

July 8, 2014

Jeffrey A. Beard, Ph.D., Secretary
California Department of Corrections
and Rehabilitation
P.O. Box 942883
Sacramento, CA 94283

Dear Dr. Beard:

Management Letter—California Department of Corrections and Rehabilitation, Combined Inmate Welfare Fund for the Fiscal Years Ended June 30, 2012 and June 30, 2011

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its financial audit of the California Department of Corrections and Rehabilitation's (CDCR) Inmate Welfare Fund (Fund) for the fiscal years ended June 30, 2012 and June 30, 2011.

During the course of the engagement, we became aware of certain matters that present an opportunity for CDCR to strengthen its internal controls over Fund accounting and financial reporting. This management letter summarizes our comments and suggestions regarding these matters. This letter does not affect our report dated May 30, 2014 on the Fund financial statements for the fiscal years ended June 30, 2012 and June 30, 2011.

Observation 1: Inadequate Segregation of Duties and Access to SAP¹ Accounting System

We observed inadequate segregation of duties related to the SAP accounting system. During our audit, monitoring policies and procedures related to segregation of duties and access to SAP did not exist. We observed the following instances of inadequate segregation of duties:

- Some Business Information System (BIS) personnel are assigned SAP access which allows them to enter accounting transactions.
- Staff with access to add, delete, and edit vendor data (Master Data) include staff at the Regional Accounting Offices who are directly involved in daily accounting transactions.
- Some accounting staff responsible for account reconciliations are also assigned access to SAP which allows them to make adjusting entries to those accounts.

Insufficient segregation of duties and improper access to information systems increase the risk of errors and irregularities.

State Administrative Manual (SAM) section 20050 and Government Code section 13403 state that a satisfactory system of internal accounting and administrative controls shall include a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

¹ Systems Applications and Products in Data Processing.

Recommendations:

- A. Review and eliminate incompatible duties.
- B. Develop and implement policies and procedures to ensure proper segregation of fiscal duties and access to SAP. Periodically review and revise the procedures to ensure documented processes reflect current activities.
- C. Monitor compliance with policies and procedures to ensure they are implemented as intended.
- D. Retain documentation of assigned access to information systems for audit.

Observation 2: Erroneous Restatement of Account Balances

We identified instances of restatements of SAP pre- and post-closing trial balance amounts after the financial reporting for fiscal years 2010-11 and 2011-12 was closed. Specifically, Encumbrances, which are included in the financial reports as a component of Accounts Payable, decreased by \$188,134 between the SAP reports generated August 2011 and May 2013, and increased by \$86,400 between the SAP reports generated August 2012 and March 2013. Due to a system error, when an encumbrance was liquidated at the line-item level, the purchase order, encumbrance amount, and expense amount were restated within SAP for the prior fiscal years affected. Therefore, the underlying accounting records did not accurately support the Fund financial statements and increased the risk of errors and misstatements.

Per SAM section 7110, a system of accounting for governmental finance must furnish the means of presenting currently and accurately the financial condition of each fund.

Recommendations:

- A. CDCR Accounting Services should work with the SAP BIS Team to ensure liquidation of encumbrances in SAP does not restate account balances on financial reports for prior periods.
- B. Perform tests of SAP system corrections to ensure remedies are fully functional, effective and working as intended.

Observation 3: Insufficient SAP System Testing and Change Documentation

The SAP BIS change control process did not include a formal method of documenting end-user testing and authorization of changes to SAP reports. Specifically, when we requested documentation of formal approval for changes to the SAP Bank Reconciliation Report, only informal e-mails were provided.

Lack of formal documentation of end-user testing and authorization increases the difficulty of determining whether changes to SAP reports were fully tested and approved. Changes that were not approved or authorized increase the risk that inaccurate information is presented in the financial statements.

Per SAM section 4819.36, agencies are responsible for establishing project management and oversight activities. Per the Statewide Information Management Manual (SIMM) section 45, Information Technology Project Oversight Framework, agencies must ensure that planning and tracking activities include a formal change control/approval process and that system engineering activities include formal testing and user sign-off of test results.

Recommendation:

- A. The SAP BIS Change Control Board should develop and implement a formal method for documenting authorization of requested changes to SAP reports and subsequent user acceptance testing. Documentation should be retained for audit.

Observation 4: Insufficient Payroll Review and Monitoring

CDCR does not have sufficient processes to ensure payroll costs charged to the Fund are accurate or supported. During testing at CDCR Headquarters and a sample of selected Institutions, we encountered multiple instances of inaccurate or incomplete data supporting amounts charged to the Fund.

To monitor Fund payroll expenditures, CDCR Headquarters maintains a spreadsheet detailing the employee name, position number and salary amount. At the Institutions, employee rosters are maintained in support of the expenditures charged to the Fund. We identified the following instances of inaccurate or insufficient documentation supporting the amounts charged to the Fund:

- Thirteen timesheets sampled could not be located.
- Ten position numbers on the spreadsheet, employee roster and/or timesheet were incorrect or missing.
- Three timesheets were not signed by the employee or supervisor.
- Four timesheets were dated by employees at the beginning of the month.
- Two timesheets were not dated by the supervisor.
- Two employees' salary data was incorrectly recorded or missing on the spreadsheet.
- Two monthly payroll warrant registers could not be provided.
- Three employees' payroll costs were charged to the General Fund although they worked on Fund activities. In one instance, it took CDCR ten months before the error was identified and corrected. The other two instances represented employees performing Fund duties temporarily for two months; however, the errors were not identified or corrected by CDCR.
- One employee was charged to the Fund for four months; however, documentation supporting activities performed was not provided. CDCR reversed one month's salary charged to the Fund.
- Two employees charged to the Fund were not listed on the employee roster.
- One employee's position date filled was incorrect on the employee roster.

Although the above instances did not result in a material misstatement of the Fund financial statements, collectively, the instances represent a weakness in CDCR's internal control over its payroll monitoring and review processes. Due to these weaknesses, CDCR is at increased risk of the Fund being inappropriately charged for time not spent on Fund activities, and material misstatements in its financial records occurring and not being timely detected.

The Financial Integrity and State Manager's Accountability Act, Government Code section 13400, et. Seq., requires state agencies to maintain effective systems of internal control as an integral part of its management practices to ensure the reliability of financial information. All levels of management must provide active, ongoing oversight and monitoring processes for the prevention and early detection of fraud and errors in program administration, and must routinely monitor, evaluate, and improve internal controls when necessary. This responsibility includes documenting the system through flowcharts, narratives, and desk procedures as specified in SAM section 20050.

Recommendations:

- A. Develop and implement policies and procedures to ensure payroll information is accurately reported and timely updated on the spreadsheet and employee roster.
- B. Policies and procedures should be periodically reviewed and revised, approved by CDCR management, and communicated to staff.
- C. Strengthen controls over the processing of employee timesheets to ensure information is reviewed for accuracy, appropriately signed and authorized, and reconciled with the spreadsheet and employee roster. Variances should be investigated and resolved timely.
- D. Ensure documentation supporting amounts recorded in the Fund financial records is retained for audit.

The information in this letter is intended solely for the use of CDCR and Institution management, those charged with governance, and others within CDCR, and is not intended to be used by anyone other than these specified parties.

We appreciate the assistance and cooperation of CDCR management and staff. If you have any questions regarding this letter, please contact Cheryl McCormick, Assistant Chief, at (916) 322-2985.

Sincerely,

Original signed by:

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

cc: On following page

cc: Mr. Martin Hoshino, Undersecretary of Operations, California Department of Corrections and Rehabilitation
Ms. Diana Toche, Undersecretary, Administration and Offender Services, California Department of Corrections and Rehabilitation
Mr. Scott Carney, Director, Division of Administrative Services, California Department of Corrections and Rehabilitation
Mr. Bryan Beyer, Director, Internal Oversight and Research, California Department of Corrections and Rehabilitation
Ms. Lori Zamora, Deputy Director, Office of Audits and Court Compliance, California Department of Corrections and Rehabilitation
Mr. Jason Lopez, Deputy Director (A), Fiscal Services, California Department of Corrections and Rehabilitation
Mr. William Bramer, Associate Director, Accounting Services, California Department of Corrections and Rehabilitation
Mr. Jaime Corvera, Accounting Administrator III, Accounting Services, California Department of Corrections and Rehabilitation
Ms. Michele Gomez-Essex, Accounting Administrator II, Accounting Services, Inmate Welfare Fund, California Department of Corrections and Rehabilitation
Mr. Paul Smith, Program Director, Enterprise Information Services, Business Information Systems, California Department of Corrections and Rehabilitation
Ms. Linda Wong, External Audits Manager, Office of Audits and Court Compliance, California Department of Corrections and Rehabilitation