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Alexander Bustamante
SENIOR VICE PRESIDENT
CHIEF COMPLIANCE AND AUDIT OFFICER

October 28, 2020

INTERIM EXECUTIVE DIRECTOR HUSTON

RE: Final Report Project No. P20A017: Payroll Tax

Attached is a copy of the final report for: Audit Services Project No. P20A017 Payroll Tax. With the issuance of this final report, please destroy any previous draft versions. We very much appreciate the assistance provided to us by you and members of your staff during our review. If you should have any questions please feel free to contact me at 510-987-9646 (email: matthew.hicks@ucop.edu).

A handwritten signature in black ink, appearing to read "Matt Hicks".

Matt Hicks
Systemwide Deputy Audit Officer

Attachment

cc: Senior Vice President Bustamante
Executive Vice President Nava
Associate Vice President Cianca
Production Director Saint Martin
Systemwide Associate Audit Director Cataldo
Finance Manager Barraza
Contractor Zahid
Contractor Choi
Contractor Zhang
Contractor Enriquez
Contractor Subudhi

UNIVERSITY OF CALIFORNIA
ETHICS, COMPLIANCE AND AUDIT SERVICES
OFFICE OF THE PRESIDENT
INTERNAL AUDIT SERVICES

Payroll Tax Internal Audit Report
Audit No. P20A017
September 2020

Audit Conducted by:
Farhan Zahid Contractor
Karina Enriquez, Contractor

Executive Summary

Introduction and Background

As part of the University of California Office of the President (UCOP) 2019 – 2020 fiscal year internal audit plan, Internal Audit performed a review of UCPATH Center’s controls supporting the processing, filing, and payment of payroll taxes for certain campuses.

In 2015, the UCPATH Center implemented a partnership to assist the UC locations that had not yet transitioned from the legacy payroll system (the Payroll/Personnel System or PPS) to UCPATH with the processing, filing, and payment of payroll taxes. This partnership was referred to as the PPS partnership. During the scope period of the review of September 1, 2019 through December 31, 2019, UC Santa Cruz was the only location that was utilizing the payroll tax process as part of the PPS partnership.

The UCPATH Center’s Production and Finance teams were responsible for executing the tasks associated with the processing, depositing, filing, and payment of payroll taxes. The Production team prepared the calculation for payroll tax deposits on a biweekly basis and completed the corresponding tax deposits. The Finance team was responsible for completing the filings with the appropriate regulatory bodies (i.e. Employment Development Department and Internal Revenue Service) on a quarterly basis via the government portals. The two government portals utilized by Finance and Production teams are Employment Development Department of California’s (EDD) e-Services for business and the IRS’ Electronic Tax Payment System. The portals allow for the University to manage, pay, and update its payroll taxes online.

As part of the PPS Partnership, the UCPATH Center was also responsible for all communication related to the payroll tax process for the schools under the partnership. As such, when penalties were assessed against UC Santa Cruz by the Internal Revenue Service (IRS) and EDD for delayed payments of payroll tax deposits, which totaled to \$842,169.20, it was the UCPATH Center who was responsible for investigating and addressing these items. The UCPATH Center reviewed the payroll tax deposits and determined that the notices were correct. The UCPATH Center Production team failed to complete the payroll tax deposits for the period of September 2019, which resulted in delayed payments to both the IRS and EDD. As such, in an effort to further understand the failures in controls supporting the processing, depositing, filing and payment of payroll taxes, the UCPATH Center leadership requested this internal audit review.

As of January 1, 2020, the partnership is no longer active. All locations under the partnership have transitioned to UCPATH. Therefore, future tax filings will be done through the UCPATH Center via processes and activities that differ from the partnership’s arrangements. The processes and activities related to these current state processes were not in the scope of this review and recommendations made within this report are provided as an aid for management in applying leading practices, if deemed applicable, within the current control environment.

Objectives and Scope

Internal Audit performed an assessment to evaluate the design effectiveness of controls at the UCPath Center over the processing and payment of payroll taxes for the PPS Partnership, specifically in relation to the Finance and Production Departments' involvement in the process.

The assessment included evaluating the design effectiveness of in-scope, internal controls, including:

- Compliance with relevant policies, procedures and guidelines for the processing, filing and payment of payroll taxes.
- Training provided to employees that were involved with processing, filing and payment of payroll taxes.
- Reconciliation procedures to ensure the accuracy and timeliness of payroll tax filings and payments to the appropriate regulatory bodies (i.e. Social Security, IRS, etc.).
- Business continuity controls to ensure ongoing operations, as it relates to procedures involved in the processing, filing and payment of payroll taxes.
- Access controls over related systems and share file sites.

Procedures Performed

To accomplish the project objectives and scope as documented above, Internal Audit performed the following procedures:

1. Conducted interviews and walkthroughs with key stakeholders to develop an understanding of key processes, controls and documentation maintained to support the payroll tax processing, filing and payments by the Payroll Production and Finance teams.
2. Assessed relevant documentation, including policies, procedures, standards, baselines, and guidelines for payroll tax processing, filing and payments by the Payroll Production and Finance teams.
3. Assessed the processes and controls related to the tasks performed by the Payroll Production and Finance teams as part of the PPS Partnership to determine the design effectiveness of these controls.

Conclusion

Based on the audit procedures performed, Internal Audit identified several deficient controls as summarized below.

1. A biweekly reconciliation to confirm accuracy and timeliness of payroll tax deposits specific to the PPS Partnership was not performed.
2. Processes to cross-train employees on key functions related to the processing, filing, and payment of payroll taxes, such as completing the Tax Deposit Record or filing the quarterly 941 form for the PPS Partnership were not formalized.

3. Access to the government portal was not sufficiently controlled in a manner that supported business continuity when the primary individual responsible for filing was unavailable.
4. Policies and procedures related to processing, filing, and payments for payroll taxes for the PPS Partnership were not available to all relevant UCPATH Center personnel.

While the PPS Partnership ended on January 1, 2020 as a direct result of campuses transitioning out of the partnership and into UCPATH Center payroll processes, the corrective actions identified below were designed to address related risks in the current state processes.

Further details of the observations tabulated above are provided within the **Opportunities for Improvement and Actions Plans** section of this report.

Opportunities for Improvement and Action Plans

1. *Access to the government portal should be controlled and made available in a manner that supports business continuity in the event that a primary individual responsible for filing is unavailable.*

During the audit scope period, the Payroll Associate in the UCPath Production Department was the only individual in the department who had access to the government portals, as she was responsible for completing the Tax Deposit Report for each pay period. For UCPath Finance, the former UCPath Staff Accountant prepared the quarterly 941 and 941 B schedule payroll tax filings and, subsequent to the Finance Manager's review, completed the filing, and was the primary user of the government portals for the Finance Department. The UCPath Finance team kept a file with the credentials of all government portals in a spreadsheet stored on the department's SharePoint site.

During the scope period of the review, the team had identified that the passwords in the spreadsheet were outdated and the UCPath Finance team was unable to log into the government portals. Subsequent to this event, the team has created new accounts and made those passwords available to the team via the department's shared drive, to which only authorized individuals have access. The passwords are required to be shared with the department given that the portals provided by the government agencies are limited and as such it was not possible for each person to have their own individual account

Action Plan: While the partnership is no longer active, the UCPath Production and Finance teams should continue to develop practices to ensure that access to any portal critical to daily operations should have the appropriate backup assignment and appropriate password management. Accordingly, UC Path Center management will implement the following access management strategies:

1. A generic email address will be utilized for the department that would address verification codes, changes in password, or notifications, so that in the event that an individual is out or leaves the organization, the email notifications do not go specifically to that individual for response.
2. As applicable, configure the portals to send out notifications to additional users (e.g. supervisors) whenever a password change is made. If the timing of a change does not align with expectations, then the supervisors can investigate accordingly.
3. Develop formal processes to require any password logs be updated whenever a password is changed.

Target Date: N/A – Completed during field work

2. *Processes to cross-train employees on key functions related to the processing, filing, and payment of payroll taxes, were not formalized.*

During our review there was only one primary, designated individual in the Production Department trained to complete the Tax Deposit Record, which the Accounts Payable Team used to make the biweekly cash deposits to the corresponding regulatory agencies. While additional individuals did have training to complete the associated tasks in the absence of the primary individual, the responsibilities for backup support were not formally designated and communicated. As such, in the event that the primary individual was unavailable to complete this task, there was a potential for delays or gaps in the completion of the tax deposit calculation, AP voucher, and final deposit of payroll taxes.

Within the Finance Team, prior to September 2019 there was only one individual who was formally designated to complete the quarterly payroll tax filings. When this individual went on leave, there was no other person formally designated to complete this task. Given that the quarterly payroll tax filings require timely processing, a secondary preparer who was experience in preparing the payroll tax filing should have been formally designated in order to avoid potential filing delays.

Action Plan: While all locations have transitioned from the PPS Partnership process, UCPath Center management should ensure that employees are cross-trained in the critical components of current and future payroll tax filing processes and that backups are identified for all critical functions to mitigate the risk of potential delays in processing and filing of payroll taxes.

Target Date: N/A – Completed during field work

3. *Access to policies and procedures related to processing, filing, and payments for payroll taxes for the PPS Partnership were not available to all relevant UCPath Center personnel.*

Policies and procedures that articulated how to complete the processing, filing, and payment of payroll taxes under the PPS Partnership, such as the "BPQR - Quarterly Tax Filing" procedures and "UCSC Quarterly Taxes Report Instructions 1.16.2020" procedures, as well as the "2019 UCSC Schedule" were developed by the UCPath Center. These policies and procedures are considered a primary guidance tool for new hires. However, not all personnel in the UCPath Production and Finance departments were aware of how to access these policies and procedures. As such, not all personnel had the appropriate resources and tools to appropriately complete their job responsibilities. Additionally, the lack of access to department policies and procedures may have resulted in knowledge gaps regarding personnel's expected roles and responsibilities.

Currently, the Production Team has initiated development of a repository of all applicable departmental policies and procedures, and the repository of policies and procedures will become available to staff via the department's SharePoint site.

Additionally, while UC Santa Cruz has transitioned to UCPATH and will no longer be under the PPS Partnership, in an effort to ensure that all team members have visibility to critical departmental tasks, as of January 2020, the UCPATH Production management team has implemented a new checklist system. The checklist tracks all critical departmental tasks, as well as the respective preparers. Preparers are required to sign off on the list as they complete their respective tasks.

Action Plan: Although the partnership concluded as of January 1, 2020, UCPATH Center management will continue to move forward with the implementation of remediation efforts by ensuring that all critical departmental tasks are visible to all pertinent employees, and that all employees are made aware of and given access to the repository of applicable departmental policies and procedures.

Target Date: October 31, 2020

4. ***A biweekly reconciliation to confirm accuracy and timeliness of payroll tax deposits specific to the PPS Partnership was not performed.***

The Production Team was responsible for completing all activities pertaining to the biweekly payroll tax deposits, inclusive of calculations and final deposits. However, the department did not have the appropriate controls, such as a formal biweekly reconciliation, to assess the accuracy and timeliness of the deposits that needed to be completed on a bi-weekly basis. The lack of a formal biweekly reconciliation hindered their ability to identify any missed deposits and take necessary steps (e.g. filing for an extension) to avoid penalties from being assessed against UC Santa Cruz.

Due to the lack of a control in place to ensure the accuracy of the tax deposits and to mitigate the potential of under depositing in taxes (given that this would result in penalties being assessed against the school), the UCPATH Production team included an additional \$10,000 in their calculation to cover any potential underpayment. The inclusion of the \$10,000 dollars was a practice that was inherited as part of the PPS Partnership due to a prior under deposit of taxes by UC Santa Cruz prior to the beginning of the partnership in 2015. However, this practice proved often to result in tax overpayments for the school; specifically, for the period of Q4 2019, it was noted that an overpayment of approximately \$75,000 was completed.

Action Plan: While the PPS Partnership is ineffective as of January 1, 2020, management has implemented a biweekly reconciliation to confirm the accuracy and timeliness of payroll tax deposits. If any issues are identified during the reconciliation process, these will be reported and escalated to management. Additionally, management has created

desk procedures outlining the reconciliation and escalation process to ensure that all pertinent is aware of these processes.

Target Date: N/A – Completed during field work