



## THE CITY OF SAN DIEGO

DATE: September 28, 2018

TO: Tracy McCraner, Department of Finance Director and City Comptroller

FROM: Eduardo Luna, CIA, CGFM, City Auditor  
Office of the City Auditor

SUBJECT: Fraud Hotline Investigation of a Mishandled Payroll Check

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On June 20, 2018, the Office of the City Auditor received an allegation that a Department of Finance (Finance) employee improperly processed a payroll check. Specifically, the allegation was that the last paycheck for a deceased City employee was picked up before the regular payroll date by a Mayoral staff member and delivered to the family's home without the prior knowledge or approval of the family.

The complainant's allegation was substantiated based on the evidence we obtained and reviewed. Although the intent of delivering the check early was to assist the grieving family, it was a breach of City policy for the Mayoral staff member to distribute a payroll check early. Due to the risk of theft, we confirmed that all of the funds were properly deposited into the former employee's bank account.

We also found that the City's internal controls procedures do not specifically address physical custody and transfer of paper payroll checks even though approximately 130 paper checks are processed every pay period and hand-delivered to City employees.

We made two recommendations and City management agreed with both recommendations.

### **Review of City Policy on Processing Paper Payroll Checks**

There are two internal controls process narratives that relate to paper payroll checks. Process Narrative 103, titled “Off-Cycle Payroll Check Processing,” and Process Narrative 399, titled “Enter, Review, and Correct Payroll Entries” cover out-of-sequence and paper paychecks, respectively.

Process Narrative 103 does not specify how Finance should distribute out-of-sequence paper payroll checks. Specifically, there are no written protocols describing whether paper payroll checks should be mailed or picked up in person by the employee or their authorized designee. In this case, the check was distributed to an unauthorized third party who hand-delivered the check to the home of the employee’s family with no documentation demonstrating the receipt of the paycheck by the family.

According to Finance, there are approximately 130 employees in the City who receive paper checks each pay period. For these checks, Department Payroll Specialists deliver the checks to employees. The requirements for in-person pickup of paper paychecks, such as identification requirements, should be codified to prevent the risk of theft of paychecks.

Process Narrative 399 states, “paychecks are not permitted to be distributed early, for any reason.” It also states that Department Payroll Specialists are the only people authorized to hand-deliver checks to employees. In this case, the check was distributed early, and distributed to someone other than the Department Payroll Specialist for delivery to the employee’s family.

### **Conclusion**

The allegation of a mishandled paper paycheck was investigated and substantiated. We found that a Finance employee breached existing procedures by providing a paycheck early. Moreover, Finance did not have written guidelines regarding what was required in order to distribute a paper paycheck.

The City breached protocol by distributing the check early to the Mayoral staff member for delivery two days prior to the normal payday. Moreover, the City released the check to someone who is not authorized to receive and distribute paychecks, and to someone the family did not specifically name as a representative authorized to pick up the check.

**Recommendations and Management's Responses**

**(See Attachment A for Definitions of Fraud Hotline Recommendation Priorities)**

**Recommendation 1**

**We recommend that the Department of Finance determine if corrective action with respect to the employee who authorized the early release of the paper paycheck to someone other than the City employee's representative or Department Payroll Specialist is necessary, and if so, take the appropriate corrective action. (Priority 1)**

**Management Response:**

The Department of Finance has determined that there is no further corrective action required as to the Payroll Specialist employee in question. The deceased employee had been properly terminated in the system prior to the check being processed, issued and released. The Department of Finance has confirmed that there was no ethical, fraudulent or other violation committed in this case and the circumstance under which this request was made allowed for the action taken. The employee who released the check acted on a request from Human Resources who has authority to make such a request.

**Target Implementation Date:** September 28, 2018

**Recommendation 2**

**We recommend that the Department of Finance revise the Process Narrative regarding “Off-Cycle Payroll Check Processing” (PN-103) to include: procedures for in-person pickup of payroll checks, including who is authorized to receive them, what identification is required, and how to document receipt of the paycheck. Finance should also enforce the existing policy “Enter, Review, and Correct Payroll Entries” (PN-399) and not distribute payroll checks early, for any reason. (Priority 2)**

**Management Response:**

The Department of Finance agrees with this recommendation and will revise both Process Narratives 103 and 399 to include recommended and additional language as needed to clearly detail the process.

**Target Implementation Date:** October 31, 2018

Fraud Hotline Investigation of a Mishandled Payroll Check

This investigation was conducted under the authority of California Government Code §53087.6 which states:

(e) (2) Any investigative audit conducted pursuant to this subdivision shall be kept confidential, except to issue any report of an investigation that has been substantiated, or to release any findings resulting from a completed investigation that are deemed necessary to serve the interests of the public. In any event, the identity of the individual or individuals reporting the improper government activity, and the subject employee or employees shall be kept confidential.

(3) Notwithstanding paragraph (2), the auditor or controller may provide a copy of a substantiated audit report that includes the identities of the subject employee or employees and other pertinent information concerning the investigation to the appropriate appointing authority for disciplinary purposes. The substantiated audit report, any subsequent investigatory materials or information, and the disposition of any resulting disciplinary proceedings are subject to the confidentiality provisions of applicable local, state, and federal statutes, rules, and regulations.

Thank you for taking action on this issue.

Respectfully submitted,

A handwritten signature in black ink that reads "Eduardo Luna". The signature is written in a cursive, flowing style.

Eduardo Luna  
City Auditor

## Attachment A – Definition of Fraud Hotline Recommendation Priorities

### DEFINITIONS OF PRIORITY 1, 2, AND 3 FRAUD HOTLINE RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for Fraud Hotline recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration’s responsibility to establish a target date to implement each recommendation taking into considerations its priority. The City Auditor requests that target dates be included in the Administration’s official response to the findings and recommendations.

Priority Class <sup>1</sup>	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls exists.
3	Operation or administrative process will be improved.

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<sup>1</sup> The City Auditor is responsible for assigning Fraud Hotline recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.