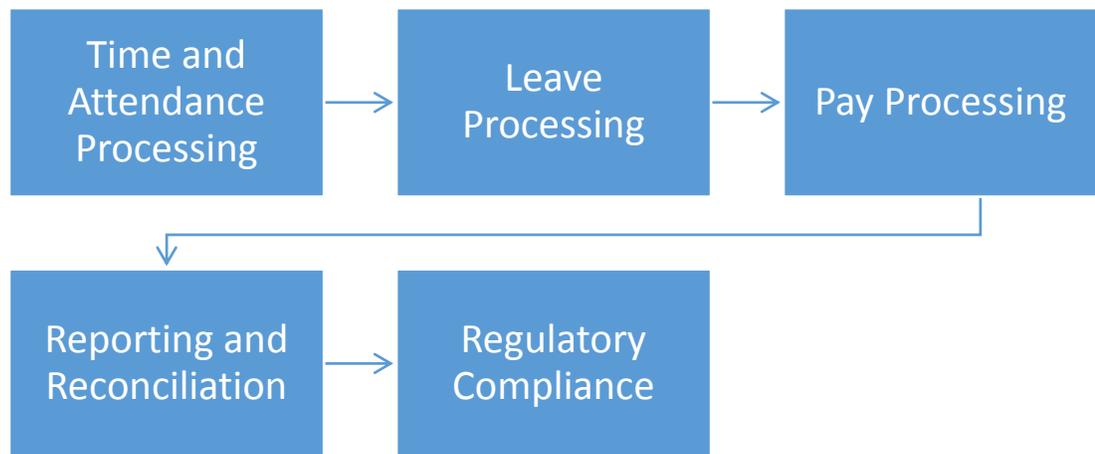
- h. **Customized Exception Reports and Systematic Payroll Calculations are not periodically reviewed.** Standardized reports that usually come with each software program do not always provide the necessary information needed to complete departmental tasks, in that event, customized reports are developed to provide the information needed. Once the reports are created and tested, they are not reviewed periodically. To ensure that customized reports provide accurate information that can be relied upon for financial reporting purposes, the reports should be reviewed periodically and when major system updates have been completed.

Finding 3: Opportunities are present to improve and update processes for payroll activities (Risk Classification C)

Organizations responsible for payroll activities have defined processes in place to address related administration and management aspects of payroll processing as shown below:

Results

Figure 1: Payroll Process



Payroll could better utilize resources and plan activities by having a clearly defined organizational structure around key aspects of payroll processing as shown above. Under the current structure, we noted the following issues:

- a. There is no one dedicated group of individuals fully responsible for certain portions of pay processing, except in the area of time and attendance processing and leave processing.
- b. Few of the staff are cross trained to assume roles and responsibilities of others should any prolonged absence occur.
- c. Payroll staff perform activities that are outside of key Payroll processing activities that are already performed by County departments. These activities could be discontinued if uniform county wide procedures are developed and appropriate training is provided to department payroll clerks.
- d. Payroll conducts audits and other review tasks even though County departments have not yet completed their time and attendance processing activities, further creating inefficiencies through overlap in processes.
- e. Payroll does not have adequate controls over unemployment insurance payments and pays unemployment insurance without checking to ensure that the payments are for eligible employees.
- f. Payroll does not have adequate controls over direct deposit account changes. Employees can submit requests for account changes without requiring proper identification.

Results

Finding 4: Internal Controls over calculation and payment of State and Federal Taxes should be improved. (Risk Classification A)

To minimize the risk that material amounts of penalty and interest charges will be assessed, paid and remain undiscovered, a number of preventive and detective internal control procedures are generally utilized. The nature and materiality of the risk to be managed dictates the optimum combination of the two. During the audit, we noted that the Payroll Manager's delay in filing required returns and the resulting payments of penalties and interest happened without the ACTTC management's awareness because of a lack of appropriate preventive and detective controls. As a result of returns being filed late, over a period of five years, the County paid approximately \$700,000 in penalties and interest to the State. The IRS transferred approximately \$600,000 from the County's credit balance to pay penalties and interest. The County was also assessed approximately \$1.2 million by the IRS due to errors in application of payments submitted for the County and other entities. For penalty and interest details see Table 1, found in Appendix C of this report. The following are the weaknesses we noted and their impact:

- a. There was no initial or secondary review of tax liability payments processed (preventive control). Although there were several people involved in the payment process in addition to the Payroll Manager, none were assigned the responsibility to identify and act upon potentially inappropriate payments such as penalties and interest.
- b. There were no fund reconciliations or other procedures to monitor the effectiveness of the preventive controls (detective controls). Reconciliation is a common way to identify in a timely manner errors that were not prevented. Had appropriate detective controls been in place, ACTTC management would have become aware of the assessment and payment of penalties and interest sooner.
- c. The budgetary process did not result in closely estimating expenditures for the unemployment insurance (UI) fund, which reduced the usefulness of the budget variance analysis (budgetary control). The budget development process for the UI fund relied primarily on prior year expenditures and did not include 1) an evaluation of internal and external factors and challenges that could impact future UI benefits payments and 2) a review of the backup for quarterly expenditures.
- d. There was no separate oversight of the payroll tax filing process and IRS and State payroll account activities performed by the Payroll Manager (detective control). This allowed the delays in filing of the payroll taxes and assessment of penalties and interest to continue without the knowledge of ACTTC management. For delays in filing payroll tax returns see Table 2, found in Appendix C of this report.
- e. Appropriate supporting documents were not used to process payments from the UI fund (preventative controls). Although the County had engaged a contractor to review and approve bills for unemployment benefits from the State, their reports were not used as supporting documents.

Results

Absent or ineffective governance and internal control activities have contributed to these issues. A number of these issues would have been avoided or corrected timely if appropriate policies and procedures existed covering 1) segregation of incompatible functions, 2) detail procedure requiring appropriate reconciliations, recording and classification of transactions, and maintenance of appropriate supporting documents, 3) oversight including verification of key control activities being performed and review of relevant variances, and 4) clearly defined roles and responsibilities. Through enhancing governance over Payroll, the recurrence of penalties and interest could be avoided.

Finding 5: County needs could be better met with business intelligence activities (Risk Classification C)

One of the key aspects of advanced payroll departments is the ability to conduct advanced analytics or business intelligence activities. These activities can help department officials and managers identify areas for operating efficiency and effectiveness, such as overtime analysis, employee leave analysis, and project related direct and indirect costs for grant-related reporting.

Although Payroll does not perform payroll-related analytics, our analysis of key metrics show some potential opportunity for improvement. Another area of potential improvement is payroll cost efficiency.

In the absence of conducting payroll analytics by Payroll, some departments have contacted the ISD to run ad-hoc and other special reports, which raises a critical internal policy issue for the County on data ownership and protection. Data ownership and data confidentiality needs to be addressed to help clarify roles and responsibilities in this area.

Conclusions

Payroll processing is a set of essential business functions that are County-wide. These functions require uniform administration and oversight to ensure the accuracy of the County's \$500 million annual payroll requirement. While Payroll ultimately processes the vast majority of checks correctly, a number of conditions support that the payroll process requires substantial updating and added internal controls. These conditions include a wide range of transaction corrections made each pay period, differences in payroll transaction processing within and across departments, system issues, absence of appropriate payroll reconciliations and tax liability reporting concerns.

The existing operating structure delegating responsibility to County departments for payroll processing without well-developed oversight authority by Payroll coupled with the absence of a uniform set of policies and procedures to govern payroll processing hampers needed process improvement. These issues highlight the need for re-structuring payroll processing to increase its efficiency and effectiveness. Restructuring current business processes to spend more time on payroll reconciliation activities, developing and administering training programs, and providing actionable data and reports to county departments on operating efficiencies through payroll analytics offers the County an enhanced potential to maximize the capabilities of current staff and information systems.

Recommendations

Recommendation #1: Developing Countywide Policies and Procedures can Enhance Coordination and Implementation of Payroll Processing (Risk Classification C)

Payroll should assume responsibility for developing, evaluating and enforcing County-wide payroll policies and procedures that focus on the accuracy of payroll processing. This should include an updated County-wide policies and procedures manual. The manual should include, at a minimum:

- a. Procedures for time and labor reporting:
 - Management review of time and labor reports,
 - Vacation, sick, and family leave reporting,
 - Overtime processing,
 - Garnishment processing,
 - Workers compensation requirements.
- b. Payroll audits:
 - Monitoring and reporting, temporary employees, and terminated employees.
- c. Policies for ownership of payroll data:
 - Check distribution,
 - Oversight,
 - Changing direct deposit information,
 - System quality assurance checks,
 - Removing extra help employees from the system.
- d. Payroll-related training requirements for staff.
- e. Uniform and rigorous county wide policy for employee privacy protection.

These policies and procedures should be centrally maintained, and reviewed and updated at least annually. After uniform County-wide policies and procedures have been implemented, Payroll should reduce the time it spends reviewing payroll transactions submitted by departments and focus their efforts on higher payback activities.

ACTTC Management Response:

ACTTC management concurs that Recommendation #1 could add value to the payroll process. However, management does not believe there are sufficient resources in payroll that could be devoted to this effort, and current payroll resources need to be assigned to processing bi-weekly payroll, filing payroll tax returns, and maintaining and configuring the system. ACTTC management will evaluate the resources needed to fully implement this recommendation.

Recommendation #2: Develop County-wide payroll training program (Risk Classification C)

The Payroll Manager should develop a County-wide training program and conduct related training for all staff that process or work on other payroll-related activities. The training program should address the newly developed County-wide policies and procedures, requirements for supervisory review as well as changes to State and Federal payroll reporting requirements. The training program should also address requirements for privacy protection.

Recommendations

ACTTC Management Response:

ACTTC management concurs that Recommendation #2 could add value to the payroll process. The Board of Supervisors recently approved a new position that will be shared by HR and ACTTC that will specifically focus on countywide training for both HRMS and TimeSaver. ACTTC and HR Management will evaluate a feasible training plan given the limited resources in this area.

Recommendation #3: Information System controls need better execution (Risk Classification C)

Payroll should coordinate with ISD to improve controls over application access, and change management to ensure payroll information is safeguarded and the integrity and continued availability of the payroll systems. Updates on these controls should include but not be limited to:

- a. Passwords, should meet minimum requirements as set by ISD Account Management Policy to include:
 - Be a minimum of eight characters,
 - Contain three of the following character types: lower case letters, upper case letters, numbers, and special characters,
 - Have an expiry period of between 60 and 90 days,
 - Prohibit passwords being re-used until changed at a specified number of times.
- b. User account privileges based on best practices requirements should be implemented for the applications:
 - The reviews should be conducted on the principal of least privilege, whereby each individual is only granted access to the functions and data that are required for the performance of their primary duties,
 - User access reviews should be performed at least annually,
 - Accounts should be reviewed to ensure that the system enforces a proper segregation of duties,
 - Review access authorization to outside entities such as EDD and IRS to verify that only authorized County employees have system access.
- c. Periodic review of custom applications settings. System edit checks for payroll amounts, deductions, accruals, and overtime should be updated to reflect the average payroll amount for the County employees. These procedures should be documented and performed on a regular basis.
- d. Change notification procedures. ISD should be notified upon any HRMS pay code updates so that they can be mapped and added to EFS or other system interfaces.
- e. In accordance with best practices, Payroll should perform the following relating to change management procedures and documentation over major system front-end changes (pay tables, reports, system alert settings):
 - Identify change to be made
 - Require the programmer to make the change in a test environment
 - Require a person other than the programmer to test the change in the test environment,

Recommendations

- Require completed change to be moved to production only after appropriate approval and sign offs have been made and documented.

Once Payroll calculations have been tested and set, they should be reviewed, at least annually, to ensure complex calculations are functioning as designed. Reviews of systems calculations should be conducted after major system changes as updates could have effects on the systems calculations. As the system calculations are set and will calculate the same for all in a set group, a test of one could be calculated.

ACTTC Management Response:

ACTTC management concurs with Recommendation #3. ISD has assigned a project manager to the HRMS and TimeSaver systems. The ISD project manager has already implemented additional change management controls in this area. ACTTC management will continue to work with the ISD project manager to further improve controls over system access and change management.

ISD Management Response:

Passwords: Management Agrees: The current version of TimeSaver is 6.0.x which the vendor will stop supporting August 2016. There is currently a project in pilot mode to migrate to TimeSaver 8.0 which can include functionality to use the ISD maintained Active Directory (AD) as the primary authentication system. ACTTC Payroll division and ISD S&P should assess the viability of AD authentication as part of the phase 1 of the upgrade project or in an additional phase. AD functionality within TimeSaver system would provide improved compliance to the account management policy and would provide additional functionality for user account management privileges. User account management privileges could be managed using AD group management for improved control. A similar approach should also be considered with ePersonality.

User Account Privileges: Management Agrees: Human Resources and Payroll are the process owners and control access to the actual production applications. If access is driven by Active Directory (AD) groups as described above, HR and/or Payroll team would submit a request to Information Systems Department (ISD) indicating which staff should be included or removed. ISD team would execute the request providing a desired separation of duties control; however, they do not do so without explicit instruction from the process owners. In terms of ISD access to production systems, these protocols are in place:

- There is a specific Active Directory group whose members only include those developers who actively support the application. It does not include members of the team who do not typically support this product.
- The AD group for developers has access to test servers, but does not have access to production servers or databases. There are production network shares which the team can access for production support purposes. These directories are used to pick up / drop off files for batch processing.
- There are additional AD groups for ISD infrastructure teams such as server support or database administration support roles. These groups have access to the production databases and servers as this is a requirement to administer them at a systems level. Examples of when this need occur:
 - To install application patches provided by the vendor
 - To install server related software or patches

Recommendations

- To install, schedule, and run programs written in-house by ISD developers which extract payroll or benefits data that must be sent to outside sources such as health plan administrators.

Periodic Review of Application Custom Settings: This is a function that would not typically be performed by ISD as we are not subject matter experts in payroll processing.

Change Notification Procedures: Management Agrees. For ISD related changes to the HRMS and TimeSaver applications, infrastructure and application development teams follow the ISD protocol for Change Management. This involves, (1) Opening a change ticket to document the nature of the change and time of change (2) Seeking management approval for the change (3) Communicating with the application owner.

However, changes to the system can also be made via the application itself and by functional users having elevated application privileges. To date, these application changes have not been formalized as part of the change management process for the HRMS and TimeSaver applications. The County has been very successful in instituting this process with the support organization for the Enterprise Financial System (EFS). Both technical and functional teams are required to provide documentation for any proposed change to the system. Once going through an internal approval process, the changes are coded and tested within test environments. Outputs of test results are also captured and documented. After testing is successfully performed, the team seeks approval for the move to production from EFS project managers. After approval, changes are scheduled into pre-determined maintenance windows depending on complexity of changes (more complex changes requiring database backup are typically scheduled in the evenings). This formal process provides transparency around all changes that are made to the production system and has resulted in increased application stability as it relates to change. It is the intent to incorporate this same process for the HRMS and TimeSaver applications. The support team has begun to have discussions in this direction, but nothing has yet been finalized. This is primarily due to workload constraints in HR and Payroll affecting the functional teams due to current business cycles for open enrollment and labor negotiations.

Recommendation #4: Develop program to monitor compliance with ISD security, account management and change management guidance (Risk Classification C)

ISD should ensure County departments are aware of and adhere to Information Security, Account Management, and Change Management policies and standards as systems are added or updated on the County's network. ISD should develop a compliance program to ensure County departments are following ISD guidance to safeguard the Counties network and integrity and confidentiality of data. Policies and standards should be evaluated and reviewed on a regular basis to ensure they are up-to-date as technology, overall, changes rapidly.

ISD Information Security Policies and Guidance

Policy for Information Security – dated: 5/2/2011

Policy for Account Management – dated: 7/15/2011

Policy for Change Management – dated: 7/15/2011

Recommendations

Standards for Account Management – dated: 7/15/2011

ISD Management Response: Management Agrees.

A committee which is comprised of technology liaisons from Health Services, Sherriff, Probation, DA, HR, and County Counsel was developing a new policy for IT professionals to cover IT controls, information security, and compliance at the time of the Payroll Audit. The policy has replaced those referenced in the above recommendation and add other compliance controls consistent with the industry standards. The 9-4 Information Technology (IT) Professional Policy development process along with periodic Technical Advisory group meetings has provided information security awareness and directives to the IT professionals to ensure appropriate and authorized access, integrity, confidentiality, and availability of data and information systems within the County of Sonoma. The new policy has been reviewed by the County Administrator's Office (CAO) and County Counsel, and meet and confer sessions with the labor groups have been completed. The policy has been presented to Management Advisory and Department heads prior to the Board of Supervisors adoption which occurred on July 12, 2016.

ISD, in conjunction with our departmental partners are planning a significant outreach and awareness training campaign program including plans for compliance monitoring to comply with 9-4.

Additionally, HR (Risk Management) purchased countywide Security Awareness Training and Education (SATE) SANS software entitled "SANS Securing the End User." HR and ISD intend to pilot the program in May and June 2016.

Recommendation #5: Perform and document disaster recovery testing on payroll systems (Risk Classification C)

ISD, working with Payroll, should test the HRMS and TimeSaver systems to ensure the systems and data can be recovered in a timely manner after a natural or man-made disaster. Testing should be scheduled periodically with findings from the tests incorporated into the disaster recovery procedures.

ISD Management Response: Management Agrees.

ACTTC has assembled a team from both ISD, ACTTC, and management from other departments to address this need. The objective of the team is to develop a comprehensive solution to providing support in the event of a disaster. This solution should encompass plans for both technical and non-technical strategies for maintaining business continuity for critical services. ACTTC is currently identifying and prioritizing Payroll/HR processes and the timeframe for which they will need to be recovered. In parallel, ISD team is preparing the infrastructure in our data recovery (DR) site which is located at the Emergency Operations Center within the County Campus. While this is an ongoing project which is likely not to complete for several months, it is still possible to recover critical Payroll applications (TimeSaver and HRMS) from the nightly server backups. Depending upon when an actual event occurs, a loss of some data is likely so this, of course, is not the preferred solution. DR to existing systems, including full refresh to test and demo environments is routinely performed. Once the DR sites are available a rehearsal will be performed.

Recommendations

Recommendation #6: Evaluate and restructure Payroll to mitigate critical risks and achieve operational objectives (Risk Classification C)

The Payroll Manager should restructure Payroll implementing, at a minimum, the following changes:

- a. Update the Payroll accounting policies and procedures to cover required reconciliations, classification of payroll transactions, maintenance of documentation adequately supporting transactions, segregation of functions etc.
- b. Provide targeted payroll processing training program based on identified payroll processing needs.
- c. To the extent possible, delay payroll transaction review until Departments have certified the accuracy of their payroll records.
- d. Eliminate payroll transaction reviews that have already been performed by County departments.
- e. Defer non-critical work activities until after employee paychecks have been issued.
- f. Delegate a Payroll staff person to formally track all inquiries received by the Payroll System Applications Help Desk; prepare an annual report and incorporate the results into annual payroll training.
- g. Conduct additional work flow reviews to evenly distribute workloads among staff. The work flow reviews should identify all tasks performed weekly, bi-weekly, and monthly and reassignment of activities should be based on the skill set of existing staff.
- h. Require Payroll staff to participate in American Payroll Association monthly meetings.
- i. Require verification of identity for employees requesting direct deposit changes.

ACTTC Management Response:

ACTTC management concurs with Recommendation #6. The Board of Supervisors recently approved the addition of one Department Information Systems Specialist position to Payroll, and Payroll has been separated into a daily operations section and a system support section. The Assistant Payroll Manager has been assigned oversight of the daily operations section, and the Department Information Systems Coordinator has been assigned oversight of the system support section. The Payroll Manager will oversee both the Assistant Payroll Manager and the Department Information Systems Coordinator. ACTTC management believes that this restructuring will continue to mitigate critical risks and achieve operational objectives. ACTTC management will continue to evaluate the resources needed to fully implement this recommendation.

Recommendation #7: - Internal Controls over calculation and payment of State and Federal Taxes should be improved. (Risk Classification A)

The ACTTC management should evaluate internal controls over filing of Federal and State payroll tax returns and the operation of the Unemployment Insurance (UI) and the payroll revolving funds. At a minimum the following actions should be completed, a number of which management has started to implement:

- a. Perform a comprehensive risk assessment of the area.

Recommendations

- b. Reconcile the Payroll Revolving and UI Funds periodically.
- c. Perform prior period fund reconciliation to gain assurance that improper payments were not made in the past.
- d. Assign a second person to review payments from the two funds for appropriateness (require reporting of penalties and interest payments or other possible inappropriate payments)
- e. Assign an individual independent from the tax return filing responsibilities to monitor activities in IRS and State accounts.
- f. Review the methodology for estimating unemployment benefits payments and adjustments as necessary. Annual variances analysis should be performed.
- g. Credit balances in the IRS and the State accounts should be subject to the same type of controls as cash outside of the Treasury. They should be recorded in the County's books (some, but not all, were recorded as Salary & Benefits) if they are material and not temporary. The causes for all material variances should be investigated and corrections made to internal processes to minimize credit balances in accounts with IRS and the State.
- h. Payments to EDD should be made only after ensuring that individuals requesting unemployment benefits were County employees and entitled to unemployment benefits.

Once Payroll calculations have been tested and set they should be reviewed, at least annually, to ensure calculations are functioning as designed.

ACTTC Management Response:

ACTTC management concurs with Recommendation #7 and has implemented all of the recommendations. Additionally, ACTTC management is working with County Counsel to seek the abatement of all remaining State Economic Development Department (EDD) and Internal Revenue Service (IRS) penalties and interest for reasonable cause. Work toward penalty abatement is ongoing as of this writing. Over the 5 year period covered by this audit, the individual amounts of penalties and interest assessed by the EDD, and the IRS represent less than .050% of the \$2.5 Billion in total payroll processed

Recommendation #8: Documented Communication and Coordination protocols between Technical and Functional subject matter experts is needed (Risk Classification C)

HRMS and TimeSaver applications could benefit from better communication and coordination between technical and functional subject matter experts and ongoing governance. During the audit we noted that upgrades to TimeSaver and HRMS experienced delays due to constrained resources and other competing priorities for both teams. We also noted that there are not clear policies related to payroll data ownership that caused confusion amongst team members.

Recommendations

ISD and ACTTC Management Response: Management Agrees

A steering committee and a leadership team has been established consisting of key stakeholders from both the functional and technical areas. This team includes representatives from Human Resources, Auditor-Controller-Treasurer-Tax Collector, Information Systems Department, General Services, Human Services, Transportation and Public Works, Water Agency and Health Services. The leadership team discusses and sets the priority for projects such as upgrades and will provide guidance to the functional and technical teams. The leadership team will also discuss policies related to data ownership, confidentiality of data, disaster recovery, along with other major county initiatives and how they impact the HRMS and TimeSaver systems. During the audit period the County was implementing a new financial system, PeopleSoft and the decision was made to focus on this implementation first, then undertake upgrades to the HRMS and TimeSaver systems after PeopleSoft went live.

Recommendation #9: Develop, implement, and monitor payroll performance metrics (Risk Classification C)

The Payroll Manager should develop and adopt a set of performance metrics to assist with continuous process improvement. These analytics should be performed by staff with the knowledge, skills and abilities to compute these metrics, interpret trends and recommend corrective actions for improvements. Examples of relevant performance metrics include, but are not limited to:

- a. Number of incorrect vacation payouts upon employee termination per pay period.
- b. Number of incorrect data entries per pay period.
- c. Number of adjustments not made by the departments per pay period.
- d. Time to setup new employee profiles in the payroll system.
- e. Number of work hours to perform payroll audits.
- f. Number of exceptions identified while performing department payroll audits.
- g. Average cost to issue a paycheck.

ACTTC Management Response:

ACTTC management concurs that Recommendation #9 could add value to the payroll process. However, management does not believe there are sufficient resources in payroll that could be devoted to this effort, and current payroll resources need to be assigned to processing bi-weekly payroll, filing payroll tax returns, and maintaining and configuring the system. ACTTC management will evaluate the resources needed to fully implement this recommendation.

Recommendation #10: Eliminate manual payroll check issuance (Risk Classification C)

The Payroll Manager should, in collaboration, with the Human Resources Department, develop a program to eliminate manual check issuance for new employees and encourage existing employees to convert to electronic deposit.

Recommendations and Staff Acknowledgement

ACTTC Management Response:

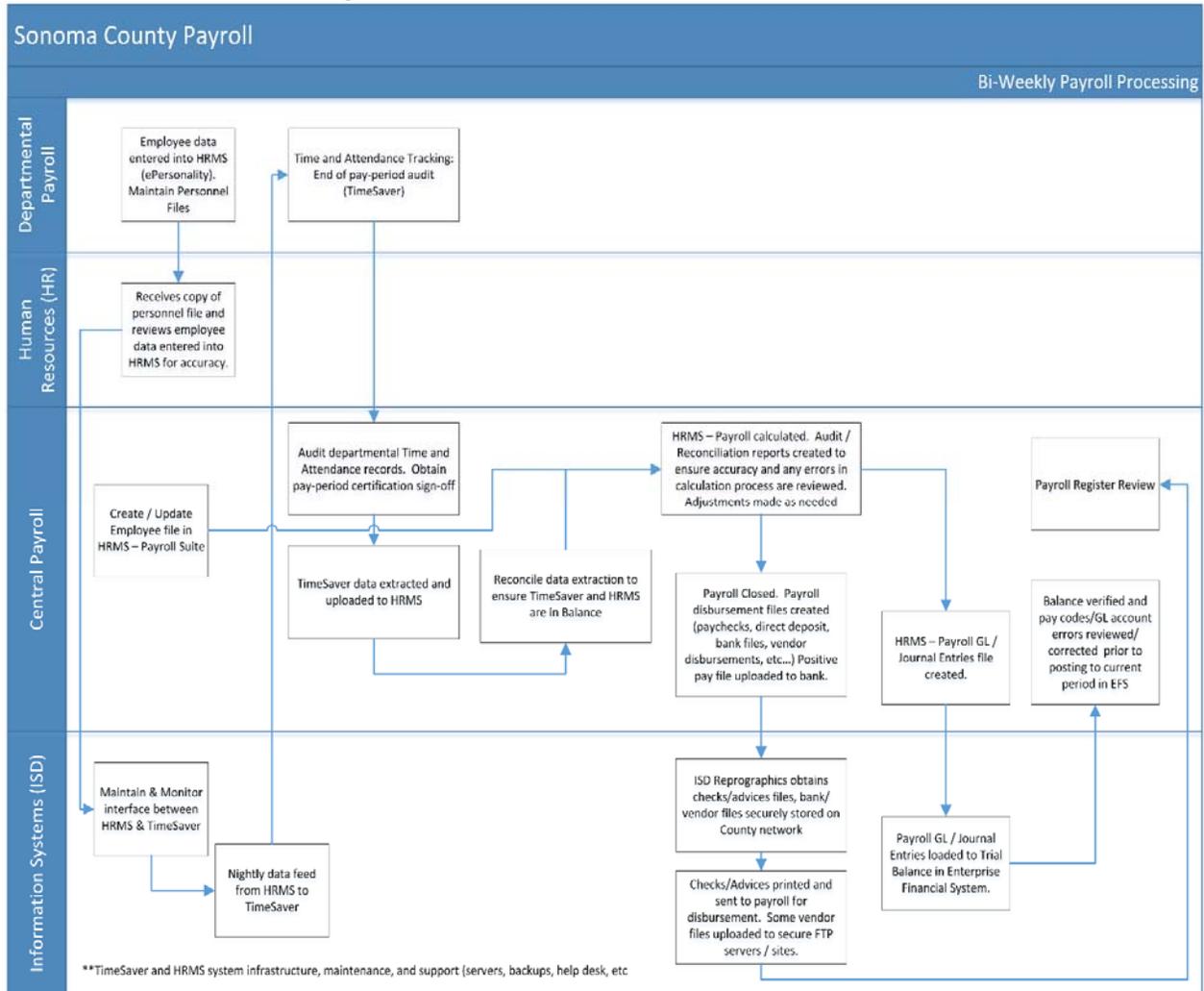
ACTTC management concurs, in concept, with Recommendation #10. Payroll clerks already encourage employees to utilize the HRMS portal and eliminate manual check issuances. The bargaining agreements with the unions do not mandate eliminating manual check issuances so employees must still be given the option of receiving a manual check until this is included in the bargaining agreements. As such, payroll will continue to encourage and promote the use of the HRMS portal and the elimination of manual check issuances. ACTTC management has made the suggestion to employee relations on many occasions that it would be beneficial to include this requirement in the bargaining agreements. However, to date this provision has not been bargained into the agreements.

Staff Acknowledgement

We would like to thank the ACTTC Payroll Division, ISD, and County Departmental Management and Staff for their time, information and cooperation throughout the review.

Appendix A –Payroll Process

Time and Labor Processing



Appendix B – Payroll Risk Mitigation Matrix

ACTTC conducted a countywide risk assessment in 2014 that assessed twelve key countywide business processes that without sufficient policies, procedures, and systems in place could pose a higher risk to the County of fraud, waste, and abuse. In one business process, payroll, which is administered by nearly all county departments, the risk assessment identified eleven key high risk areas. The table below shows these potential risk and their relevance to the current audit. Specific issues are discussed in the Results section of this report.

Identified Potential Risk (County wide risk assessment)	Existence of Risk Identified from the Current Audit	Action Recommended to Mitigate the Risk
1. Fictitious employees in the system	Yes. The audit identified that temporary employees who are no longer employed with the system remained in the payroll system. These accounts can be reactivated without knowledge of the County department.	Develop County-wide policies, procedures and standards governing the payroll process, including but not limited to: procedures for time and labor reporting, management review of time and labor reports, vacation, sick, and family leave reporting, overtime processing, garnishment processing, workers compensation requirements, payroll audits, monitoring and reporting, temporary employees, and terminated employees.
2. Recurring errors due to heavy reliance on computer systems	Yes. The audit identified multiple recurring errors with payroll processing by various departments. These areas are related to the re-opening of payroll records after the information has been certified and reoccurring errors with processing employees with leave without pay status.	Develop a County-wide training program and conduct related training for all staff that process or work on other payroll-related activities. The training program should address the newly developed County-wide policy and procedures, requirements for supervisory review as well as changes to state and federal payroll reporting requirements.
3. Incorrect changes in employee status, pay rates, withholding etc.	Yes. The audit identified that processes for accurately capturing leave without pay status do not contain sufficient controls to prevent the occurrence of errors.	Develop County-wide policies, procedures and standards governing the payroll process, including but not limited to: procedures for time and labor reporting, management review of time and labor reports, vacation, sick, and family leave reporting, overtime processing, garnishment processing, workers compensation requirements, payroll audits, monitoring and reporting, temporary employees, and terminated employees.

Appendix B – Payroll Risk Mitigation Matrix

<p>4. Employee contract terms not entered correctly in the system</p>	<p>No. Contract and MOU information is entered into the HRMS system and the data is sent to HR to review for accuracy.</p>	<p>None.</p>
<p>5. Payments made for time not worked</p>	<p>Yes. The audit identified that the County must issue promissory notes for employees who have been overpaid under multiple circumstances, which can include, but not limited to, over reporting of hours worked.</p>	<p>Develop, document and implement County-wide policies, procedures and standards governing the payroll process, including but not limited to: procedures for time and labor reporting,</p>
<p>6. Inaccurate labor reports that are used for claiming</p>	<p>Yes. The audit identified that the County’s ISD department prepares time and labor distribution reports for departments for grant related purposes, but concerns exist about the accuracy and confidentiality of information of those reports because of the absence of Payroll Section involvement in their preparation and review.</p>	<p>Develop, document and implement County-wide policies, procedures and standards governing the payroll process, including but not limited to policies for ownership of payroll data, check distribution, oversight, changing direct deposit information, payroll-related training requirements for staff, system quality assurance checks, removing temporary employees from the system, and uniform and rigorous county wide policy for employee privacy protection.</p>
<p>7. Errors in interpreting State and Federal withholding requirements</p>	<p>Yes. The audit identified the Payroll Section did not comply with requirements for timely filing of state and federal withholding requirements, leading to late penalties and fines.</p>	<p>Revamp the process for state and federal tax liability reporting, including the development of quality assurance activities to ensure proper oversight and compliance.</p>

Appendix B – Payroll Risk Mitigation Matrix

<p>8. All compensations subject to withholding and reporting are not captured</p>	<p>Not tested.</p>	<p>Not tested.</p>
<p>9. Time and labor data is not reviewed and approved by supervisors</p>	<p>Yes. The audit identified that County departments responsible for their time and labor processing have different procedures for supervisory review and approval of employee timesheets. Some departments require supervisors to review and others departments delegate responsibility to other personnel. In addition, some departments have one supervisor review up to 80 timesheets while other departments have one supervisor review no more than 15 timesheets for accuracy and completeness.</p>	<p>Develop County-wide policies, procedures and standards governing the payroll process, including but not limited to: procedures for management review of time and labor reports.</p>
<p>10. Overtime payments are incorrectly calculated</p>	<p>Yes. The audit examined processes for reviewing overtime pay by selected departments. No substantial exceptions were identified.</p>	<p>Develop County-wide policies, procedures and standards governing the payroll process, including but not limited to: procedures for time and labor reporting and overtime processing.</p>
<p>11. Correct tax payer identification</p>	<p>Yes. The audit identified that the Payroll Section does not have processes in place or other controls to check for the accuracy of the information presented by the employee when requesting changes in direct deposit accounts.</p>	<p>The Payroll Manager should restructure its Central Payroll requiring verification of identity from employees requesting direct deposit changes.</p>

Appendix C – Table 1 and Table 2

Table 1
County of Sonoma, CDC, and SMART
Penalties and Interest Assessed
January 1, 2011 to September 30, 2015

	State (EDD)*	Federal (IRS)*	Total*
Assessed and Paid			
Sonoma County	642,485	612,019	1,254,504
CDC	26,555		26,555
SMART	4,670		4,670
Total	673,710	612,019	1,285,729
Assessed but not Paid			
Sonoma County			
CDC		818,964	818,964
SMART		378,610	378,610
Total		1,197,574	1,197,574
Grand Total	673,710	1,809,593	2,483,303
Waivers requested from the EDD by management and awaiting determination	673,710		673,710
Waivers anticipated by management from the IRS based on the verbal representations of the IRS agent assigned to Sonoma County		1,809,593	1,809,593

*Rounded to nearest whole dollar

Table 2
State and Federal Missed Filing Deadlines Analysis
January 1, 2011 to September 30, 2015

	Returns Required	Returns Filed Late	Average Days Late	% Late
State				
State Income Tax	19	14	143	75%
State Wage Returns	19	16	92	84%
UI Returns	19	11	122	58%
UI Wage Returns	19	16	126	84%
Total	76	57	121	75%
Federal				
Sonoma County	19	19	239	100%
CDC	16	16	575	100%
SMART	10	10	364	100%
Total	45	45	393	100%

Appendix D – Report Item Risk Classification

For purposes of reporting our audit findings and recommendations, we classify audit report items into three distinct categories to identify the perceived risk exposure:

- **Risk Classification A: Critical Control Weakness:**
Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s), policies, and/or business goals of a department/agency or the County as a whole. Management is expected to address Critical Control Weaknesses brought to their attention immediately.
- **Risk Classification B: Significant Control Weakness:**
Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.
- **Risk Classification C: 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.

The current status of implementation of recommendations will be followed up no later than the end of the second fiscal year after the report has been issued. Critical control weakness findings will be followed up between six months and one year of the date of the report.