TEXAS REAL ESTATE COMMISSION

Internal Audit Services

AN INTERNAL AUDIT OF

Payroll

Report No. 26-002

February 11, 2025

This report provides management with information about the condition of risks and internal controls as a specific point in time. Future changes in environmental factors and actions by personnel may impact these risks and internal controls in ways that this report cannot anticipate.

Internal Audit Report Summary

Audit Report #:	26-002
Audit Name:	Texas Real Estate Commission Payroll Audit
Audit Report Date:	December 30, 2025
Internal Control Assessment Rating	Some Improvement Needed
Business Objective:	To establish management controls and procedures that ensure position classification complies with state and federal regulations, and that overtime and compensatory time are earned, approved, recorded, and used according to regulations and internal policies and procedures.
Scope:	The audit scope period was September 01, 2023 through September 01, 2025.
Conclusion:	The management controls and procedures related to position classification, overtime and compensatory time comply with state and federal regulations and are operating effectively. There are opportunities to enhance the controls and processes by updating policies and procedures and strengthening internal documentation.

	High	**Medium**	**Low**	**Total**
Total Number of Findings by Risk Ranking:	**0**	**1**	**0**	**0**

Total Number of Improvement Opportunities	**1**

Why This Review Was Conducted:

McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the Texas Real Estate Commission performed this internal audit as part of the approved FY 2026 Annual Internal Audit Plan.

Conclusion

The purpose of this audit was to determine whether TREC has established effective and efficient payroll processes that ensure timely and accurate compensation for employees, including the proper management of overtime and compensatory time, in compliance with applicable laws, regulations, and internal policies.

TREC has established controls and procedures to ensure position classification complies with state and federal regulations and that overtime and compensatory time are earned, approved, recorded, and used according to applicable requirements. Based on the audit procedures performed, we conclude that these controls and procedures require some improvement. Specifically, documentation of pre-approval for overtime and compensatory time and formalization of the employee reclassification process should be strengthened to ensure compliance with regulations and internal policies. Recommendations to address the internal control weaknesses identified are included in the table below.

Business Objective / Focus Area	Business Risk Rating	Control Effectiveness	Recommendation(s) and Opportunities for Improvement	Root Cause			
				Governance	People / Staffing	Processes	Technology
Business Objective #1 Organizational Planning	Inherent Risk: **Medium** Residual Risk: **Medium**	Generally Effective (See Business Objective #1)	**Recommendations to Address Findings** 1. Reinforce the existing overtime pre-approval requirement outlined in the Employee Handbook by communicating the policy through training and reminders and developing a standardized overtime request form with HR acknowledgment. Additionally, update the Employee Handbook to reference the need for directors to maintain documentation of the pre-approval, and include Human Resources in communication between directors and employees to ensure related documentation is maintained.	X		X	
			2. Reinforce the existing weekly director overtime approval requirement outlined in the Employee Handbook by communicating the policy through training and reminders, formalizing quarterly compensatory and overtime audits to monitor compliance, and implementing accountability measures for policy non-compliance.	X		X	

Business Objective / Focus Area	Business Risk Rating	Control Effectiveness	Recommendation(s) and Opportunities for Improvement	Root Cause			
				Governance	People / Staffing	Processes	Technology
			Opportunity for Improvement OFI 1. Consider formalizing the employee reclassification process in the HR procedures manual to ensure consistency, transparency, and compliance with applicable laws and internal policies. The language should outline the criteria for initiating a reclassification, required documentation, approval workflow, effective dates, and communication protocols.			X	

Introduction

We performed this audit as part of the approved FY 2026 Annual Internal Audit Plan. This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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 accomplishes that requirement.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach. A detailed summary of audit activities performed is included in Appendix A.

Functional Area Responsibilities and Activity Summary

This section of the report provides a summary of policies, procedures, and responsibilities of the Human Resources and Payroll (HR/Payroll) departments with respect to position classification, overtime, and compensatory (comp) time.

TREC's Employee Handbook aligns with Texas Government Code §659.015 and the Texas Payroll/Personnel Resource – Overtime Policy, which defines overtime rules. Characteristics of exempt or non-exempt positions are defined by the Fair Labor Standards Act (FLSA), and each entity is required to classify its positions accordingly.

Segregation of duties in payroll processing is documented in the Payroll Processing Guide. HR manages classification records, while Payroll calculates overtime and compensatory time, verifies supervisor approvals, and enforces policies on comp time usage. Finance confirms fund availability before payroll runs and releases payments after validation.

Positions are classified as non-exempt under the FLSA when they are eligible for overtime compensation and compensatory time for hours worked beyond 40 in a workweek. Positions are non-exempt unless they meet the following FLSA exemptions based on responsibilities performed:

- Executive
  - Manages the enterprise or subdivision of the enterprise, directs the work of at least two other full-time employees, and has the authority to make hiring, termination, promotion, or other change in status for other employees.

- Administrative
  - Performs office or non-manual work directly related to the management or general business operations of the employer. Employee exercises discretion and independent judgment with respect to matters of significance.

- Professional
  - Performs work requiring advanced knowledge, which is defined as work that predominantly is intellectual in character, and which includes work requiring consistent exercise of discretion and judgment.

- Computer
  - Employed as a skilled worker in the computer field, with responsibilities consisting of managing, implementing, and analyzing the application of computer system functionality.

Non-exempt employees at TREC may work overtime and earn compensatory time at a rate of 1.5 hours for each hour of overtime worked. TREC does not provide monetary payment for overtime hours. The only exception occurs when an employee transitions from non-exempt to exempt status and has accrued compensatory time; in that case, the accrued time will be paid out.

Management provided an Active Employee Roster as of September 30, 2025 with 151 employees, with 87 classified as non-exempt and 64 classified as exempt. **Exhibit 1** illustrates the division of these employees based on FLSA regulations.

Employee Classification	Number of Employees
Non-Exempt Total	87
Exempt • Executive • Administrative • Professional • Computer Total	 11 28 15 10 64
Total Employees	151

Exhibit 1: TREC Non-Exempt and Exempt Employee Classifications

Exhibit 2 below shows monthly gross payroll for FY 2024 and FY 2025. Because payroll amounts fall within a narrow range, the y-axis is zoomed to highlight month-to-month variations. Overall, payroll levels are consistent across both years, with expected fluctuations related to staffing and payroll timing. Overtime was immaterial in both periods—$260.32 in FY 2024 and $3.42 in FY 2025—representing less than 0.03% of total gross pay; therefore, it is not shown separately on the chart.

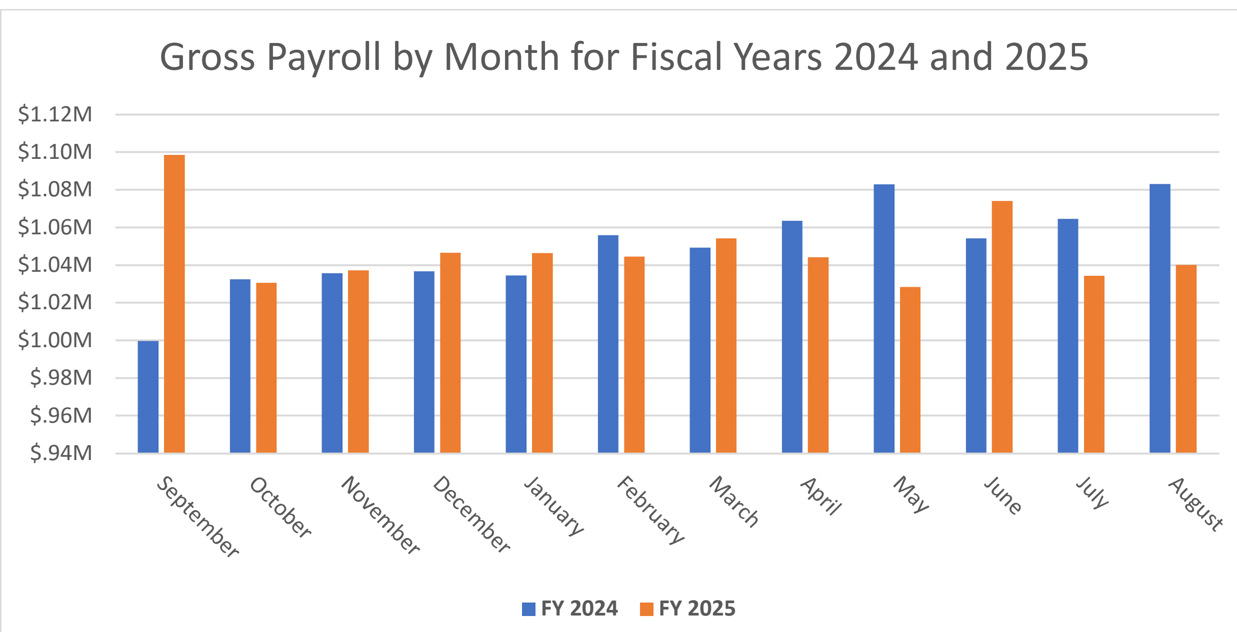

Exhibit 2: Monthly Gross Payroll for Fiscal Years 2024 and 2025

Exhibit 3 provides an overview of the organization structure of TREC's Human Resources and Payroll Departments.

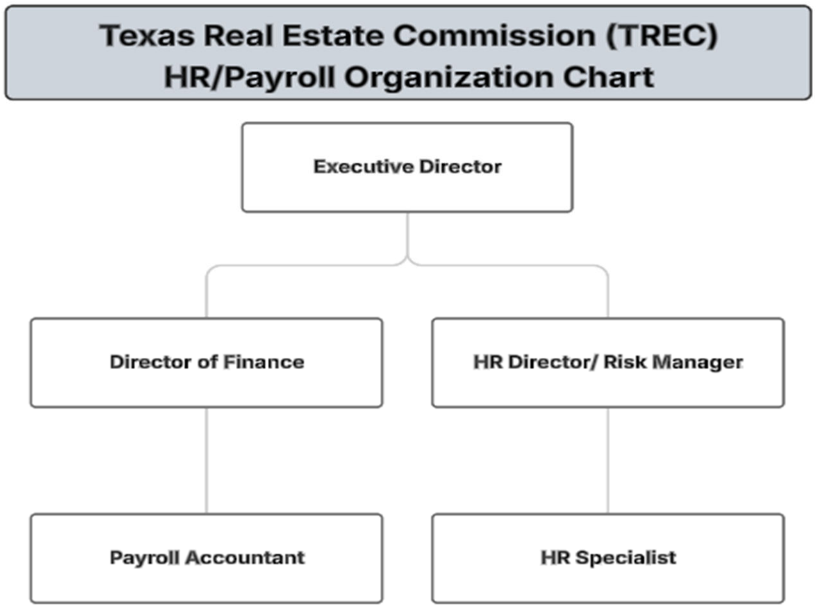

Exhibit 3: Human Resources and Payroll Organizational Structure

Exhibit 4 illustrates the TREC Overtime Request Workflow, which outlines the steps employees and supervisors must follow to ensure compliance with pre-approval requirements and documentation standards.

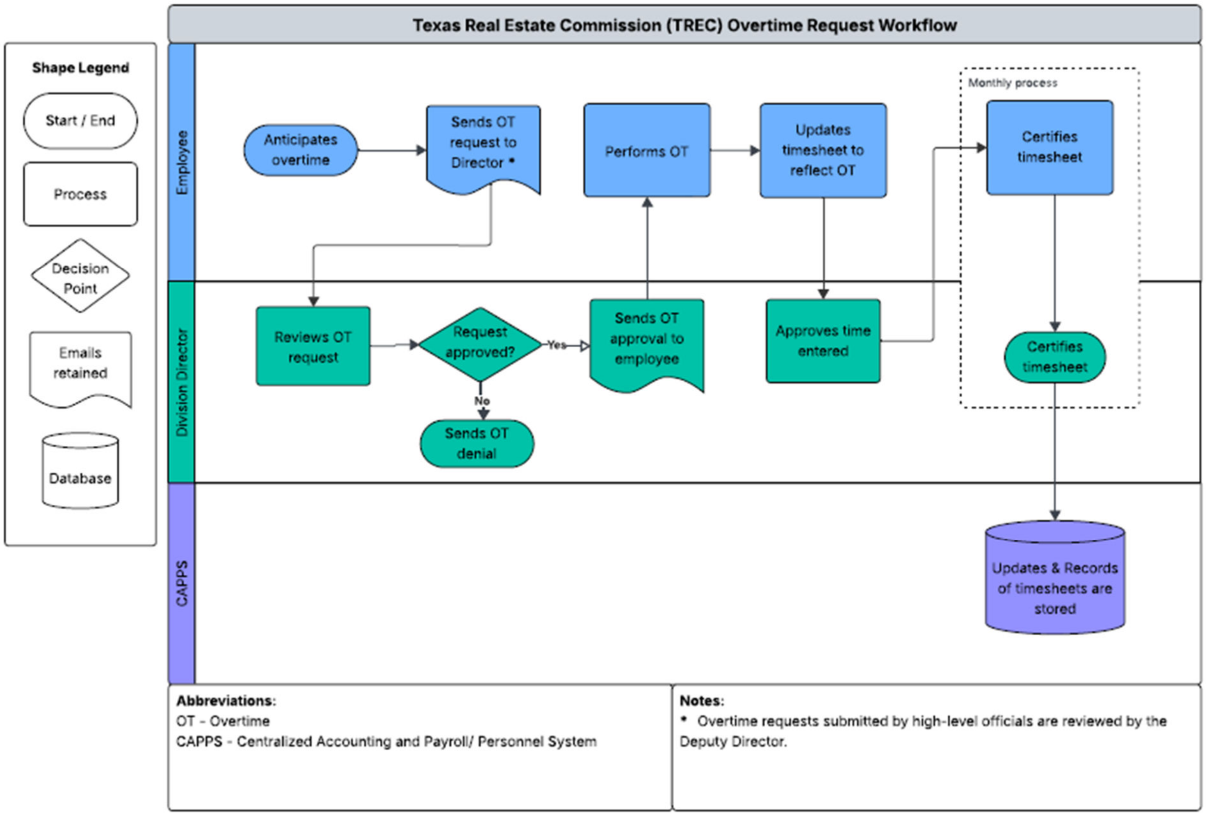

Exhibit 3: TREC Overtime Request Workflow

Findings and Risk Rating Summary

We define a finding as an internal control weakness or non-compliance with required policy, law, or regulation. We define an improvement opportunity as an area where the internal control or process is effective as designed but can be enhanced.

Inherent risk is the business risk associated with the respective function or process if internal controls were not in place or were not effective (what could go wrong). Residual risk is Internal Audit's ranking of the remaining risk or likelihood of a negative event occurring with the internal controls and processes in place.

The Internal Audit Report Summary located on the first page of this report provides a summary of our audit results. See the Detailed Business Objectives, Focus Areas, and Internal Controls Discussion section of this report for more information on issues identified, recommendations, and management responses.

Detailed Business Objectives, Focus Areas, and Internal Controls Discussion

This section of the report provides discussion on the audit's focus areas, grouped by business objective, and provides a summary of our audit procedures, findings, and recommendations. Each business objective includes the definition, inherent risk to the organization if controls were not in place or were not working, and the residual risk to the organization's ability to achieve the respective business objective based upon the effectiveness of controls and processes in place.

Business Objective #1: Operations & Technology (Control Activities)

Operations & Technology refers to the processes, controls, and technology in place to ensure that the respective department or function executes its responsibilities in an effective and efficient manner. This involves implementing standardized procedures, automated controls, and checklists to ensure compliance with relevant laws and internal policies. Control activities are designed to prevent and detect errors, fraud, and inefficiencies, thereby safeguarding the organization's assets and ensuring the reliability of financial and operational information. Effective control activities are essential for maintaining operational integrity, enhancing performance, and achieving organizational objectives.

Business Objective(s):

To establish management controls and procedures that ensure position classification complies with state and federal regulations, and that overtime and compensatory time are earned, approved, recorded, and used according to regulations and internal policies and procedures.

Audit Focus Areas of This Discussion:

We focused on internal controls and business processes for the following activities:

- Documentation of payroll policies and procedures
- Overtime and compensatory time

Business Risk Ranking

Risk	Low	Medium	High
Inherent		X	
Residual		X	

Control Rating

Generally Effective	Some Improvement Needed	Major Improvement Needed	Unsatisfactory
	X		

Root Cause

Governance	People / Staffing	Processes	Technology
X		X	

Policies and Procedures

We reviewed the TREC Employee Handbook and the Payroll Processing Guide to determine if payroll policies and procedures are current and formally documented. We compared these policies to applicable laws and regulation guidelines related to overtime and compensatory time and found no inconsistencies.

However, we noted the HR procedures manual does not contain language to address reclassifications resulting from agencywide employment classification reviews. TREC conducted an agencywide classification review to ensure classifications aligned with FLSA standards. This review resulted in some positions being reclassified between August and October 2025. There was no documented policy or procedure to govern this process.

In addition, we noted that some practices do not align with the requirements outlined in the Employee Handbook. For example, we learned in our discussions with management, it is common for Directors to inform employees they may work overtime as needed during periods of increased workload to complete specific projects. In these instances, employees worked overtime without submitting a request or obtaining documented approval in advance, as required by policy. The Employee Handbook does not include criteria for authorizing this practice and does not instruct Directors or employees to document the request and approval. The Employee Handbook directs the employee to record the hours worked over schedule in the electronic timekeeping system.

Classification of Positions and Overtime Approval Process

We selected a sample of 15 employees and reviewed their position job descriptions to determine if they met the FLSA exemption criteria. We noted no exceptions.

We also reviewed the January 2025 and September 2025 Time and Leave Report to confirm the overtime or compensatory time records are consistent with the position classification and were recorded/calculated correctly for each employee selected. Each hour of overtime earned by a non-exempt employee converts to 1.5 hours of compensatory time, and exempt employees can only earn compensatory time. We noted that five employees had their classification change delayed until October 1 due to errors in CAPPS (State of Texas HR System). We reviewed the October 2025 Time and Leave Report and verified the classification change was properly reflected and calculation had been corrected for each employee. We found no exceptions.

We requested documentation confirming Division Director pre-approval for overtime and compensatory time; however, no such documentation was maintained. As a result, we could not confirm whether overtime and compensatory time were authorized in accordance with policy.

Findings and Opportunities for Improvement

Finding:

1. TREC's current practices for authorizing, documenting, and approving overtime and compensatory time are not fully aligned with the requirements established in the Employee Handbook. Policies require employees to obtain documented pre-approval before working overtime and require Directors to review and approve compensatory time earned on a weekly basis in CAPPS. However, existing practices do not consistently ensure adherence to these requirements, and monitoring controls are insufficient to enforce compliance.

Examples Noted:

a) **Lack of Pre-Approval Documentation for Overtime:** For a sample of 15 employees, we requested documentation demonstrating that the employee received pre-approval from their director to work overtime, when applicable. Of 15 employees reviewed, four were not applicable for this test. Of the remaining 11 applicable cases, 11 exceptions were identified where required supervisor pre-approvals were not documented as required by policy. In addition, when a supervisor grants employees the ability to earn overtime or comp time, documentation of such pre-approval was not maintained.

b) **Lack of Approvals for Compensatory Time in CAPPs:** For a sample of 15 employees, we reviewed the Management Approval Audit Report generated from CAPPS to determine whether compensatory and overtime hours were supported by documented director approval, as required by the Employee Handbook. Six employees were not applicable for this test. Of the remaining nine applicable employees, we noted five instances in which compensatory time did not have documented weekly director's approval in the CAPPS system, as required by policy. Policy requires directors to approve compensatory time earned on a weekly basis; however, TREC does not have a formal enforcement mechanism or a formal monitoring process to ensure compliance with this requirement. Current monitoring activities consist of informal, undocumented quarterly reviews of compensatory and overtime activity, which do not ensure compliance with the weekly approval requirement.

Opportunity for Improvement:

OFI1. **No Formal Procedure for Employee Reclassification:** TREC does not currently have a formally documented procedure to govern agencywide classification reviews. While reclassifications may occur as business needs arise, the absence of a formalized process increases the risk of inconsistent application, misclassification of employees, and potential non-compliance with applicable laws and internal policies. Our review noted a reclassification process was conducted by Human Resources and General Counsel and implemented in August 2025 – October 2025. However, the reclassification changes were not supported by formally documented approval or a standardized approval process. Establishing a formally documented employee reclassification procedure would help define required approvals, standardize documentation, and mitigate the risk associated with undocumented approval practices.

Recommendations to Address Findings:

1. **Strengthen Compliance with Overtime Pre-Approval Requirements:** TREC should reinforce the existing requirement outlined in the Employee Handbook by communicating the policy:
   - Communicating expectations to Directors and employees through targeted training and periodic reminders.
   - Developing a standardized overtime/comp time pre-approval form or electronic workflow with HR visibility or acknowledgment.
   - Updating the Employee Handbook to explicitly require Directors to maintain documentation of all overtime pre-approvals.
   - Ensuring HR is included in communication or documentation procedures to support consistent recordkeeping across divisions.

   These actions will help ensure all overtime is supported by documented approval and reduce the risk of policy non-compliance.

2. **Strengthen Monitoring and Enforcement of Weekly Compensatory Time Approvals:** To ensure Directors consistently review and approve compensatory time earned on a weekly basis, TREC should:
   - Reinforce the weekly approval requirement through training and periodic reminders.
   - Formalize quarterly reviews or audits of compensatory and overtime activity to verify compliance.
   - Implement accountability measures for non-compliance to ensure expectations are understood and enforced.

   These actions will promote consistent weekly approval and reduce the risk of compensatory time being earned or paid without proper authorization.

Improvement Recommendation

OFI 1. **Formalize the Employee Reclassification Process: TREC should** formalize and document the employee reclassification process in the HR procedures manual to ensure consistency, transparency, and compliance with applicable laws and internal policies. This should include:

- Criteria or triggers for initiating a reclassification.

- Required documentation to support the classification decision.
- Defined approval workflow and responsible roles (e.g., HR, General Counsel, Division Director).
- Documentation and record-retention expectations.
- Effective date guidance.
- Communication protocols for affected employees and system updates.

Formalizing the reclassification process will help ensure consistent application and reduce risks associated with undocumented or inconsistent reclassification practices.

Management Response:

1. Management agrees with the recommendations. TREC will conduct training with division directors and managers to remind them of their responsibility to receive requests in writing (via email) to work overtime and that they will be responsible for keeping the requests for future reference. This training will also reiterate that it is recommended that regular compensatory time be approved on a weekly basis by directors, but that directors can require employees to submit time on a schedule best suited for their division and that all time (to date) must be approved by the director or time administrator before payroll is processed. (*See Employee Handbook, ages 26 and 34)*

   Training will happen before the end of March 2026.

OFI 1. Management agrees with the opportunity for improvement. A process/procedure document has been drafted to address performing any FLSA reclassification reviews and approvals in the future. This process/procedure became effective February 1, 2026. A copy of the document has been provided to Internal Audit.

Appendix A: Audit Activities Performed

The detailed procedures performed as part of this audit are presented in the table below.

AUDIT ACTIVITIES PERFORMED	
Criteria Used	➲ COSO Internal Control Integrated Framework – Operations and Technology ➲ Fair Labor Standards Act (FLSA) ➲ Texas Government Code, Section 659 Compensation ➲ Texas Comptroller's Office Overtime Policy
Management Controls in Place	➲ Written policies and procedures guide overtime and compensatory time responsibilities for ensuring compliance with regulatory requirements. ➲ HR and Payroll systems maintain employee classification records aligned with job description and FLSA criteria. Classification is reviewed during onboarding and periodically by HR. ➲ Payroll systems automatically calculate overtime and compensatory time based on hours worked and employee classification. Supervisors approve time entries before payroll processing. ➲ Payroll policies restrict payout of state compensatory time and require usage within 12 months. The information system flags unused compensatory time nearing expiration and notifies employees.
Control Tests Applied	➲ Reviewed internal policies and procedures to determine alignment with applicable laws and regulations. ➲ Performed a sample-based review of employee records to verify that classification as exempt or non-exempt is accurate and consistent with job descriptions and FLSA criteria. ➲ Performed a sample-based review of payroll records to verify that overtime and compensatory time were calculated accurately, properly approved and configured in accordance with policy and that comp time accruals did not exceed regulatory limits. ➲ Performed a sample-based review of employee records to verify that compensatory time was properly used within the required timeframe.