



OFFICE OF THE CITY AUDITOR
Long Beach, California

C-3

LAURA L. DOUD, CPA
City Auditor

December 6, 2011

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file the attached report titled Terminated Employees Audit and request City Management to review the recommendations, develop strategies for implementation, and update the City Auditor as to the status of the recommendations within six months from the date of receipt and filing of this report.

DISCUSSION:

Our Office performed a review of the City's internal controls over the processing of terminated employees to determine if benefits were appropriately handled, City-owned assets were retrieved, and access to City information systems was disabled timely.

Several different parties are involved when an employee terminates service. Individual departments, Human Resources, and Technology Services all play critical roles in the processing of required forms, benefits, and access to assets and City systems. Overall, we identified controls that should be strengthened to minimize the City's potential liability. The key findings and conclusions are:

- The City incurs approximately \$1 million a year in unemployment claims. However, some employee files lacked sufficient documentation to substantiate claim eligibility and possible appeals. Without appropriate documentation, we were unable to confirm if certain claims were paid appropriately.
- The City lacks an Administrative Regulation detailing the issuance and retrieval of City-owned assets. As a result, processes between Departments vary substantially, and in most cases, we were unable to determine if all assets were collected upon an employee's termination.
- A more thorough reconciliation process involving terminated employee listings and benefit payments would decrease the City's exposure to potential claim liabilities.

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- The processing time for removing a terminated employee's network system access needs to be significantly reduced to avoid unauthorized access to City systems.

Detailed information regarding the results discussed above is included in the attached report.

We express our appreciation to the Departments of Human Resources and Technology Services, as well as the departments included in our review for providing their time, information, and cooperation during the audit.

TIMING CONSIDERATIONS:

City Council approval is requested on December 6, 2011.

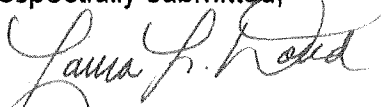
FISCAL IMPACT:

Without strong internal controls, the City is exposed to potential liability and loss resulting from the inappropriate handling of benefit claims, non-retrieval of City-owned assets, and unauthorized access to data and facilities.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,



LAURA L. DOUD, CPA
CITY AUDITOR

Attachment

Audit Report
Terminated Employees Audit

November 2011



Audit Staff

City Auditor: Laura L. Doud
Assistant City Auditor: Deborah K. Ellis
Deputy City Auditor: Janet Day
Audit Manager: Sotheary Hul
Staff Auditor: Hannah Morgan

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Executive Summary

The Office of the City Auditor (OCA) recently completed an audit of the City's internal controls over the processing of terminated employees for the period April 1, 2009 through March 31, 2011. During the two-year audit period, 994 separations from the City of Long Beach (City) were filed and 699 unemployment insurance claims totaling approximately \$1.9 million were paid.

Our audit evaluated the City's procedures for managing unemployment insurance claims, accounting for City assets issued to employees, settling terminated employee benefits and removing access to City systems. The processing of terminated employees is the responsibility of many parties. Individual departments must complete separation forms and retrieve City-issued assets, Technology Services Department (TSD) ensures employee network system access is removed, and Human Resources (HR) ensures eligible leave accruals are properly paid out, benefits are terminated or extended appropriately upon separation, and unemployment insurance benefit claims are protested or appealed if appropriate.

Overall, we found improvements are needed citywide over the processing of terminated employees in the following areas:

- The City's unemployment claims are significant, totaling approximately \$1.9 million during the audit period. We found several terminated employee files were lacking adequate documentation to support claim eligibility and decisions related to the appeal process. As such, we were unable to confirm whether these claims were paid appropriately.
- The lack of a City Administrative Regulation as well as the lack of a standard procedure addressing the issuance and retrieval of City-owned assets has resulted in the inability to determine if all City assets were collected upon an employee's termination.
- Not all benefit plans are terminated timely. Because terminated employee listings are not always reconciled to benefit payments, the City could be exposed to potential claim liabilities.
- Significant lag time exists between an employee's termination date and network system access removal, increasing the risk for unauthorized access to City systems.

Details of the above issues and recommendations are included in the body of this report. We would like to thank HR, TSD, as well as the departments selected for review, for the time, information, and cooperation provided to us during the audit.

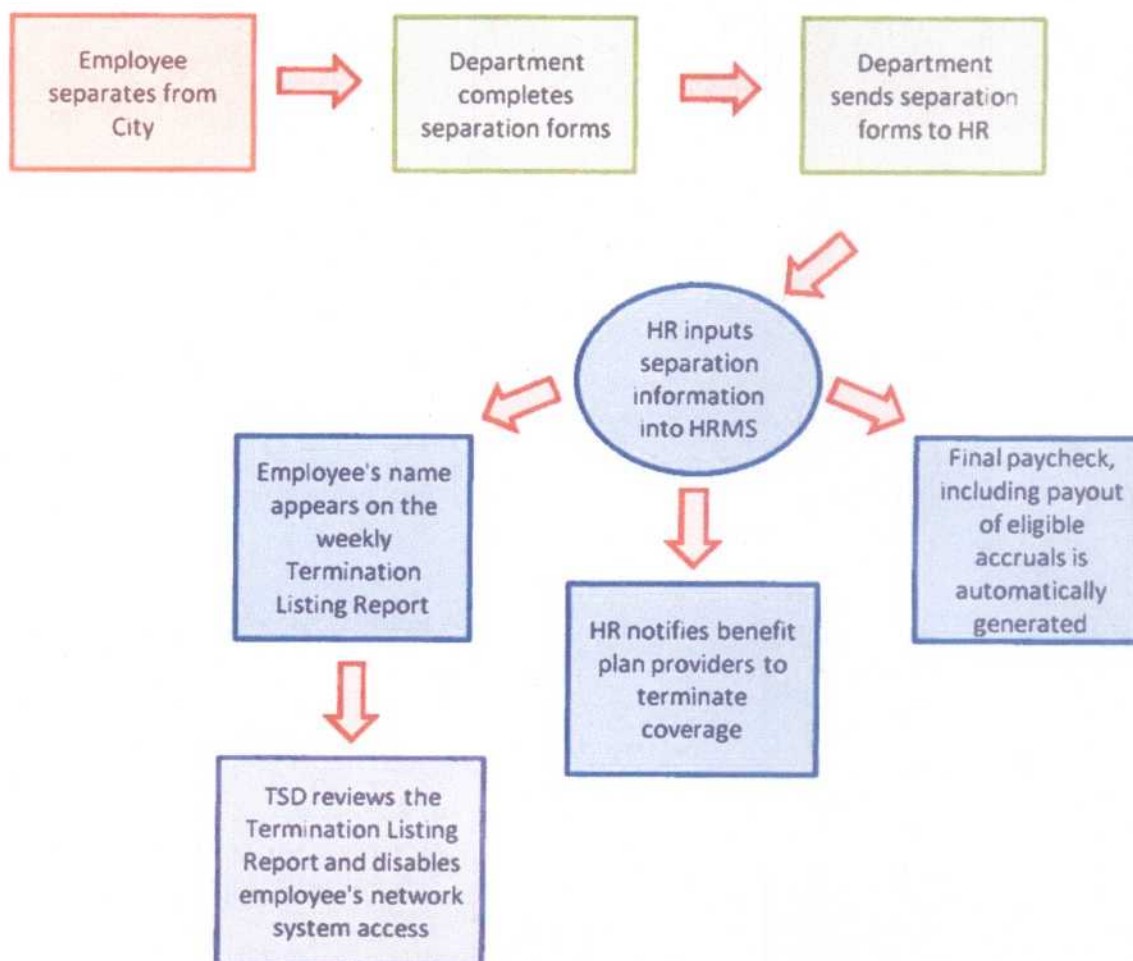
Background

Terminations

HR provides services in the areas of labor relations, classification and compensation, employee benefits, equal employment opportunities, and risk management. During the two-year audit period of April 1, 2009 through March 31, 2011, HR processed 994 terminations (separations).

Terminations from the City include both voluntary separations, such as resignations and retirements, and involuntary separations, such as layoffs and dismissals. Chart 1 illustrates the typical process that occurs when an employee separates from the City.

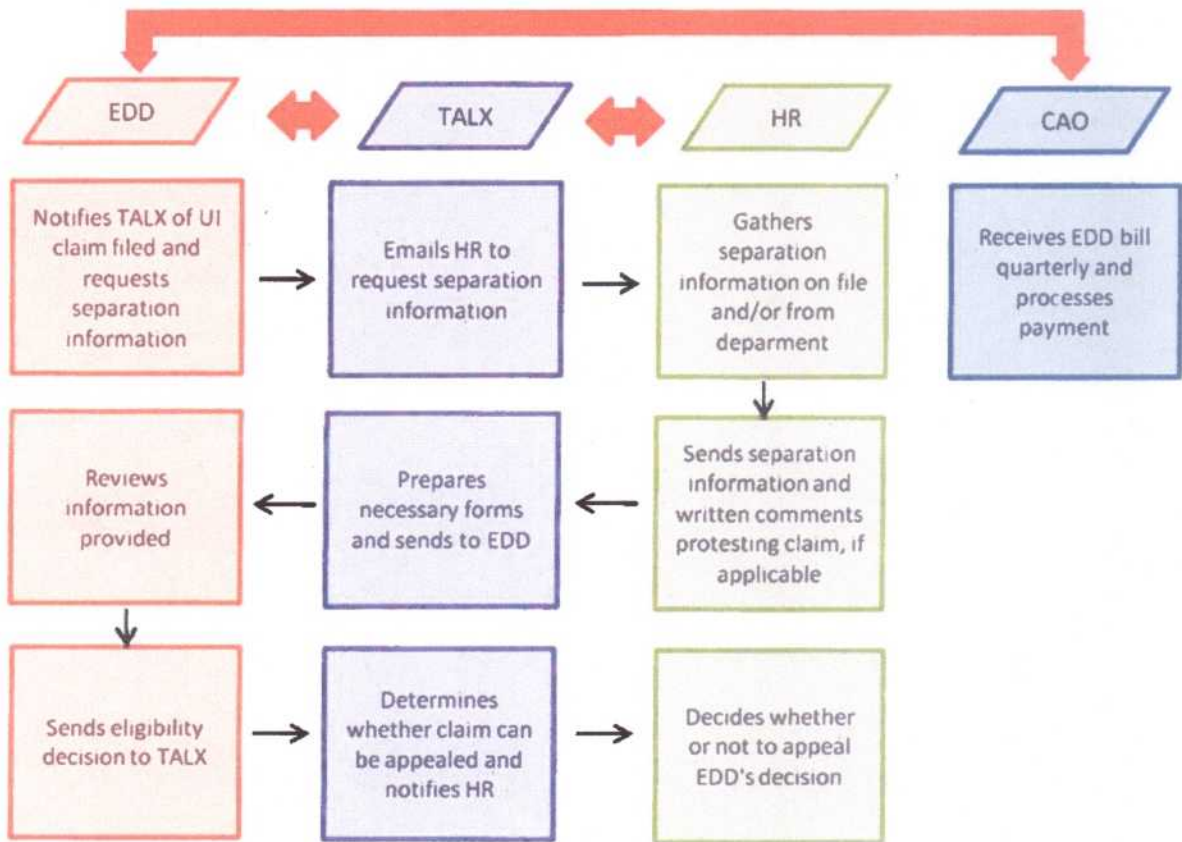
**Chart 1
City Separation Process**



Unemployment Insurance (UI)

During the two-year audit period, the City paid 699 UI claims totaling approximately \$1.9 million. The City, as a reimbursable employer, is required to reimburse the State's Employment Development Department (EDD) for each UI claim paid to eligible former employees. HR, the City Attorney's Office (CAO), and a third-party vendor, TALX, each play a role in administering the City's UI claims as illustrated below.

**Chart 2
UI Benefits Process**



Audit Objectives, Scope, and Methodology

The objective of our audit was to determine whether adequate internal controls are in place over the processing of terminated employees, including settling terminated employee benefits, managing unemployment insurance claims, accounting for City assets issued to employees and removing access to City systems and accounts. The scope of the audit was for the period April 1, 2009 through March 31, 2011.

During our audit, we performed the following procedures:

- Interviewed HR personnel and obtained an understanding of the internal controls related to our audit objectives;
- Selected seven departments with the highest rate of termination and interviewed selected Citywide department personnel to obtain an understanding of the controls over tracking of City assets and system access;
- Reviewed health benefit payments to determine whether benefits were terminated or extended appropriately upon an employee's separation, on a sample basis;
- Independently confirmed with the health benefit providers that no services were provided to employees after they were terminated from the City's group benefit plan, on a sample basis;
- Reviewed selected UI benefit claims to determine whether documents were submitted timely to TALX and opportunities to protest/appeal claims were taken, when applicable;
- Identified an employee's leave accrual balance upon termination and re-calculated leave accrual payouts for accuracy, on a sample basis;
- Identified retirees who elected to apply sick leave accruals towards health benefit payments and determined whether accruals were properly applied, on a sample basis; and
- Obtained the network access report from Technology Services Department and determined whether access was removed timely for selected terminated employees.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Findings and Recommendations

Finding #1 – Inability to Verify Eligibility of Some Unemployment Insurance Claims

During the two-year audit period, the City paid 699 UI claims totaling approximately \$1.9 million. While HR does use the third-party vendor TALX to assist with the filing of UI claims, there does not appear to be formal policies on appropriate documentation to maintain in the employee's file to ensure all claims are properly reviewed and appealed when necessary. As a result, we found instances of employee files lacking appropriate documentation, which would allow us to determine claim eligibility.

Retention of adequate documentation (e.g., termination/resignation letters, communication with TALX, etc.) supporting claim eligibility is critical in ensuring that the City is only paying for valid claims. Of the claims selected for review, 31% of the employee files did not have UI supporting documentation. These claims represent a total liability of approximately \$219,000 paid by the City. Without adequate documentation detailing the circumstances of employees' terminations, we were unable to confirm the eligibility of those claims and whether payment was appropriate.

The City has the ability to appeal a UI claim when they believe an employee should not be entitled to benefits due to reasons for separation (e.g., misconduct, retirement, etc.). During the audit period, we found instances where it appears HR should have appealed a claim, but did not. Of the claims selected for review, 5% of the files contained a Notice of Determination from TALX indicating the ability to appeal and supporting documentation indicating the reasons for termination (i.e., misconduct). However, the file did not contain any information regarding HR's decision on why the claims were not appealed. Without the appropriate justification maintained in the file, we were unable to determine if these claims, totaling \$31,900, were thoroughly reviewed prior to deciding to forego the appeals process.

Recommendations to Finding #1:

To ensure adequate documentation and proper review of UI claims, written policies and procedures surrounding the UI claims process should be developed and include, at a minimum, the following:

- HR's responsibilities over the UI process;
- Guidelines for protesting and appealing UI claims, including requirements for written justification for potential ineligible claims that are not protested/appealed; and
- Document retention requirements.

Finding #2 – Unable to Account for City-Issued Assets

Each department issues City-owned assets to its employees. These assets vary based on need, and include items such as keys to facilities, laptops, cell phones, uniforms, and security equipment like batons and tasers. The City does not have an Administrative Regulation covering processes and controls over City-issued equipment to employees. As a result, none of the departments reviewed had a consistent practice of centrally tracking and maintaining records of issued assets making it impossible to ascertain in many cases whether assets issued to former employees were properly returned upon termination.

Findings noted during our review include:

- Lack of appropriate checklist or documentation indicating when and what assets were issued to employees;
- Records of assets issued and retrieved are not maintained in employee files;
- For departments using checklists, not all types of assets issued are tracked; and
- Procedures can vary within a department with supervisors employing different methods for tracking assets.

Besides the dollar loss to the City when assets are not returned, there is also the risk of how a former employee may continue to utilize the asset. For example, laptops may contain critical or confidential information; keys can provide unlimited access to City facilities; and, items like badges and IDs could be used to gain public trust. Departments need to immediately begin implementing controls to ensure assets issued to employees are recorded, maintained, and properly retrieved.

Recommendations to Finding #2:

HR should develop citywide policies and procedures (Administrative Regulation) outlining appropriate controls over the issuance and retrieval of City-owned assets. This should include, at a minimum, appropriate documentation, document retention, authorized signatures by both the employee and respective supervisors, and adequate justification when assets are not retrieved upon separation of employment.

Finding #3 – Benefits not Terminated Timely

When an employee is terminated, HR calculates the final leave accruals to be paid and discontinues the employee's benefit plan (e.g., health, dental, life, in-hospital indemnity insurance) at the end of the month in which the employee separates from the City. However, employees who are laid off or elect COBRA coverage can continue receiving benefits for a specified time period after separation.

Our review found that HR accurately calculated all eligible leave accruals and properly applied sick leave accruals towards retiree health benefits where applicable for all terminations selected.

However, we did find that some benefit plans were not terminated timely. With the exception of one benefit provider, all plans provided by the City are "self-funded". Instead of paying a premium, benefit providers are paid a monthly administrative fee to manage the City's plans and are reimbursed for all eligible claims paid. Of the separated employees selected for review, an additional month of coverage was provided to 10% of employees with in-hospital indemnity insurance and 3% of employees with health and/or life insurance. Because the plans are "self-funded", the City has the ability, within a certain time frame, to adjust monthly payments to account for any fees or claims paid in error beyond the termination date. However, HR was not aware these errors existed.

It appears only the monthly fees were overpaid for the errors found; but, if claims had been submitted during the additional month of coverage, the City's maximum potential liability could have ranged from \$21,000 to \$42,000 for just the in-hospital indemnity coverage. However, per HR, based on average claims the City's potential liability would be much less. Due to health information privacy laws, we were unable to verify this information.

Recommendations to Finding #3:

Review current practice to ensure all benefit plans for former employees are terminated timely. In addition, develop a reconciliation process to identify health benefit fees and claims that may have been paid for employees not terminated timely, and ensure adjustments are made to future payments.

Finding #4 – Network System Access is not Disabled Timely

In order to prevent unauthorized access and misuse of City systems, it is critical that network system access is promptly disabled upon an employee's termination. We found that current procedures allow for significant delays in terminating former employees' network system access, thus giving individuals continued access to the City's systems for weeks and even months after termination.

When an employee separates from the City, departments fill out an HR-1 form (termination form) and submit it to HR. HR inputs the termination date into the system and a Termination Listing Report is generated. TSD reviews this report on a weekly basis and per their internal policy, network system access is supposed to be disabled within seven business days. To complete this process beginning with the department and ending with TSD, it could take approximately 27 days for access to be disabled. However, of the former employees reviewed, 25 of 87 (or 29%) were not disabled within 27 days. Rather, it took as long as 91 days after termination for access to be disabled. Table 2 summarizes the lag days between an employee's termination and their network system access removal.

Table 2
Network System Access Removal Lag Time

Lag Days	# of Employees
0 - 27	62
28 - 55	15
56 - 83	8
84+	2
Total	87

Timely removal of former employees' network system access is critical in preventing misuse of City systems, ensuring data integrity and safeguarding confidential information.

Recommendations to Finding #4:

HR and TSD should work together to ensure the City has an adequate process to ensure network access for separated employees is terminated as quickly as possible. For example, requiring departments to immediately submit a Tech Services Request directly to TSD upon an employee's termination could result in access being discontinued within a few days.

Appendix A

Management's Response

Human Resources Department



Date: October 31, 2011
To: Laura L. Doud, City Auditor *Deborah Mills*
From: Deborah Mills, Director of Human Resources
Subject: Department Response to Terminated Employees Audit

The Department of Human Resources provides the following responses to the Terminated Employees Audit that evaluated the City's procedures for managing unemployment insurance claims, accounting for City assets issued to employees, and settling terminated employee benefits.

"The City's unemployment claims are significant, totaling approximately \$1.9 million during the audit period. We found several terminated employee files were lacking adequate documentation to support claim eligibility and decisions related to the appeal process. As such, we were unable to confirm whether these claims were paid appropriately."

As detailed in the audit report, Human Resources, the City Attorney's Office, and a third-party vendor, TALX, each play a role in administering the City's unemployment insurance claims. Most decisions regarding claim eligibility are granted or denied based on state law and numerous unemployment insurance laws and regulations.

The State of California, Employment Development Department provides benefits to employees who are laid off or out of work due to no fault of their own. The Unemployment Insurance Code and California Code of Regulations, Title 22, even permits individuals who are discharged, terminated or voluntarily quit to collect unemployment insurance benefits. Specific criteria must be met. State EDD staff determines whether the criteria under state law is met prior to granting benefits. State laws governing unemployment benefits are liberally construed in favor of employees and EDD staff makes the determination of appropriate level of benefits.

The three parties involved in administering the City's unemployment insurance claims take into consideration many factors when considering whether a claim warrants an appeal or not. Documenting specific guidelines for protesting and appealing claims would be very challenging given the many factors. In some instances, there are legal and strategic reasons considered that result in the determination not to proceed against a claimant. These include avoiding providing testimony in an administrative setting that could later be used in a civil trial or providing evidence in an unemployment hearing, which can be used in a subsequent civil proceeding against the City.

The Department of Human Resources acknowledges that personnel files do need more clarity and closure as it relates to unemployment insurance claims

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and will ensure, where appropriate, to provide adequate documentation in the future.

“The lack of a City Administrative Regulation as well as the lack of a standard procedure addressing the issuance and retrieval of City-owned assets has resulted in the inability to determine if all City assets were collected upon an employee’s termination.”

The following rules and policies currently exist that provide overarching standards for handling City assets.

Financial Policies and Procedures (FPP) 7-1, section V.B.8., defines City assets or Walk-away items that are not capitalized (i.e. do not meet capitalization threshold criterion) as generally small, mobile, and easily converted to personal use, having a street value or fair market value of at least \$250 but less than \$5,000. The FPP 7-1 requires that departments track walk-away items. Examples of walkaway items include, but are not limited to, firearms, video equipment, two-way radios, cameras, GPS units, smart phones, facsimile machines, PDAs, computers, laptops, computer peripherals, printers, and power tools. Walk-away items do not include conference room tables, chairs, bookcases, sports equipment, etc.

Under the Civil Service Rules and Regulations, Section 84 defines causes for suspension, demotion, release or discharge and Subsection 84.11 defines the destruction, misuse, misappropriation, unauthorized use of or unauthorized possession of City property as a cause.

In addition, specific departments (e.g. Police and Parks, Recreation & Marine), have created their own policies and checklists to ensure that City assets are returned upon separation from the City. Finally, the Department of Human Resources provides standard checklists for use by departments that include a note to “Collect All City Property.”

The Department of Human Resources assists all departments in disciplinary actions or post-separation actions when a violation of any of the above policies and rules occurs. Over the past year, there have been minimal actions against employees or terminated employees where a theft or misuse of City property has occurred. However, the department stands ready to work with you or your staff when these violations are reported directly to the City Auditor's Office.

The department will also initiate a re-education campaign through its monthly Administrative Officers meetings and quarterly Payroll Personnel meetings to assist City departments in strengthening their internal documentation and

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procedures to ensure that assets issued to employees are recorded, maintained, and properly retrieved.

“Not all benefit plans are terminated timely. Because terminated employee listings are not always reconciled to benefit payments, the City could be exposed to potential claim liabilities.”

The Department of Human Resources obtains personnel reports on the first of each month that details employee terminations and new hires for the previous month. These reports are used to update the databases of our benefit providers, which can take up to ten working days. In regards to terminated employees, the report provides an end date for each employee that is usually different from the actual separation date. As an example, if an employee's separation date is March 1, the end date is March 31. Employees that work at least one day of their last month are eligible for benefits coverage until the end of their last month.

In the example above, if an employee visits a medical provider between April 1 and April 10 (assuming 10 working days), there is the potential that the City will need to pay for the service. However, the City has the ability, within 60 days, to adjust the employee's account for any fees or claims paid in error beyond the termination date. The Department of Human Resources will address the Audit's concerns and ensure additional reconciliation processes are created.

The In-Hospital Indemnity benefit is similar in coverage in that, if an employee works at least one day of their last month, they are covered for the entire month. While this benefit is “self-funded,” the monthly fee that the employee pays goes into a separate fund that pays for reimbursements for in-hospital stays. This fund has always maintained a positive fund balance.

In regards to potential liability, the liability would only be created if an in-hospital stay occurred within the 10-day window described earlier. In this instance, the actual potential dollar payout could be between \$500 and \$2,000, assuming an average number of five in-hospital days for either a regular employee or a management employee. This average is based on a review of in-hospital stays that averaged 4.4 days for 2008 and 5.5 days for 2009. This potential liability, however, will be moot after December 31, 2011 since this benefit will no longer be provided. In the interim, the Department of Human Resources will address the Audit's concerns on this matter and ensure additional reconciliation processes are created.

The Department of Human Resources appreciates the review conducted by the Office of the City Auditor and will promptly address the concerns as stated above.

Appendix B

Management's Response

Technology Services Department



Date: October 19, 2011
To: Laura L. Doud, City Auditor
From: Curtis Tani, Director of Technology Services 
Subject: **Management Response to Terminated Employees Audit Report**

Attached for your review, please find the Technology Services Department's (TSD) Management Response to the subject audit. TSD appreciates the work of your team as it relates to the Audit Report. TSD agrees with the findings and is happy to report that for the last six weeks, the Department has disabled network access for separated employees within two business days of notification, **100 percent** of the time.

Should you have any questions or concerns, please contact me at x6234.

Attachment

cc: Patrick H. West, City Manager
Suzanne Frick, Assistant City Manager
Reggie Harrison, Deputy City Manager
Janet Day, Deputy City Auditor
Jyl Marden, Assistant to the City Manager

Management Response

The Technology Services Department (TSD) appreciates the City Auditor's *Terminated Employees Audit*. TSD takes very seriously the responsibility of ensuring a safe and secure communications infrastructure. The Department has already taken steps to rectify the deficiency noted in the Audit Report, but looks forward to working with Human Resources and the City Auditor's Office in identifying any additional steps that can be taken to strengthen the process.

Audit Finding #4: Network System Access is not Disabled Timely

Background: Before outlining the steps utilized by TSD to handle removal of network access, it is important to note that TSD identifies employees no longer employed by the City as one of two distinct categories: 1) Terminated Employees and 2) Separated Employees.

The process for removing an employee's network access is dependent upon the type of "exit" from the City. Terminated employees are individuals removed from employment for disciplinary reasons, or for cause. TSD is typically notified immediately from management-level personnel in the terminated employee's host department or from Human Resources. Because time is of the essence in this type of exit, TSD immediately (same day, typically within minutes, or on an agreed upon time with the host department) removes all network access for that employee. This is the case 100% of the time.

The other, more typical, category of "exit" from office is that of a Separated Employee. This category is for employees who exit due to retirement, resignation, etc. The process highlighted in the Audit Report is for this type of separation from the City. This type of exit from the City workforce reflects a lower risk separation.

By way of process, on a weekly basis, TSD receives the *Termination Listing Report* from the City's Human Resources Management System. Because the report is TSD's first knowledge of a separated employee, the Department uses the report date to begin our seven business day clock to disable network access. TSD has no prior knowledge of a City employee having separated.

Based on this report identifying recently separated employees, TSD has historically employed a two-step process to manage network access disabling. The first step in the process was for TSD's Help Desk to review the weekly report and create a ticket, or work order, for other TSD workgroups to disable system access. The Help Desk also immediately disabled the individual's email access. Without an active email account or physical access to City computers, the City's risk of a security breach is greatly minimized. Users with VPN (Virtual Private Network) access to the City's information systems had that their rights terminated within four business days of notification.

The second step in the process was the disabling of the network access by TSD's Server Support operation. While the department agrees with the audit findings, it should be noted that many of the identified "lags" in network access disabling occurred before this two-step process was implemented. Additionally, without email access, physical access to City facilities, and/or VPN access, separated employees did not have direct access to City information.

Update to Audit Finding #4

In an effort to reduce TSD's response time, the Department has streamlined its process to disable a separated employee's network access. Instead of a two-step process, the Department has given the Help Desk security rights to disable an employee's network access. Now, the network access can be disabled as soon as the Help Desk receives the weekly *Termination Listing Report*. In fact, since implementing this change in September 2011, TSD has been able to terminate **100 percent** of separated employees' network access accounts within two business days of official notification (*Termination Listing Report*). TSD will commit to working with Human Resources to identify ways to minimize the amount of time from actual separation to when the name appears on the weekly report.