July 8, 2015

To: Tom Peterson – Executive Vice Chancellor and Provost
               Michael Reese – Vice Chancellor for Business and Administrative Services

Subject: Audit of Payroll Processes

Ref: Report No. M15A008

Internal Audit has completed an audit of payroll processes at UC Merced. Management in different departments have put together management corrective actions for the issues identified. We will follow up to verify that management corrective actions are completed.

We appreciate the help we received from the staff of Central Payroll, Academic Payroll, and Administrative Payroll during this audit.

Todd Kucker
Internal Audit Director

Attachment

cc: SVP Vacca
       Chancellor Leland
       Vice Chancellor Feitelberg
       Associate Chancellor Putney
       Interim Vice Provost Camfield
       Assistant Vice Chancellor and Controller Riley
       Assistant Vice Chancellor Powell
       Assistant Vice Chancellor Jones
       Interim Assistant Vice Chancellor Toth
       Executive Director Deegan
       Associate Director Salazar
       Director Johnson
       Interim Director Bustos
       Associate Director Kinsman
       Manager Snyder

UNIVERSITY OF CALIFORNIA, MERCED
AUDIT AND ADVISORY SERVICES

Payroll Processes
Report No. M15A008

July 8, 2015

Work Performed by:
Brandi Masasso, Internal Audit Analyst

Management Summary

Internal Audit has completed an audit of payroll processes at UC Merced. We evaluated internal controls managed by the different campus departments that process payroll: Central Payroll, Academic Payroll, and Administrative Payroll. Each group manages important aspects in verifying that employees are properly paid.

From the audit testing, we concluded that internal controls over payroll have been adequately designed and are operating effectively. Overall, we noted that employees were properly set up in the payroll system and were correctly paid. Potential internal control improvements were identified in the following areas:

- Improve monitoring of hours for temporary employees
- Timesheets should be approved by supervisors before employees are paid
- Closely monitor the use of overtime
- Removing access to payroll information when access is no longer needed

There will continue to be changes in payroll processes as the UCPATH project is completed. The issues noted during the audit relate to processes that will continue to be managed at UC Merced.

Purpose and Scope

As part of the Fiscal Year 2014 – 2015 audit plan, Internal Audit has completed an audit of payroll processes at UC Merced. The purpose of the audit was to evaluate whether internal controls over payroll have been appropriately designed and are operating effectively.

The audit objectives were:

- To determine whether appropriate internal controls have been set up for accurate payroll processing; and,
- To review the roles and responsibilities of the different departments involved with payroll processing.

To achieve the audit objectives, internal controls over the following payroll processes were reviewed:

- Approval of timesheets and overtime
- Setting up new hires in the payroll system
- Separating employees and processing final paychecks
- Payroll check distribution (including direct deposit)
- Approval and processing of different types of compensation
- Reconciliation of vacation and sick leave balances
- IT security of setting up and removing access in payroll system

We reviewed the setup of new employees, the separation of former employees, and payroll transactions during the current fiscal year.

Background

There are three departments at UC Merced that manage and process payroll for employees.

- Central Payroll is part of Business and Financial Services within the Business and Administrative Services division. Central Payroll actively promotes and monitors compliance with State and Federal tax, payroll laws, and provides guidance regarding payroll procedures and systems.

- Academic Payroll is part of the Provost's Office. Academic Payroll processes bi-weekly and monthly payroll and maintains payroll files for faculty, staff, and students in the Academic area. The department works closely with Academic Personnel to manage payroll for faculty, lecturers, graduate students, and other academic employees.

  Academic Payroll also processes payroll for staff and students in departments that serve the student and academic populations, which includes departments in Student Affairs, the Office of Research, and the Library.

- Administrative Payroll is part of the Administration Coordination Team (shared services) in Business and Administrative Services. Administration payroll processes bi-weekly and monthly payroll and maintains payroll files for staff and students in administrative and other non-academic units.

In all departments, supervisors have an important role in managing employee payroll. They certify that employees have worked the hours reported on timesheets and approve overtime when it is necessary.

UC Merced utilizes the Personnel/Payroll System (PPS) which is a legacy system that will be replaced with the UCPATH project is completed. UCPATH is a UC system initiative to replace the PPS system with a modern, web-based system. There will continue to be significant changes to how payroll is managed at UC campuses as UCPATH is fully implemented.

The campus currently has two timekeeping systems. During 2014, a new Time Reporting System (TRS) was implemented. The older Payroll Time Reporting (PTR) system is still utilized by various academic employees and by some employees with certain union requirements.

Conclusion

From the audit testing, we concluded that internal controls over payroll have been adequately designed and are operating effectively. Overall, we noted that employees were properly set up in the payroll system and were correctly paid. Potential internal control improvements were identified in the following areas:

- Improve monitoring of hours for temporary employees
- Timesheets should be approved by supervisors before employees are paid

- Closely monitor the use of overtime
- Remove access to payroll information when access is no longer needed

Observations and Management Corrective Actions

1. Improve monitoring of hours for temporary employees

During the audit, we noted instances where temporary employees became eligible for UC benefits and permanent employment because they worked more than one thousand hours during a year. It is the responsibility of department supervisors to monitor the number of hours worked by temporary employees.

As steps were not taken to limit the number of hours worked by the temporary employee, there is significant additional financial commitments by departments. This permanent employment was not properly authorized by Human Resources and there was not budgeted permanent funding to pay for the positions.

Competitive recruitment from a pool of qualified candidates is essential in proving non-discriminatory hiring practices. Competitive recruitment procedures are completely bypassed when temporary employees becomes eligible for permanent employment from poor monitoring of hours.

We recommend that steps be taken to more closely monitor the hours worked by temporary employees. Payroll, Human Resources, and the Budget Office should be involved in monitoring these hours in order to prevent this type of hiring.

Management Corrective Action

Human Resources will limit the unregulated access to the limited term continuous recruitment pool. Currently, career and contract recruitments must go through Human Resources in order to open a posting. Limited recruitments do not; the limited pool is open and available for departments to go in and select a limited employee at their discretion. Closing this open access will give Human Resources better knowledge and control over recruitment activities in the Limited Employee arena, and it will help facilitate better labor relations and affirmative action needs in Human Resources.

Human Resources and the Budget Office have proposed that Human Resources notify departments when a limited employee is approaching 600 hours so that Human Resources can better plan and prevent the automatic conversation to career at 1,000 hours. This is not fool-proof but better than what is currently being completed.

The Budget Office is also working up rules to regulate the financial implications of this type of conversion. Human Resources shares their concerns regarding financial implications, along with other concerns over impact to Workforce Planning, EEO-AA recruiting standards, and labor relations impact as stated above.

This action plan will be completed by July 31, 2015.

2. Timesheets should be approved by supervisors before employees are paid

Supervisors play an important role in verifying that employees are appropriately paid for time worked. During the audit, we noted instances where non-exempt employees were paid for time reported although their supervisors had not yet approved their timesheets.

Employees are paid for time worked, even when supervisors are slow to approve timesheets. This puts the campus at risk of paying for time that was not worked by employees.

The timekeeping systems automatically send out reminders to supervisors when a timesheet has not been approved. The payroll processors also follow up with their own reminders, but they currently have little authority to force supervisors to fulfill their review responsibilities.

To bring attention to this breakdown in controls, we recommend late timesheet approvals be periodically reported to the Ethics and Compliance Program Management Committee. The level of risk to the campus can then be reviewed to determine whether the issue should be reported to campus leadership (the ECP Executive Committee).

Management Corrective Action

Central Payroll will put together procedures for identifying when a supervisor is repeatedly late in approving employee timesheets. A summary of late timesheet approvals will be compiled and provided to the Ethics and Compliance Program Management Committee. This committee can then evaluate whether risks in this area are increasing to determine whether campus leadership should be involved.

This is currently considered a low risk issue as there are very few adjustments to compensation paid to employees after supervisors get caught up with their late approvals.

This action plan will be completed by August 31, 2015.

3. Closely monitor the use of overtime

During the audit, we reviewed the management of compensatory time and overtime by campus departments. We noted excessive amounts of overtime charged in Facilities. The table below shows the large increase in overtime hours worked by Facilities employees during 2012 through 2014.

Year	Overtime Hours	Percentage Increase over Prior Year
2014	5,212	26%
2013	4,148	32%
2012	3,143	

Overtime worked was very disparate among employees. Of the thirty-four facilities employees who worked overtime during 2014, twelve worked more than 100 hours of overtime and together accounted for 82% of the total overtime. One employee worked 674 and 466 hours of overtime in 2014 and 2013, respectively.

We recommend that written justification and approval for overtime be obtained in advance of the work. We also recommend that Facilities Management analyze the additional overtime costs to determine whether the large amount of overtime justifies hiring additional employees rather than continuing to incur premium overtime pay.

Management Corrective Action

Facilities Management has already implemented actions to more closely monitor the use of overtime. Approval for overtime is now required before overtime is worked.

One difficulty which has caused a large portion of the overtime worked is the limited number of Physical Plant operators. Operators are on-site 24 hours per day and work twelve hour shifts. Whenever an operator takes vacation or sick leave, another operator has to work overtime to fill in for the other operator. This ongoing difficulty can only be corrected by hiring additional operators.

Facilities Management will continue to explain the need for additional physical plant employees and request funding for additional operators during workforce planning and budget requests.

The action plan for improving monitoring of overtime was completed before the report was issued.

4. **Remove access to payroll information when access is no longer needed**

When an employee's position requires payroll system access and the ability to make changes in the payroll system, the access is reviewed and approved by Central Payroll. After access has been set up, it is incumbent upon the employee's department to notify the Financial Management and Controls department Security Administrators when the employee no longer needs the access.

During the audit, we noted an instance where an employee with the ability to make changes to benefits in the payroll system took a position in another department and, therefore, no longer needed the access. While the employee no longer needed access to the payroll system in her new position, the employee still had the ability to make changes in the payroll system. It appears that the department did not notify the Security Administrators to remove the access.

As a mitigating control, Financial Management and Controls periodically reviews access to the payroll system. While payroll access was not removed in a timely manner, the change in the employee's status would most likely have been identified during their periodic review.

We recommend that department business officers be reminded of their responsibilities for managing access to campus systems. We also recommend that a report be generated to identify when an employee's appointment changes. This report should be reviewed to identify employees who have special payroll system access.

Management Corrective Action

Financial Management and Controls will educate and remind department business officers of their responsibility to contact the campus Department Security Administrators (DSA) when there are changes in employment or job responsibilities. Training efforts will be increased on this topic by reminding business officers during the annual Distributed Administration Controls Security System (DACSS) review, at the monthly MSO meetings, and in the Financial Management Certification Program.

Financial Management currently reviews financial system access on a monthly basis for all separated employees and employees who change departments. If access remains for someone who separates or changes jobs, the DSA's temporarily suspends access until they can speak with the department business officer about the situation. This is the current back-up plan when departments do not notify DSA of a change.

This action plan was completed before the report was issued.

Other Payroll Processing changes to consider

During the audit, Internal Audit identified potential processing changes which should be considered. These are not internal control issues or unmanaged risks so management corrective actions are not required.

- During the audit, we reviewed the work of the three departments that manage different aspects of payroll transactions. Overall, it appears that the departments have put together effective processes for managing payroll information. Academic Payroll and Administrative Payroll each manage and review the payroll for various campus units. We recommend that the two departments work together to review the different workloads which the two departments are handling. As managing the payroll details related to academic employees can require special expertise, the departments might consider transferring the payroll processing of non-academic departments to Administrative Payroll. This might allow Academic Payroll to focus on the payroll of only academic employees.

- We noted that employees who prepare and review payroll transactions have the ability to set up new employees in the payroll system and make changes to pay rates. Best practices regarding segregation of duties in payroll and Human Resources usually limits system access so an employee who manages payroll cannot make changes to an employee's personnel records. The risk is that a payroll employee could make unauthorized changes. To mitigate the risk of unauthorized changes, the system generate a Post Authorization Notification (PAN) to a mandated reviewer when a new employee is set up and when changes are made to pay rates. The process relies heavily upon this review that occurs after changes have been made.

  While there are appropriate mitigating controls for reviewing the set up of new employees and changes to payroll information, the Controller's Office and Central Payroll might review whether the controls should be designed differently as the campus continues to grow. We recommend that setting up new employees and changing pay rates be managed by employees not involved with processing payroll transactions.