Agenda Item

Audit Advisory Committee

Item #: 2.1.	7/30/2026	**File #:** 26-0437

TO: **Chair and Members of the Audit Advisory Committee**

FROM: **Trang Nguyen, Finance Director**

1. SUBJECT

Results 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 evaluated payroll calculations, leave administration, overtime, and internal controls. While no exceptions were identified related to employee compensation or payroll calculations, the report includes several recommendations to strengthen internal controls and clarify provisions within the City's Memoranda of Understanding.

3. RECOMMENDED ACTION

1. Receive the results of the Agreed Upon Procedures for Payroll; and
2. Provide comments and recommendations for the presentation of the report to the City Council.

4. DISCUSSION AND BACKGROUND

BACKGROUND

On February 24th, the City Council approved the agreement with LSL Certified Public Accountants (LSL) for the annual financial audit services and an Agreed Upon Procedure (AUP) for Payroll. Prior to the approval of the agreement, staff reviewed the scope of work and received feedback from the Audit Committee on February 12th.

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.

Overall, the AUP concluded that the City's payroll calculations and payments were accurate. LSL found no exceptions related to employee compensation, payroll calculations, leave accruals, overtime calculations, Fair Labor Standards Act (FLSA) compliance, or information technology controls.

The AUP identified several opportunities to strengthen policies and internal controls, including:

- 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.
- Strengthening segregation of duties between Human Resources and Payroll by assigning responsibility for maintaining employee pay rates to Human Resources and implementing an independent review of pay rate changes. LSL identified this as a significant deficiency in internal controls.
- 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.

Staff is seeking recommendations from the Committee on the presentation of the results to the City Council. Feedback and recommendations from tonight will be included in the report to the City Council.

5. ATTACHMENTS

- City of Orange Payroll AUP