

**University of California  
Los Alamos National Laboratory**

**Compliance and Operational Analysis  
LANL Payroll Processes and Internal  
Controls**

**April 15, 2003**

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Ms. Anne C. Broome  
Vice President-Financial Management  
University of California  
1111 Franklin Street  
Oakland, California 94607-5200

Subject: Report of Compliance and Operational Analysis re: Payroll Processes and Internal Controls

Dear Ms. Broome:

Ernst & Young (E&Y) has completed a compliance and operational analysis of the Los Alamos National Laboratory (LANL) Payroll processes and internal controls, and our Report is attached. This report is intended solely for the information and use of the University of California Management.

Implementation of the recommendations contained in the attached Report will provide for an enhanced control environment for the payroll processes. We recommend periodic follow-up to determine accomplishment of the recommended actions.

We appreciate the cooperation and assistance provided to us during the course of our work. If you have any questions, please contact Mr. Brian F. Simmons at 214.969.8629.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Simmons", with a long horizontal stroke extending to the right.

Brian F. Simmons  
Central Region Director  
Government Contract Services

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## **I. Overview**

The University of California, Vice President - Financial Management retained Ernst & Young LLP (E&Y) to conduct an independent compliance and operational analysis of the Los Alamos National Laboratory (LANL) Payroll processes and internal controls.

In accordance with E&Y's Engagement Letter dated February 4, 2003, E&Y is pleased to provide the results of E&Y's analysis of LANL's payroll processes and internal controls. The E&Y report is comprised of three (3) parts: (I) an Overview/Background, (II) Procedures Performed, and (III) Observations and Recommendations.

The E&Y services were performed in accordance with the Statement on Standards for Consulting Services (CS100) of the American Institute of Certified Public Accountants (AICPA) as stated in the Engagement Letter. The Standards for Consulting Services (CS100) do not result in issuance of an opinion and does not constitute an audit or an examination made in accordance with generally accepted auditing or attestation standards, the objective of which is the expression of an opinion on the elements, accounts, or items of a financial statement. As a result, E&Y does not express an opinion on LANL's payroll processes and internal controls. The procedures performed by E&Y did not constitute an audit or an examination made in accordance with generally accepted auditing or attestation standards.

### **A. Background**

The University of California is the designated operating contractor under a prime contract (W-7405-ENG-36) awarded by the Department of Energy (DOE) for operation of the LANL. A description of the overall duties of the operating contractor is contained in Paragraph C.001 of Modification Number M552, entitled Statement of Work. Paragraph I.096 of the aforementioned contract modification requires that:

“The contractor shall maintain and administer a financial management system that is suitable to provide proper accounting in accordance with DOE requirements for assets, liabilities, collections accruing to the Contractor in connection with the work under this contract, expenditures, costs, and encumbrances; permits the preparation of accounts and accurate, reliable financial and statistical reports; and assures that accountability for the assets can be maintained.”

The governing regulations for the operating contract are the Department of Energy Acquisition Regulation (DEAR). The DEAR implements and supplements the Federal Acquisition Regulation (FAR).

To fulfill LANL's financial management responsibility, LANL utilizes two handbooks: (1) The DOE Accounting Handbook and (2) an internally developed LANL Financial Management Handbook based, in large part, on the DOE Accounting Handbook. The DOE Accounting Handbook presents the DOE's standards, procedures, and operational requirements in support of accounting policies, principles, and applicable legal requirements for DOE operations. The LANL Financial Management Handbook describes the principle accounting, planning, and reporting requirements. The LANL Financial Management Handbook consists of six major topics: "Indirect Budget", "Data Warehouse", "Time & Effort", "Accounting", "Formal Budgeting", and "Related Resources."

Accounting policies that supplement the guidance contained in the Financial Management Handbook are contained in LANL's Accounting Resource Manual. LANL accounting policies are implemented by specific desk procedures.

The E&Y analysis of the payroll processes and internal controls focused on specific accounting functions that are performed in LANL's accounting organization (BUS-1). The Accounting organization consists of approximately 100 employees. The Accounting organization is further subdivided into smaller functional units: Travel, Accounts Payable and Contract Accounting, General Accounting and Work for Others (WFO), Property Accounting, Payroll, and support related functions.

The Payroll staff of 13 employees is responsible for processing wage and salary payments for LANL employees and affiliates (non-employee). Payments for Personal Service Agreements are processed through Accounts Payable.

As of January 2003, LANL headcount totaled 8,586 employees, 3,485 contractors, 939 consultants, 1,368 students, and 271 special program guests. Employee time and attendance (T/E) is processed through the regular bi-weekly payroll; non-employee T/E is processed through the affiliate payroll system. Employee payroll costs were \$697.1 million in Calendar Year (CY) 2002 (affiliate payroll costs were \$6 million in the calendar year). Approximately 96 percent of employees and affiliates pay is electronically direct deposit and the remaining 4 percent being distributed in-house.

DOE's Financial Stewardship Objective (from the DOE Financial Stewardship Model) for payroll is that: "All employees are properly and promptly paid in accordance with wage contracts for services actually performed and approved for appropriate charge numbers in a timely and cost efficient manner with adequate safeguarding of personnel records."

## **B. Summary of Observations**

As a result of our analysis, we identified three observations related to the strengthening of payroll processes and internal controls. These observations related to uncompensated overtime, timekeeping awareness training, and timesheet approval.

## **II. Procedures Performed**

### **A. Scope of Analysis**

The scope of compliance and operational analysis of payroll processes and internal controls included the following:

- Understand the process for LANL's payroll activities.
- Assess written policies, procedures, and internal controls related to payroll functions for compliance with DOE and contract requirements.
- Perform interviews of key personnel.
- Analyze and understand the results of prior reviews on policies, procedures, systems, and practices.
- Sample selected transactions to determine if actual practices are in compliance with written policies, procedures, contractual, and DOE requirements.

### **B. Objectives of Analysis**

The objectives of the payroll processes and internal controls were to:

- Document LANL's key internal controls including LANL's stated policies, procedures, systems, and forms.
- Analyze the consistency of application and adequacy of LANL's policies, procedures, systems, and forms to assess compliance with applicable contractual provisions.
- Determine whether sampled items, in accordance with relevant contract and operational requirements, were properly reviewed, approved, and appeared appropriate in the circumstances.

## **III. Observations and Recommendations**

Based upon the procedures performed, we identified three (3) items/control enhancement opportunities in the Payroll internal control processes. Management should address the

control opportunities identified from our procedures to further strengthen internal controls in the Payroll processes. In our view, the observations and recommendations are presented in order of their importance. The items identified and the recommendations resulting from our procedures follow:

**A. Payroll Process Observations**

**1. Uncompensated Overtime**

**a. Observation**

Current LANL practice is that overtime is not recorded or allocated to projects worked by exempt employees charging labor direct. Therefore, if a direct salary exempt employee is working on multiple projects (charge codes) during the period that significant uncompensated overtime is worked, the actual distribution of labor costs may not be allocated to the projects worked. We noted that Group Leader Survey Data commented on a perceived high level of uncompensated overtime worked by exempt employees.

**b. Recommendation**

LANL should perform a study to determine whether or not the level of unrecorded overtime is significant. If the level of unrecorded overtime is significant, procedures should be instituted to provide for proper accumulation of time and allocation of associated costs for exempt employees considering all hours worked. If the level of unrecorded overtime is not significant, no further action would be warranted by LANL.

**2. Timekeeping Awareness Training**

**a. Observation**

LANL does not require periodic timekeeping awareness training to reinforce the importance of accurate, timely submission, and approval of timekeeping.

**b. Recommendation**

LANL should institute periodic timekeeping awareness training. The timekeeping training should reinforce the importance of accurate, timely submission, and approval of timekeeping for all employees and affiliates and each individual's responsibility.

### **3. Timesheet Approval**

#### **a. Observation**

The Financial Management Handbook allows timekeepers to enter and approve employee time in the electronic system. When timekeepers enter and approve an employee's time, managers still maintain approval authority and are required to manually approve hard-copy printouts of the timesheets. Payroll can be processed with or without the manual signature. The E&Y procedures identified 11 out of 15 managers who manually approved time for 60 T/E printouts with the remaining 4 managers electronically approving the time. Of the 60 T/E printouts analyzed, 23 documented a manager's signature after the payroll process had begun and one T/E printout displayed a non-manager's signature. Of these 23 items, 5 were approved as of the date of our request for the records.

#### **b. Recommendation**

To enhance compliance with the approval requirement, we suggest that all timesheets be approved electronically. This should increase reliability of the timekeeping system approval process and reduce cost.