Agenda Item

Orange City Council

Item #: 9.3.	8/25/2026	**File #:** 26-0483

TO: Honorable Mayor and Members of the City Council

THRU: Jarad Hildenbrand, City Manager

FROM: Trang Nguyen, Finance Director

1. SUBJECT
Result of the Independent Accountants' Report on the Agreed Upon Procedures for Payroll

2. SUMMARY
LSL Certified Public Accountants completed the Payroll Agreed-Upon Procedures engagement approved by the City Council on February 24, 2026. The engagement concluded that the City's payroll calculations, employee compensation, leave administration, overtime calculations, and related payroll processes were accurate, with no exceptions identified. The report also included recommendations to strengthen internal controls, clarify provisions within the City's Memoranda of Understanding, and further reduce operational risk.

3. RECOMMENDED ACTION
Receive and file the results of the Agreed Upon Procedures for Payroll.

4. FISCAL IMPACT
None.

5. STRATEGIC PLAN GOALS
Goal 2: Enhance Economic Development and Achieve Fiscal Stability.

6. DISCUSSION AND BACKGROUND
BACKGROUND

Staff is currently implementing the Human Capital Management module as part of the City's new Enterprise Resource Planning (ERP) system. Given the significance of payroll as the City's largest operating expenditure and the opportunity to validate existing processes before implementation of the new system, staff recommended engaging an independent firm to perform an Agreed-Upon Procedures (AUP) engagement. The purpose of the AUP was to independently assess payroll calculations, evaluate internal controls, and identify opportunities to strengthen payroll governance. On February 24, 2026, the City Council approved the agreement with LSL Certified Public Accountants (LSL) to perform the City's annual financial audit services and the Payroll AUP.

DISCUSSION

LSL began fieldwork for the Payroll Agreed-Upon Procedures (AUP) engagement in May 2026. The engagement included interviews with Human Resources and Payroll staff and testing of 47 payroll transactions covering employee compensation, leave and time-off, payroll internal controls, and overtime pay.

While the AUP did not identify errors in payroll calculations or employee compensation, LSL identified several opportunities to further strengthen internal controls and improve policy clarity.

The AUP identified two significant internal control findings:

- Strengthening segregation of duties between Human Resources and Payroll by assigning responsibility for employee data management to Human Resources and Payroll is responsible for payroll processing.
- An independent review of changes to the employee data such as pay rate, deductions, and accrual.

And the AUP has two operational improvement recommendations:

- Clarifying Memoranda of Understanding (MOUs) by specifying the pay rates used for vacation, sick leave, and overtime calculations.
- Clarifying MOU provisions regarding the treatment of accumulated sick leave upon separation.
- Establishing a best practice review process whereby proposed MOU provisions are reviewed by executive management and the City Attorney prior to labor negotiations and provided to CalPERS for review before implementation.

Many of these recommendations are procedural in nature and are intended to improve the clarity of the City's MOUs and strengthen internal controls. Importantly, the AUP did not identify errors in employee compensation or payroll calculations. Rather, the recommendations are intended to reduce future risk, improve consistency, and align the City's payroll administration with industry best practices.

<u>Message from Audit Committee</u>

The Audit Committee had a special meeting on July 30th to review the AUP results. Overall, the Committee congratulated staff on a successful audit as the audit did not note any material miscalculations or errors with the payroll process. The Committee acknowledged LSL's recommendations and expressed concerns with three findings. The Committee strongly recommend the City Council direct staff to:

- Establish clear segregation of duties between Human Resources and Payroll;
- Establish an independent review of changes to the employee data; and
- Clarify the MOU languages in the upcoming negotiations.

The Committee emphasized that implementing these recommendations would significantly strengthen the City's internal control environment by improving segregation of duties, enhancing independent oversight of employee data changes, and reducing the risk of errors or unauthorized changes to payroll records.

CONCLUSION

Overall, the AUP provides independent assurance that the City's payroll calculations and payments are accurate while identifying opportunities to further strengthen governance and internal controls. Staff concurs with the recommendations, which are consistent with the City's ongoing efforts in recent years to strengthen governance, clarify business process ownership, enhance internal controls, and promote accountability and transparency across the organization.

7. ATTACHMENTS

- City of Orange Payroll AUP