

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

Follow-Up: Sonoma County Payroll Process

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**Follow-Up:
Sonoma County Payroll Process
For the Period July 1, 2011 - June 30, 2015
Engagement No. 4050**

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Executive Summary

As part of the 2022/2023 annual Audit Plan, the Internal Audit Division (IA) of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (ACTTC) conducted a follow-up audit of the Sonoma County Payroll Process Audit report dated May 31, 2016. The original report contained 10 recommendation categories and 33 recommendations which were accepted by management.

The primary objectives of the audit were to determine if 1) controls were in place to ensure accurate processing of payroll transactions and 2) systems and processes to recognize, process, remit, and report payroll transactions can be improved.

The audit identified a total of \$1,809,593 in penalties and interest owed or paid to the IRS and \$673,710 in penalties paid to the EDD for a total of \$2,483,303. These penalties and interest assessments were the result of late filings of payroll tax returns. There were significant delays (several hundred days past the due date in many cases) in filing tax returns, and there were internal control weaknesses that allowed such delays and assessment of related penalties and interest to remain undetected by department management.

As of the date of our follow up, the department was able to recover all penalties and interest from the IRS. The penalties and interest in the amount of \$673,710 paid to the EDD was not recovered. Outside counsel was hired at a cost of \$434,775 to assist the department in negotiating with the taxing agencies.

As discussed further in the report, the department has implemented effective detective controls to reduce the risk that penalties and interest will be incurred and not detected in a timely manner. We did not find any late filings or assessment of penalties in our follow up.

The body of the follow up report discusses the status of all recommendations. The following is a discussion of recommendations that were not fully implemented as of the date of this follow up report:

Recommendation #1: Developing Countywide Policies and Procedures can Enhance Coordination and Implementation of Payroll Processing

During our audit we noted disparate processes for reviewing and approving payroll transactions across the county making it difficult for the payroll division to assess the accuracy of payroll transactions. We recommended the payroll division develop and enforce uniform policies and procedures over review and approval of payroll transactions for all departments. We identified a number of areas over which such policies and procedures needed to be developed and included in the manual.

Per Payroll management as of the date of our follow up, this recommendation has not been implemented due to a lack of resources.

Recommendation #2: Develop County-wide payroll training program

We recommended the payroll division conduct training sessions relating to the policies and procedures. This has not been done as the above recommendation has not been implemented.

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Recommendation #3: Information System controls need better execution

We made a number of specific recommendations under this category to better control access to the payroll system and data, manage system changes and perform analytical procedures to identify potential errors in data processing. All recommendations have been sufficiently implemented with the exception of the implementation of annual user authorization reviews and controls relating to timely changes to the downstream system reflecting permanent data changes in the payroll system, such as procedures to ensure timely updates to pay codes within EFS (recommendation 3d). The absence of such procedures has resulted in ongoing interface failures that cause delays in payroll processing.

Recommendation #4: Develop program to monitor compliance with ISD security, account management and change management guidance

During the audit we noted that adequate policies and procedures around information security, account management, and change management were not in place and monitored for compliance, exposing the payroll and other such systems to risks. At the time of the 2016 audit, no enterprise information security policy existed, so the desire was for every department to follow ISD department policies. Since then, County Administrative Policies 9-2: Information Technology Use and Security Policy Manual, 9-4: Information Technology Professionals Policy and 9-5: Policy for Information Technology Governance have been issued. Policies 9-2, 9-4 and 9-5 contain guidance in all these areas, and ensuring compliance with these policies is now the responsibility of each Local Agency Department Head/General Manager (as outlined in 9-2, 9-4, and 9-5). Although these policies have been established and responsibility for ensuring compliance has been defined, these policies do not define how compliance will be monitored, or who is responsible for the monitoring. As a result, a comprehensive compliance program has not been developed to monitor whether County departments are following Administrative policies related to information security. Based on these policies, it would be the responsibility of the Information Security Steering Committee (ISSC) to recommend Countywide information technology and security policies, standards, and guidelines, including policies and procedures for monitoring countywide compliance with IT security controls, and it would be the responsibility of the IT Governance Council to approve the new or updated policies. Both, ISSC and IT Governance Council have not been functional since approximately 2013.

We continue to recommend that the County fully implement this recommendation to better manage information technology risks discussed in the original audit report.

Recommendation #6: Evaluate and restructure Payroll to mitigate critical risks and achieve operational objectives

The objective of the recommendation under this category was to help improve the efficiency and effectiveness of the processes at the payroll division. They covered updating policies and procedures to include critical functions, training, timing transactions to reduce reworks, reducing duplicate work, better prioritizing work, using user assistance request history to identify department payroll clerk training opportunities, improve work distribution, participation in professional organizations and strengthening control over direct deposit change requests.

All of these recommendations have been implemented or partially implemented with the exception of two.

Executive Summary

Policies and procedures have not been updated to include key internal control functions such as reconciliations and segregation of functions. Payroll processing training needs have been identified and department payroll clerks are trained accordingly, however payroll processing staff continues to find critical timecard errors and continues to complete all audits. Payroll has not provided targeted training to Payroll processing staff.

Recommendation #7: Internal controls over calculation and payment of State and Federal Taxes should be improved

The recommendations under this category addressed controls due to the lack of which the County incurred material penalties, interest and costs to negotiate with Federal and State taxing agencies.

The department has made changes to adequately address the risk of the losses such as those discussed above. The department however has not performed reconciliations, as recommended, to ensure penalties and interest was not incurred and paid in periods prior to the period covered by our audit.

Recommendation #9: Develop, implement, and monitor payroll performance metrics

We recommended that the payroll division establish and monitor certain performance measures to assist in improving the function, saving costs and/or improving service delivery. As asserted by Payroll management, due to the lack of resources, this recommendation has not been implemented.

Recommendation #10: Eliminate manual payroll check issuance

We recommend developing a program to eliminate manual check issuance for new employees and encourage existing employees to convert to electronic deposit.

Through union negotiations, Payroll has requested unions adopt disbursement of payroll through direct deposit. Exceptions are for hardships, fraud, etc. To date, five unions out of eleven and the Salary Resolution have adopted direct deposit wording.

The objective of this follow-up audit is to determine the implementation status for these recommendations and status of IRS and State penalties and interest paid.

Further discussions are provided in the report.

Background, Objective, Scope, and Methodology

Background

Payroll is 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.

The County's payroll process is complex, requiring the involvement of the ACTTC Payroll Division (Payroll), each County department, Human Resources (HR), Information Systems Department (ISD), and the Treasury and General Accounting Divisions of the ACTTC Office. Payroll relies on three main information systems: Dimensions (replacement system to TimeSaver), Human Resource Information System (HRIS) (formerly HRMS), and the Enterprise Financial System (EFS).

Objective

The objective of this follow-up audit is to determine the implementation status of the 10 recommendations, and the status of IRS and State penalties and interest reported in the Sonoma County Payroll Process Audit report dated May 31, 2016.

Scope & Methodology

Our procedures were limited to reviewing evidence supporting the actions taken by Payroll and ISD management towards implementation of the report recommendations. To accomplish our audit objective, we reviewed Payroll records and ISD meeting minutes, performed analysis of State and Federal payments made for Sonoma County from 1/1/2011 through 3/31/2022 and for CDC and SMART payments made from 11/31/2011 through 1/1/2013 and 12/31/2016 respectively, and conducted interviews with staff and management. Where available, we reviewed documentation supporting implementation of the recommendations.

We conducted the follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing (Standards). These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the conclusion contained in our follow-up report. The Standards require that we establish a follow-up process to monitor and ensure that management has effectively implemented actions, or that senior management has accepted the risk of not taking actions. We conducted this follow-up from June 2022 through February 2023.

Implementation Status of Recommendations

The following is a discussion of the implementation status of the 10 recommendations reviewed in this follow up. Each recommendation can be referenced to the Sonoma County Payroll Process Audit report dated May 31, 2016.

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.

Status #1a – e: Not Implemented

This recommendation has not been implemented, Payroll management asserts they have not had sufficient resources to develop a Department Payroll Procedures Manual. Payroll management is dedicated to processing payroll in compliance with Federal, State, Local laws and with Labor Contracts. Payroll performs numerous audits to ensure time and labor reporting are accurate and inline with all previously mentioned governing bodies. Currently corrections are done ad hoc at the department level when errors are found by Auditor Payroll audits. In addition to the audits performed by Payroll staff, both the County time keeping system, UKG, and the County's HRIS system have built in system controls. A formal Department Payroll Procedures Manual is currently being developed, which Payroll Management expects will improve the accuracy of payroll transactions processed by department and reduce the time spent by Payroll staff performing audits and making error corrections. Once the Department Payroll Procedures Manual is developed, Payroll will implement Recommendation #2, development of a department payroll training program.

We continue to recommend that Payroll management implement this recommendation to best manage the risks discussed in our audit report.

Implementation Status of Recommendations

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.

Status of #2: Not Implemented

A formal County wide training program has not been developed and rolled out as the policies and procedures discussed in recommendation #1 above have not been developed. However, over the past several years (through the pandemic and fires) Payroll has provided ad-hoc trainings/roundtables for payroll clerks, designed to assist with consistent application of county-wide payroll policies and procedures such as termination/payoffs, tax forms, historical labor corrections, new hire paperwork, holidays, leave without pay, supervisory leave and others. We continue to recommend that management fully implement this and the previous recommendations to best manage risks discussed in our audit report.

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 the EDD and the 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.

Implementation Status of Recommendations

- d. Change notification procedures. ISD should be notified upon any HRIS 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 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,
 - 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.

Status of #3:

a.) Implemented

The payroll systems applicable to the recommendations above are HRIS and Dimensions. User access is managed by the HRIS Division of Human Resources. The ACTTC Payroll Division, in collaboration with ISD and HR, implemented a new time keeping system in May of 2022. Dimensions (replacement system to Timesaver), requires the use of complex passwords, prohibits the use of the 5 previous passwords and requires that passwords be changed every 183 days. HRIS prohibits the re-use of the 5 previous passwords and requires the use of complex passwords which are required to be changed every 90 days.

b.) In Process

The HRIS Division has established an automated process to identify employee transfers, terminations and position changes that may affect system access needs, the process runs daily, exceptions are followed up by HRIS. For the HRIS system, the HRIS Support Organization performed a security check working with departments to do a thorough cleanup of any outdated system access. As part of routine maintenance, they periodically run access audit reports. A Senior Information System Specialist audits system access for all users in power roles several times a year. This process works as a spot check for users, to make sure that the daily automated access review process is working and validated.

For Dimensions, the Payroll team receives a biweekly system generated report from HRIS, which shows employee updates (changes in position or terminations) from HRIS. Based on the employee update report, the Payroll team updates employee access accordingly.

Annual user authorization reviews for outside systems such as EDD and IRS systems have not taken place.

c.) Implemented

Periodic reviews of custom application settings are performed by Payroll. Payroll is utilizing system controls to mitigate various risks such as incorrect hours, excessive pay, employees receiving payoffs, refunds, etc. The Payroll system has multiple indicators to indicate whether amounts paid to employees are going outside of the normal payroll process. The system is generating exception reports, which are reviewed by Payroll each pay period. These procedures are documented and are performed on a regular basis.

Implementation Status of Recommendations

d.) Not Implemented

There has been some improvement in communicating pay code changes to downstream systems; however, there is no defined protocol for this communication causing files to periodically reject and require manual intervention.

e.) Implemented

In 2017 the HRIS Support team implemented a formal change management process requiring all front-end payroll system changes to be documented, reviewed, and approved prior to release to production. Full regression testing occurs with major system upgrades to ensure functionality and calculations are behaving as expected. These test scenarios and results are fully documented.

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.

Status of #4: Partially Implemented:

A comprehensive countywide compliance program, as discussed above, is not in place to monitor County departments' compliance with Administrative policies related to Information Security, Account Management, and Change Management. However, the following changes, made since our audit, help better protect the County's IT assets:

- 1) ISD deployed multiple security tools across the County.
- 2) ISD implemented online training programs designed to educate County employees about IT security risks, including email risks.
- 3) The County Board approved Administrative Policies 9-2, 9-3, and 9-5 which, among other things, clarifies and fixes roles and responsibilities related to the protection of the County's IT assets. However, the two key bodies called for in these policies, the IT Governance Council and the Information Security Steering Committee, are currently not functional.

We continue to recommend that the County fully implement this recommendation to better manage information technology risks discussed in the original audit report. The IT Governance Council and the Information Security Steering Committee should be revived to fully implement County Administrative Policy 9-5.

Implementation Status of Recommendations

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

ISD, working with Payroll, should test the HRIS and Dimensions (TimeSaver in the past) 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.

Status of #5: Implemented

The most recent functional test exercise for disaster recovery of critical systems offsite was conducted in August 2021. This marked the third functional test for Peoplesoft (following successful tests in May and August of 2020). In August 2021 a non-production instance of HRIS was activated at Alameda and basic functionality was validated by the County HRIS Manager. Offsite recovery at Alameda marks a significant improvement for the ability to carry on HRIS and other functions following a disaster event, but significant risks remain, for example from a regional disaster event.

The test exercise for financial systems was completed in September 2022. The next version of HRIS (version 505) has been built on all virtual machines, which is facilitating offsite disaster recovery and went live on September 16, 2022. To further improve resilience of IT services for Sonoma County, ISD is developing a cloud infrastructure strategy and implementation plan to migrate workloads to cloud providers, in conjunction with the continued expansion of vendor hosting services, to provide high levels of service availability.

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 workflow reviews to evenly distribute workloads among staff. The workflow 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.

Status of #6:

a.) Not Implemented

Payroll is currently working to document Payroll policies and procedures, identifying controls to mitigate risk.

Implementation Status of Recommendations

b.) Not Implemented

Payroll has not provided targeted training to Payroll processing staff, however the Payroll Manager and a staff member have acquired the Certified Payroll Professional (CPP) certificate issued by the APA and is working to provide more training to payroll staff as resources are available.

c.) Partially Implemented

To the extent possible, Payroll staff are waiting to review timecards until department payroll clerks have signed off.

d.) Partially Implemented

Over the past several years (thru the pandemic and fires) Payroll has provided ad-hoc trainings/roundtables for payroll clerks, designed to assist with consistent application of county-wide payroll policies and procedures such as termination/payoffs, tax forms, historical labor corrections, new hire paperwork, holidays, leave without pay, supervisory leave and others. Payroll staff continues to find critical timecard errors. Payroll staff continue to complete all audits to ensure accuracy and completeness of timecards and paychecks.

e.) Implemented

According to management payroll staff defer non-critical work activities until after payroll has been processed.

f.) Partially Implemented

Payroll utilizes the division inbox to track and delegate Dimensions timekeeping System inquiries. HRIS has implemented a ticketing system to track HRIS specific inquiries. A report which incorporates the results of HRIS and Dimensions timekeeping System inquiries has not been prepared. As additional resources are available, the Payroll Manager will consider a ticketing system for Dimensions inquiries, capable of compiling the results into an annual report which can be incorporated into an annual payroll training.

g.) Partially Implemented

Although workflow reviews were not conducted, Payroll created an Office Duties list which includes duties performed by staff members to address proper workflow.

h.) Implemented

Payroll Management and Accountants participate in American Payroll Association training quarterly. Additionally, management receives email updates/forums from the IRS, EDD, and the California State Association of County Auditors Payroll Managers Group.

i.) Implemented

The new payroll direct deposit application form requires department payroll clerks to sign and date that they have confirmed the identity on every new or change to direct deposit. The forms are reviewed by ACTTC Payroll staff, if the identity verification has not been completed, the application will not be processed until verification has been completed.

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

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:

Implementation Status of Recommendations

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

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

Status of #7:

a.) Implemented

In September of 2016 ACTTC Payroll performed a risk assessment and identified internal controls in place to address identified risks. In 2017 ACTTC Payroll contracted with an independent Certified Public Accountant to review payroll processes, including State and Federal tax reporting.

b.) Implemented

ACTTC Payroll implemented a monthly reconciliation of the Salary Revolving Fund to account for the ending balance and are working to finalize reconciling items and format. Two balances remain unreconciled (\$81,262 and \$79K), one related to dependent care admin/health care reimbursement and the other related to previous balances from FAMIS. These two balances remain unchanged from month to month. A reconciliation between the EFS Salary Revolving Fund and the bank balance is also performed monthly.

c.) Not Implemented

ACTTC Payroll did not perform a prior period fund reconciliation of payments to the IRS and the State.

d.) Partially Implemented

General Accounting Claims staff has received instruction to review vouchers for penalties and interest outside of regular debt payments. Unemployment insurance payments are agreed to third party administrator claims reports. Bi-weekly payroll is balanced between amounts collected and disbursed.

e.) Not Implemented

The IRS no longer allows online access to County accounts and as a result, it is not possible to implement this recommendation.

Implementation Status of Recommendations

f.) Implemented

HR has taken over managing the UI fund as of July 2022. The risk of payments such as IRS or State EDD interest and penalties being paid from the UI fund is reduced because a separate department is responsible for reviewing and approving UI fund disbursements. The methodology for estimating unemployment benefit department charges was updated and reviewed by General Accounting. When developing rates management looks at economic data and historical information.

g.) Implemented

Credit balances for the IRS and the State are reviewed by the Payroll Manager and all refunds are traced and accounted for. IRS refunds are reviewed by the Assistant Auditor-Controller and assessed for materiality. According to Payroll management, when amounts are material, they are recorded in the County books.

h.) Implemented

ACTTC Payroll entered into a contract with Equifax on 4/27/2017 to verify all unemployment claims are valid and to agree invoices received from the State for UI to Equifax reports. Payroll has also worked with the CDC and Equifax to ensure CDC staff are utilizing this service to ensure we are not overpaying.

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

HRIS (formerly HRMS) and Dimensions (TimeSaver in the past) 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 Dimensions and HRIS experienced delays due to constrained resources and other competing priorities for both teams. We also noted that there are no clear policies related to payroll data ownership that caused confusion amongst team members.

Status of #8: Implemented

Since the time of this Audit, an HRIS Support Organization was established with dedicated functional resources reporting to an HRIS Manager who oversees the HRIS Support Organization staff employed by HR. The Payroll Manager currently oversees the HRIS staff employed by ACTTC . The primary responsibility of this team is to maintain the system providing support to system users, technical upgrades, roll out of new features and reporting. A change control process has been established requiring all production changes to the system go through a development, testing and approval process. The new process requires documentation to include the nature of the change, why it is being requested, a description of changes needed to implement the change, and testing performed. When the change is ready for release to production, it requires 2 approval signatures from a list of designated approvers (HRIS Manager, Payroll Manager, Benefits Manager, ISD Project Manager) depending on the type of change. As part of the HRIS Support Organization governance structure, additional oversight bodies have been put in place. Firstly, the HRIS Support Organization team is comprised of HR/Payroll IT business analysts, and technical staff who meet weekly along with the Payroll/HR subject matter experts to ensure that work is being communicated and coordinated. Additionally, there is an HRIS Leadership team made up of executive level management representing HR, Payroll, ISD and the County Administrator's Office. This group meets monthly to discuss funding, staff resourcing and other critical issues pertaining to the HRIS Support Organization.

Implementation Status of Recommendations

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:

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

Status of #9: Not Implemented

This recommendation has not been implemented, Payroll management asserts they have not had sufficient resources to assess and execute this recommendation. Payroll is working on the recommendation related to the department payroll clerk training manual, once complete Payroll management expects capacity to be freed up due to a reduction in payroll staff audit and error correction hours, allowing Payroll staff to focus on implementing 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.

Status of #10: In Process

Through union negotiations, Payroll has requested unions adopt disbursement of payroll through direct deposit. Exceptions are for hardships, fraud, etc. To date, five unions out of eleven, and the Salary Resolution, have adopted direct deposit wording. Due to timing of entering new hires into the system, it is not administratively possible to execute payroll disbursement via direct deposit on the employees first pay day. For pay period ending 4/3/2023 the Payroll Division issued 4,859 direct deposits and processed 76 manual checks.

Implementation Status of Recommendations

Status of Interest and Penalties paid to the Internal Revenue Service (IRS) and the State Employment Development Department (EDD).

Background

The audit identified a total of \$1,809,593 in penalties and interest owed or paid to the IRS and \$673,710 in penalties paid to the EDD for a total of \$2,483,303. These penalties and interest assessments were the result of late filing of payroll tax returns. There were significant delays (several hundred days past the due date in many cases) in filing tax returns and there were internal control weaknesses that contributed to the delays and allowed the assessment of penalties and interest to go undetected.

The original audit report dated May 31, 2016 included a note regarding a significant subsequent event related to interest and penalty payments to the IRS and the State EDD which is related to Finding 7 of the original audit report. The County was responsible for filing tax returns for CDC and SMART. The former Payroll Manager during the calendar years 2011 through 2015 submitted IRS payroll tax payments for the County, CDC, and SMART. The IRS recorded the payments under a single County tax ID, rather than under three separate tax ID's. This resulted in excess payments to one account and deficiencies in the other two accounts and was the primary reason the IRS assessed \$1,809,593 in interest and penalties. Subsequent to the completion of audit procedures, but prior to the issuance of the original audit report, the ACTTC received a letter dated November 17, 2016 from the IRS stating that the County of Sonoma, CDC and SMART collectively owe \$3,973,558 in back payroll taxes, interest and penalties. In addition, State EDD wage reports were filed late, over a period of five years, and the County paid the State EDD interest and penalties of \$673,710, from the UI fund.

The Board of Supervisors (Board) authorized the County to pay the IRS for assessed payroll tax penalties and interest on the County, CDC and SMART accounts for total of \$3,973,558 in December 2016. To pay IRS interest and penalties, the Board authorized the use of \$2,826,290 from an internal malpractice insurance fund that was no longer needed due to the expiration of statutory claim limits and \$1,147,268 from the HRIS system implementation fund.

Status

County management worked with County Counsel and outside counsel to fully recover interest and penalties paid to the IRS, however the County was unsuccessful in its attempt to recover interest and penalties paid to the State EDD.

The IRS has issued over 40 refund checks and ACH payments to the County totaling \$4,271,402, which included \$297,843.57 in interest. The IRS refund checks were deposited into the County's salary revolving fund, the Board authorized transfers from the salary revolving fund of \$1,233,263 to reimburse the HRIS internal service fund and \$3,038,139 to fund a legal contingency fund. The County incurred \$434,775 in outside counsel costs through September 2018 to obtain these refunds. The outside counsel costs also include legal services performed in the County's dispute with EDD over interest and penalties paid because wage reports were filed late.

The County did not prevail in its dispute with the State EDD, the \$673,710 in interest and penalties paid to the State was not refunded to the County. Management with authorization of the Board, transferred \$673,710 from the malpractice internal insurance fund to the UI fund. A schedule of penalties, interest and legal fees paid and refunded to the County, can be found in Table 1 on page 15.

Implementation Status of Recommendations

Table 1:

Schedule of Penalties, Interest and Legal Fees Paid and Refunded

	State (EDD)*	Federal (IRS)*	Attorney's Fees*	TOTAL
Assessed and Paid				
Sonoma County	\$ 642,485	\$ 3,973,558	\$ 434,775	\$ 5,050,818
CDC	26,555			26,555
Smart	4,670			4,670
Total	\$ 673,710	\$ 3,973,558	\$ 434,775	5,082,043
Refunded				
Sonoma County		\$ 3,973,558		3,973,558
Total		\$ 3,973,558		3,973,558
Net	\$ 673,710	\$ -	\$ 434,775	\$ 1,108,485
Interest received from Federal		\$ <u>297,844</u>		
Total Federal		\$ <u>4,271,402</u>		

*Rounded to nearest whole dollar

We would like to thank Payroll and ISD Administration Management and Staff for their helpfulness and cooperation in conducting this follow-up audit. If you have any further questions regarding this report, please contact the auditor-in-charge, Olga Gray, at (707) 565-8303.

Appendix A: Status of Recommendations

In total, we reviewed 33 recommendations during this follow-up. The results are as follows:

Status	Total	Recommendation No.	Page No.	Description
Implemented	13	3a, 3c, 3e, 5, 6e, 6h, 6i, 7a, 7b, 7f, 7g, 7h 8	7 8 9 10 11 12	Payroll Systems Controls Payroll Systems Disaster Recovery Payroll Division Evaluation & Structure Payroll Division Evaluation & Structure Internal Controls over Payroll Taxes Technical and Functional Communication
In Process	2	3b, 10	7 13	Payroll Systems Controls Manual Payroll Check Issuance
Partially Implemented	6	4 6c, 6d, 6f, 6g 7d	8 9 10 11	Payroll Information Security compliance Payroll Division Evaluation & Structure Payroll Division Evaluation & Structure Internal Controls over Payroll Taxes
Not Implemented	12	1 (a-e), 2, 3d, 6a, 6b 7c, 7e, 9	5 6 7 9 11 12	Countywide Payroll Policies & Procedures Countywide Payroll Training Program Payroll Systems Controls Payroll Division Evaluation & Structure Internal Controls over Payroll Taxes Payroll Performance Metrics
Total	33			