



# COUNTY OF HUMBOLDT

For the meeting of: 3/1/2022

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File #: 22-237

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**To:** Board of Supervisors

**From:** County Administrative Office

**Agenda Section:** Departmental

**SUBJECT:**

Operational Realignment of Payroll Operations and Professional Services Agreement with CliftonLarsonAllen (CLA) for Payroll Audit Services

**RECOMMENDATION(S):**

That the Board of Supervisors:

1. Receive a report from the County Administrative Office regarding departmental submissions of outstanding financial transactions and payroll errors;
2. Consider options and provide direction regarding the realignment of payroll operations;
3. Authorize the County Administrative Officer (CAO), or designee thereof, to pursue and execute a letter of engagement and professional services agreement with CliftonLarsonAllen (CLA) in the amount of \$259,000 for payroll auditing services (Attachment 2), after review and approval by County Counsel and Risk Management;
4. Authorize the CAO, or designee thereof, to execute any and all subsequent amendments to the agreement with CLA, after review and approval by County Counsel and Risk Management; and
5. Direct the CAO to return with any supplemental budgets and personnel allocations necessary to effectuate the Board's direction.

**SOURCE OF FUNDING:**

General Fund (1100)

**DISCUSSION:**

On Aug. 24, 2021, your Board approved the transition of the county's payroll function from the Human Resources/Risk Management Department (HR) to the Office of the Auditor-Controller. Since that approval was provided, Payroll staff have been under the direction of the Auditor-Controller. Over the last several years, your Board has received many reports on outstanding financial transactions impacting the county, and during this transition staff expressed concern about the impact that moving payroll back to the Auditor-Controller would have on those transactions.

On Oct. 24, 2021, your Board requested monthly updates regarding the payroll transition and the status of financial transactions that must be finalized by the Auditor-Controller. Your Board directed the CAO

to work with the Auditor-Controller and members of your Board to develop metrics and measurables to provide information on the status of those outstanding financial transactions. Obtaining the metrics necessary for your Board to effectively evaluate the operations of the Office of the Auditor-Controller has been difficult. On Feb. 1, your Board directed departments to submit to the County Administrative Office their outstanding transactions and errors related to payroll. At that meeting your Board also directed the CAO to return with options to consider the realignment of payroll operations. This report contains the outcome of that information gathering process (Attachment 1), as well as options for the future of payroll.

**Outstanding Financial Transactions:**

The status of outstanding financial transactions, as submitted by departments, is as follows:

For Fiscal Year 2020-21:

*Journal Entries:* 204 outstanding journal entries totaling approximately \$50 million.

*Supplemental Budgets:* 1 supplemental budget transaction yet to be processed totaling \$470,777.

For Fiscal Year 2021-22:

*Journal Entries:* 197 outstanding journal entries totaling approximately \$31.1 million.

*Supplemental Budgets:* 13 supplemental budget transactions yet to be processed totaling approximately \$1.2 million.

Journal entries are transactions that move the accounting of revenue or expenditure charges from one program to another for a variety of reasons, often to ensure that departments can properly claim their expenses to state and federal funding sources to receive proper reimbursement. Supplemental budgets occur when an unexpected source of revenue is received, or expense is incurred that was accounted for in the annual adopted budget. The vast majority of these journals and supplemental budgets are for the Department of Health & Human Services, which is primarily funded by state and federal agencies.

Typically, a fiscal year (FY) is closed 3 months after the fiscal year ends, meaning most transactions can no longer be posted to the county's general ledger, which is the official record of the county's financial transactions. For Humboldt County, the fiscal year ending June 30, typically closes at the end of September, except for a "last call" round of transactions in the fall that is meant to balance the county's books, apportion interest and roll forward the existing balances in various funds from the prior year so those funds can be accessed in the next year. This process was not completed as staff expected for FY 2019-20 and still has not been completed for FY 2020-21.

**Other Transactions and Payroll Errors:**

*Accounts Payable:* 29 number of outstanding invoices (more than 2 weeks past due) totaling approximately \$3.6 million.

*Deposits:* funds totaling \$9.5 have been received by the Treasurer's Office and deposit posting details provided by the Department of Health and Human Services (DHHS) but not processed to the general

ledger account(s). This total only includes unprocessed deposits for DHHS as it was not requested from other county departments.

*Payroll Challenges:* As this is the first time that staff have been able to gather quantifiable information regarding the status of transactions and payroll errors around the county, it is difficult to gauge whether the transition of payroll to the Office of the Auditor-Controller has had a positive or negative impact. However, the attached reports provide insight into the challenges departments and employees are experiencing, and it appears some of the issues are growing. Since the transition of payroll to the Office of the Auditor-Controller, the County Administrative Office has received an increased number of reports from employees and departments expressing concerns related to pay inaccuracies, missed or late payroll payments, difficulties contacting the AC staff to rectify errors, and the resulting hardships experienced due to these inaccuracies and missed pay dates. Your Board has also been contacted by staff expressing concerns about the payroll process in both public and private settings.

In regard to workload, the Auditor-Controller has stated publicly to your Board that they are heavily impacted each payroll week (which occurs every other week) with their focus primarily being on processing payroll. As there are still several vacant positions in the Payroll Division, this critical and time-consuming task is left to the Auditor-Controller and one or two other staff (the number of filled positions) to process payroll for more than 2,000 county employees every 2 weeks. Understanding the challenges facing payroll, throughout this transition staff from various county departments have attempted to work in earnest with the Office of the Auditor-Controller to lend assistance and refine the payroll process, as needed, to ensure statutory standards are met, as well as individual, departmental, and organizational needs. However, despite staff's best efforts to create an accurate, efficient and transparent payroll process, the payroll process remains opaque and, as detailed in the reports from departments, bi-weekly payroll operations continue to suffer from challenges related to payroll accuracy, communication, and service delivery.

Unfortunately, continued communication and cooperation challenges with the Office of the Auditor-Controller have continued to impact the payroll transition and integration processes, and have contributed to a challenging payroll environment. The Auditor-Controller has refused or inadequately utilized several offers of assistance from various county departments as staff seek to demonstrate their commitment to teamwork.

To summarize, key obstacles include:

- Lack of communication
- Lack of cooperation
- Service delivery inconsistent with county values
- Lack of responsiveness from the Office of the Auditor-Controller
- Concentrated payroll knowledge
- Limited knowledge sharing

Considering the circumstances described above and in support of any direction your Board may provide, staff recommend contracting with an external auditor to conduct an audit and review of

payroll to help the county identify and rectify errors. In addition, recommendations regarding operations and process improvements to support project success and ensure county payroll operations are on firm footing will be provided. Functional areas to be analyzed and reviewed include:

- Payroll controls
- Application administration
- Segregation of duties
- Vendor management

Review and analysis of the payroll process through the functional areas noted above would allow the county to develop a comprehensive understanding of payroll operations and the opportunities for improvement.

In summary, the current state of Payroll operations has become untenable and requires immediate attention from your Board to rectify and deliver accurate and responsive payroll services to county staff. If unaddressed, these challenges have the potential to place the county at increased reputational and legal risk. The following section presents options for your Board's consideration:

### **OPTION 1: Maintain Payroll functions in the Office of the Auditor-Controller and continue to work to enhance service delivery**

Maintaining the payroll function in the Office of the Auditor-Controller is the least disruptive to the current payroll process. For this option to be successful, it would require a commitment from the Auditor-Controller to work collectively to enhance efficiency and service delivery. Analysis of the advantages and disadvantages associated with this option are as follows:

#### **Advantages:**

- Minimal disruption to current payroll process
- Placement of payroll in this office represents the ideal solution due to the significant overlap of financial responsibilities and the nexus between bi-weekly payroll, tax preparation and remittance, and other financial transactions.
- Significant resource allocation has been made to support the transition of the payroll function from the Office of Human Resources to the Office of the Auditor-Controller.
- Collective work can be done to enhance service delivery

#### **Disadvantages:**

- The Auditor-Controller has experienced challenges recruiting and retaining staff
- The Auditor-Controller has publicly rebuffed offers of assistance as a matter of internal control
- Knowledge would continue to be centralized
- Additional resource investments would be required
- Transition progress will continue to be difficult to monitor
- Communication challenges are likely to continue

### **OPTION 2: Develop independent standalone Payroll Department**

Investing in the development of an independent standalone Payroll Department would reduce the

workload in the Office of the Auditor-Controller and allow for a specialized, independent department focused on payroll accuracy and meeting service delivery standards.

**Advantages:**

- Would establish a department dedicated to efficient payroll processing and customer service
- Would allow for more department collaboration and engagement in the payroll process

**Disadvantages:**

- Limited staffing initially due to the Payroll positions that currently remain vacant
- Potential risk to continuity of operations
- Knowledge sharing challenges due to a small staffing model
- Increased costs associated with an allocation of a department head
- No established precedent among all 58 California counties

**OPTION 3: Return Payroll Function to the Office of Human Resources (HR)**

Another option for your Board’s consideration is returning the payroll function to the Office of Human Resources. During the nearly 3 years that the payroll function was housed in HR, significant experience and “know-how” was developed. This knowledge base coupled with a commitment to customer service could prove impactful to current organizational needs.

**Advantages:**

- Enhanced collaboration between HR and Payroll
- More appropriate division of responsibilities
- Enhanced information sharing
- Better collaboration with departments

**Disadvantages:**

- Staffing challenges
- Capacity limitation in current HR environment
- Challenges related to segregation of duties
- Challenges related to recruiting talent
- May require additional resource allocation
- Currently HR does not have a permanent department head appointed

**OPTION 4: Placement of Payroll Function in the County Administrative Office**

Relocating the payroll function to the County Administrative Office may provide an opportunity to stabilize current payroll operations through increased stakeholder engagement, inter-departmental collaboration, enhanced communication and responsiveness, and service delivery consistent with the county’s core values system and desired workplace culture. Relocating payroll operations to the County Administrative Office would serve as a temporary measure designed to stabilize operations and develop clearly defined processes that will serve as the foundation for payroll activities moving forward.

**Advantages:**

- Significant leadership experience in office
- Stability of team
- Availability and access to needed resources and support
- Change management experience
- Ability to leverage strong relationships with county leaders and departments to solve problems
- Long-term strategic orientation

**Disadvantages:**

- Temporary solution to structural problem
- County Administrative Office currently has broad responsibilities
- No established precedent among all 58 California counties

Given the details above regarding the advantages and disadvantages of each option presented, staff recommends your Board consider the options and provide direction regarding the realignment of payroll operations and direct the CAO to return with any supplemental budgets and personnel allocations necessary to effectuate the Board's direction.

**CliftonLarsonAllen:**

Staff recommends, regardless of the option your Board directs, that the services of CliftonLarsonAllen (CLA) should be retained to perform a payroll audit. Details of the CLA payroll audit service are include in Attachment 2.

CLA will review current policies, procedures, documentation, and memoranda of understanding from the different labor groups and facilitate discussion with staff.

CLA will assess the county's processes surrounding one test payroll period. The design analysis will allow CLA to identify specific actions to build their internal audit program surrounding the remaining payroll periods in scope, including potential for automation and analytics where appropriate. Work procedures include:

- Understand policies and procedures and analyze processes surrounding ExecuTime and timecard entries manually keyed into Finance Enterprise
- Analyze the various hourly and salary pay structures and contracts
- Understand and analyze the payroll disbursement process (i.e. checks, EFT direct deposit) and format of available records and information that can be utilized in the internal audit assessment
- Determine an efficient method for recalculation of employee pay using source HR data and comparing to actual payment amounts (to be approved by county)
- Define exception criteria and tolerances (to be approved by county)
- Identifying the payroll periods in scope for testing (to be approved by county)

CLA will provide results with an executive summary describing the scope, objectives, approach, and

overall conclusion of the internal audit assessment. In addition, CLA will describe internal control deficiencies identified along with process improvement recommendations. Accordingly, staff recommends that your Board approve the engagement with CLA to conduct a payroll audit.

FINANCIAL IMPACT:

Should your Board choose to realign the payroll function as detailed in Options 2, 3 or 4, positions will need to be deallocated from the Office of the Auditor-Controller and reallocated to the appropriate department(s). Except as noted below, this should result in a net neutral transfer between General Fund cost center departments for the following five positions:

- 2.0 full-time equivalent (FTE) Auditor-Controller Payroll Specialists I/II
- 1.0 FTE Payroll Services Supervisor
- 1.0 FTE County Payroll Services Manager
- 1.0 FTE Accounting Systems Analyst

**OPTION 1:** No additional financial impact is associated with this option unless additional resource allocations become necessary.

**OPTION 2:** In addition to the transfer of positions described above, this option would require creation of a Payroll Director position, for which salary and benefits costs are not yet known.

**OPTION 3:** Requires only the transfer of positions described above unless additional resource allocations are requested/recommended.

**OPTION 4:** Requires only the transfer of positions described above.

Should your Board authorize the CAO to pursue and execute a letter of engagement and professional services agreement with CLA the anticipated cost will be \$259,000 for payroll auditing services.

The CAO will return to your Board with any supplemental budgets and personnel allocations or reallocations necessary to effectuate the Board's direction.

STRATEGIC FRAMEWORK:

This action supports your Board's Strategic Framework by managing our resources to ensure sustainability of services and providing community-appropriate levels of service.

OTHER AGENCY INVOLVEMENT:

None

ALTERNATIVES TO STAFF RECOMMENDATIONS:

At the discretion of the Board.

ATTACHMENTS:

1. Outstanding Financial Transactions and Payroll Errors

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2. CliftonLarsonAllen Proposal

PREVIOUS ACTION/REFERRAL:

Board Order No.: G-1

Meeting of: 2/1/22

File No.: 22-121