

State Bar of California

Review of Internal Controls:

Payroll

June 30, 2010



Table of Contents

Background	1
Scope and Methodology	1
Review Results.....	4
Conclusions and Recommendations	8
State Bar of California’s Response to Audit Report	9

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Review of Internal Controls

Payroll

Payroll is the function that disburses compensation to employees. The business cycle operates independently of, but in concert with human resources function which is responsible for managing the human capital of the State Bar. The payroll business process typically includes the verification of the various components of compensation including time worked, employee pay status, benefits adjustments, taxes, and others as well as the payment of net pay, taxes, retirement, benefits and other related costs drawn from the appropriate funding source at the appropriate time.

Controls over the payroll function are intended to safeguard assets, afford accurate and timely payment and reporting, assure the accurate reflection of personnel actions or changes, and protect the best interests of the State Bar. As a result of our reviews and testing of the system, we found that the Bar has a formal set of comprehensive written payroll policies and procedures, which include the basic financial and administrative controls expected for the preparation and processing of payroll. We found payroll processes generated by bi-weekly submission of timesheets from departments appear to work as intended and that the roles and responsibilities of employees involved in the payroll cycle seem to afford the appropriate separation of potentially conflicting duties, thus, minimizing the risk of inappropriate access to payroll records and improper payroll expenditures. Further, the State Bar's independent financial auditors reached the same conclusion as a result of their review and testing of the payroll processes during their work related to the Bar's 2008 and 2009 financial statement audit.

Scope and Methodology

The State Bar of California (the State Bar) contracted with Sjoberg Evashenk Consulting, Inc. (SEC) to conduct three separate reviews evaluating the internal controls pertaining to procurement and accounts payable, payroll, and budgetary control business processes. The objectives of each review were to:

- (1) Evaluate and test the existing internal controls pertaining to the business process;
- (2) Identify significant risks and internal controls weaknesses pertaining to the business process; and,
- (3) Recommend improvements to the internal controls and procedures pertaining to the business process to mitigate any significant risks or weaknesses identified.

This report addresses our observations surrounding the State Bar's payroll processes—findings and recommendations for the procurement and accounts payable and budget reviews are issued under separate covers.

To meet the audit objectives, we conducted interviews, process mapping, and reviews and testing of documents, records and guidance to obtain an initial understanding of the payroll business cycle. Our efforts included:

- ✓ Identifying all activities and processes involved with the payroll function from entering personnel data into Oracle to distributing checks and posting payroll to general ledger accounts, including departmental and individual responsibilities.
- ✓ Evaluating and testing process and system controls (including system access levels) related to these following activities to ensure appropriate segregation of duties exists:
 - Entering and modifying personnel information in the Oracle system;
 - Reviewing and approving employee timecard information (including leave and overtime requests) and entering related data in the Oracle system;
 - Reviewing and approving payroll reconciliation processes and payroll register before payroll is finalized and posted to the general ledger in the Oracle system; and,
 - Generating manual checks and distributing payments to employees as well as securing check stock.
- ✓ Preparing flowcharts of the payroll process and identified activities, lines of responsibility, and control points.
- ✓ Meeting with the financial auditors and reviewed their workpapers. We determined that they performed walk-throughs of all the payroll functions and conducted observations of the processing activities during the payroll cycle, including the input of timekeeping into Oracle through finalizing the payroll run. In order not to unnecessarily duplicate their efforts we are relying on their testing and conclusions.
- ✓ Conducting limited testing of two payroll cycles to validate the following:
 - Timesheets were appropriately approved, amounts (hours worked, docked time, vacation/holiday/sick days taken) reflected on the timesheets agree with summary timekeeping reports and payroll registers.
 - Changes between payroll periods were appropriately documented, reviewed, and approved.
 - Approved payroll register agrees with amounts posted to general ledger accounts.
 - Compare HR position control report to payroll register.
- ✓ Performing testing of employee files to ensure personnel changes (new hires, promotions, and terminations) underwent proper review and approval before entry into the Oracle system, including:
 - Identify individuals that approved changes and entered change into the Oracle system to ensure appropriate segregation of duties occurred.
 - Compare pay rates reflected on most recent employee change forms to payroll register and published pay ranges.

- ✓ Obtaining an understanding of activities related to proposed payroll system automation upgrades such as the employee self service time entry module.
- ✓ Identifying any opportunities for improvement that can be addressed to protect the State Bar's interests by eliminating weaknesses that expose the State Bar to risk of errors, irregularities, or fraud.

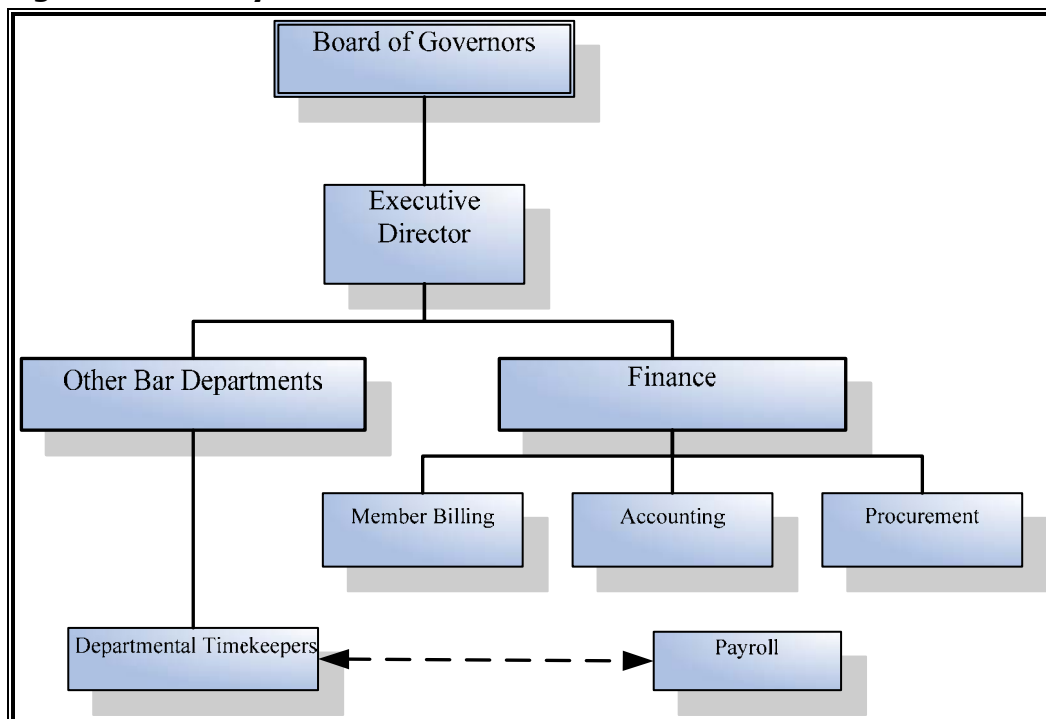
Review Results

Our review of the various activities and transactional testing of the Bar's payroll processes and procedures revealed they are closely followed as written and intended. Additionally, we found no discrepancies between amounts reflected on approved timesheets, DTS forms, final payroll registers, and general ledger accounts. We also found appropriate Human Resources approvals were in place authorizing hires and promotions, payroll signatures were present acknowledging personnel changes, salaries paid complied with MOU agreements and agreed with amounts reflected on payroll registers. Moreover, the Bar's external financial auditors provide additional oversight of payroll processing each year as the Bar undergoes a financial statement audit that includes tests by these auditors. These tests cover payroll processes and transactions and check for accuracy of pay and approval of timesheets. For Fiscal Years 2008 and 2009, the external financial auditors did not find any exceptions or significant issues related to the Bar's internal controls over payroll processing. As a result of our work and that of the external auditor, we found that the control environment over payroll functions and activities is strong.

Payroll Processes Operate as Intended and Responsibilities Appear Adequately Segregated

Our review of the State Bar's payroll processes found a combination of manual and automated processes that appear to be effective and incorporate adequate controls as depicted in Figure 1.

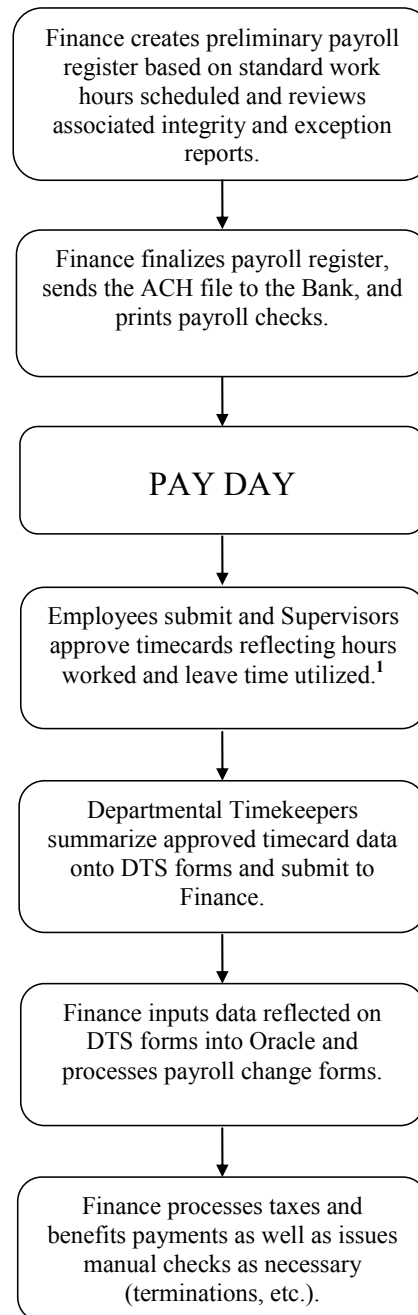
Figure 1: Bar Payroll Structure



Specifically, to administer payroll, the Bar's Finance Department utilizes the payroll module within its Oracle ERP application—this automated system generates bi-weekly payroll registers

and payroll checks, advices, and year-end tax reporting forms. Additionally, our testing of the processes did not reveal any discrepancies or issues.

Figure 2: Bar Payroll Process



1. Adjustments that impact amount previously paid on payday, such as dockages, overtime, etc. are corrected during the next payroll cycle.

As shown in Figure 2, the standard pay cycle commences when Payroll Clerks in Finance run a preliminary, simulated payroll register and the Finance Manager reviews and verifies the run for accuracy. Finance tracks all personnel and payroll related changes initiated between payroll

cycles to ensure the associated changes are made before payroll is finalized as changes can be made only during a limited time period after simulation and prior to executing the final payroll. Any changes, payroll adjustments, augmentations, or omissions identified after the final payroll run must be made as part of a supplemental or off-cycle run or as part of the next payroll cycle. Immediately after each bi-weekly pay date, employees submit completed timesheets to supervisors whose responsibility is to review the timesheet for accuracy and then to approve them.

The supervisor submits the approved timesheets to the designated Departmental Timekeeper who ensure all timecards have been submitted and appropriately reviewed, approved, and signed. Departmental Timekeepers also summarize hours worked and leave balances on DTS (departmental time summary) forms and submit the information to Finance. Next, Payroll Clerks in Finance input timekeeping information into Oracle based on the DTS forms provided by Departmental Timekeepers and signed by their supervisors. Other actions often processed through the supplemental runs or subsequent payroll cycle runs include leave buy-outs, retroactive payments, dockages, overtime payments, and termination payments.

While the Bar has an integrated, employee self service system for benefit enrollment, the timekeeping process remains a manual system via submission of paper timecards. As described above, this process requires Department Timekeepers to summarize each employee's time information and Finance to manually key the information into the Oracle system for inclusion in the Bar's payroll processing run. Although summarizing employee timesheet information twice a month requires relatively little time of the Departmental Timekeepers, there have been some efforts to develop an automated timekeeping module within Oracle to increase efficiencies—however, efforts to automate the process stalled and payroll processes continued to be a manual process as of the time of our review.

Payroll Duties Are Appropriately Segregated

The Bar's payroll and personnel activities and responsibilities are segregated within different departments—the payroll function is overseen by Finance and the personnel function is overseen by Human Resources. While departmental timekeepers are responsible for summarizing and reporting approved timecard data, payroll staff in Finance perform primary functions for processing payroll, entering payroll adjustments, generating or printing payroll reports, printing and distributing checks, and administering the Oracle Payroll application.

Proper segregation of duties requires the human resources function to input any personnel information related to employees and the payroll function to pay employees based on criteria entered into the system by personnel as well as produce various year-end earnings reports. Our review of the Bar's assigned roles and responsibilities over its payroll process suggest the system has been designed to afford the appropriate segregation of duties, as reflected in Table 1. For example, the Bar designated three different divisions or areas to administer payroll and compensation activities—individual Bar departments, Finance, and Human Resources. The separation of these groups allow for potentially conflicting duties between personnel

administration, timekeeping, payroll processing to be appropriately performed by separate individuals. Additionally, the Bar requires first-line supervisors to approve timesheets, departmental timekeepers in each department summarize timecard data, and Finance to input timecard data and process the payroll.

Table 1: Payroll Segregation of Duties

Payroll Activity	Departments			Finance			Human Resources
	Employee	Employee Supervisor	Dept. Timekeepers	Payroll Clerks	Finance Manager	Staff Accountant	Personnel
Assigns Position Control Number							✓
Establish/Maintain Employee File							✓
Completes Bi-Weekly Timesheet	✓						
Approves Employee Timecard		✓					
Summarizes Department Timecard Data			✓				
Enters Employee Timecard/Hours Worked				✓			
Initiates Pre-Payroll				✓			
Prints Payroll Register				✓			
Reviews Payroll Register for Accuracy					✓		
Enters Payroll Adjustments				✓			
Initiates Final Payroll Run				✓			
Reviews Final Payroll Processing					✓		
Prints Payroll Checks				✓			
Distributes Payroll Checks			✓				
Writes Manual Checks				✓			
Posts Payroll Activity to General Ledger					✓		
Reconciles Payroll Bank Account						✓	

Furthermore, the Bar has implemented security controls that protect the automated payroll system from inappropriate access and unauthorized use and also help to ensure the separation of duties. Specifically, only Human Resource employees have access to enter new employees into the Oracle system and Finance inputs and controls all timekeeping and payroll activities. According to Finance, Human Resources, and Information Technology management, Human Resources employees cannot modify any payroll information and Finance cannot modify any personnel information within Oracle.

The Bar has implemented other relevant controls that assist in the processing of payroll, which include:

- Supervisors and managers must review, approve, and sign the timecards of the employees in their department.
- Departmental timekeepers collect, review, and ensure timecards have been submitted and appropriately reviewed, approved, and signed before providing Finance with the approved department timecard data on DTS (departmental time summary) forms.
- Payroll clerks within Finance input the information from DTS forms into Oracle. Preliminary and final payroll runs are processed entirely through Oracle and are reviewed and reconciled for accuracy, and approved by the Finance Director and/or CFO.
- Finance has appropriate physical controls and practices in place to secure payroll assets and check distribution.
- System access is strictly limited to IT establishing and maintaining access levels in Oracle/PeopleSoft based on receipt of an approved account request form.

Conclusion

Controls over the payroll function are intended to assure the safeguarding of assets, afford accurate and timely payment and reporting, assuring the accurate reflection of personnel actions or changes, and protecting the best interests of the State Bar.

State Bar of California's Response to the Audit



THE STATE BAR OF CALIFORNIA

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July 12, 2010

Kurt Sjoberg and Marianne Evashenk
Sjoberg Evashenk Consulting, Inc.
455 Capitol Mall
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Sacramento, CA 95814

Dear Mr. Sjoberg and Ms. Evashenk:

State Bar Management appreciates this opportunity to respond to the recommendations contained in your recent audits of Budget, Payroll, and Procurement/Accounts Payable. We have reviewed the reports and agree with the recommendations you have identified to improve our control environment. Accompanying this letter are our specific responses and the steps we will take to implement the recommendations.

Management wishes to express its appreciation for the manner in which these audits were conducted and reported. In addition to providing us with recommendations for improvement, the audits also highlight areas in which the Bar's controls are strong and functioning as intended. The inclusion of this type of information in the reports is especially helpful to readers in understanding the entirety of the Bar's controls in these three fiscal-related business processes and the commitment of staff in constantly maintaining and improving them.

We look forward to continuing our collaborative relationship with your firm as our internal auditors. Please let us know if we can provide you with additional information or if you have questions regarding our responses.

Sincerely,

A handwritten signature in blue ink that reads "Judy Johnson".

July Johnson
Executive Director

Attachment/s