

Payroll Expenditures Audit February 2011

Patrice Randle, City Auditor
Craig Terrell, Assistant City Auditor
Michelle Brown, Staff Auditor

Payroll Expenditures Audit Table of Contents

	<u>Page</u>
Executive Summary	1
Audit Scope and Methodology	2
Background	2
Detailed Audit Findings	7

Payroll Expenditures Audit



Office of the City Auditor
Patrice Randle, CPA
City Auditor

Project # 10-05

February 18, 2011

Executive Summary

Employee pay is calculated accurately

Deductions are properly supported

Remittals of employee deductions are timely

Reporting is accurate, timely and in compliance with the law

Opportunities for Improvement

Create policies and procedures for the use, approval and monitoring of additional pay

Improve communication with the City Attorney's Office concerning amounts owed by terminated employees

As part of the Fiscal Year 2010 Annual Audit Plan, the City Auditor's Office conducted an audit of Payroll Expenditures. The audit was conducted in accordance with generally accepted government auditing standards, except for peer review. 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. The objectives of this audit were to determine if:

- employees are receiving authorized pay that is calculated properly;
- deductions from employee pay are valid, accurate and properly withheld;
- remittals of deductions are accurate, timely and in compliance with applicable law and procedures;
- required reporting is timely and in compliance with applicable law; and
- additional pay categories currently offered are valid and necessary.

The City Auditor's Office noted the Financial and Management Resources Department (FMR) has established adequate controls over the payroll process. Payroll personnel ensure that employee pay, including terminal pay, deductions and remittals are calculated accurately and paid properly in a timely manner. Additionally, FMR personnel prepare reports required by the federal government, such as Forms 941 and W-2, that are accurate, timely and in compliance with applicable laws and regulations.

Although adequate controls are in place, the City Auditor's Office noted an opportunity for improvement in the additional pay process. Additionally, testing indicated that the City did not seek payment of tuition reimbursement owed by a terminated employee. These findings and recommendations are discussed in the Detailed Audit Findings section of this report.

Audit Scope and Methodology

Documentation, correspondence and transactions from calendar year 2009 and calendar year 2010 through June, were included in the scope of this audit.

The audit was conducted in accordance with generally accepted government auditing standards, except for peer review. The following methodology was used in completing the audit.

- Interviewed staff within the Payroll Division to gain an understanding of the payroll process
- Performed tests to ensure that additional pay was properly authorized and recorded
- Reviewed and tested W-2 and 941 Forms required by the Internal Revenue Service (IRS) to ensure that reporting is timely and in accordance with applicable law
- Conducted tests to ensure that employee pay is properly calculated, voluntary and mandatory deductions are accurate and adequately supported; and remittals are submitted to vendors like the Texas Municipal Retirement System (TMRS) and the United Way in a timely manner.

The City Auditor's Office did not include a review of time records within the Kronos timekeeping system in this audit. A separate audit of the Kronos system was completed in December 2008. That audit concluded that the information in Kronos is accurate and transferred appropriately to the Lawson Financial System (Lawson).

Background

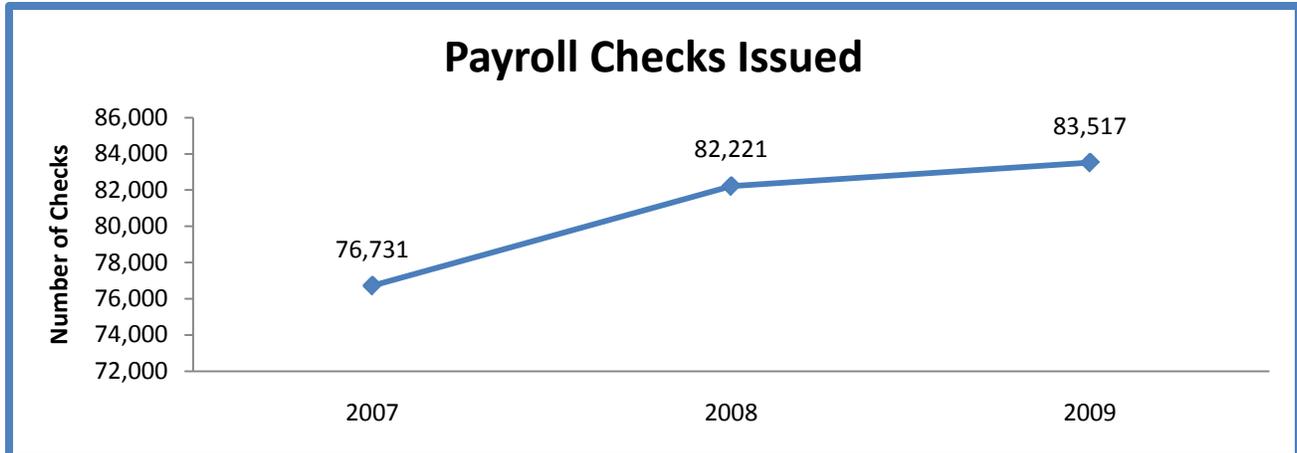
The Payroll Division (Payroll) is responsible for processing time records and deductions in order to produce checks for City employees in compliance with personnel policies. Additionally, Payroll prepares and files an IRS Form 941 quarterly along with preparing, printing, distributing and transmitting annual Form W-2 for all employees. Since its implementation in 2006, Payroll has used the Kronos Timekeeping System and Lawson to accomplish these tasks. Employee time records are recorded and approved in Kronos and the information is transferred into Lawson where it is used to calculate employee pay and issue paychecks. Lawson is also used to record pay types and deductions, issue one-time payments, create reports used for monitoring, and issue payments for remittal of deductions.

While Payroll is ultimately responsible for issuing employee checks, all City departments play a role to ensure that the process is completed appropriately. Employee pay rates are authorized by department management and input to the Lawson system. Each department within the City is responsible for reviewing and approving employee time records in Kronos. Payroll staff then ensures that the time entered is appropriate and properly approved by the department. Additionally, Payroll enters and monitors deductions (except for those related to health benefits which are monitored by the Workforce Services (WFS) Department) and garnishments, ensures that additional pay records have been entered accurately, and processes payroll to issue employees checks. Finally, the Position Control Coordinator within the Office of Management and Budget records additional pay and personnel actions in Lawson.

Payroll staff is made up of five positions. These positions and their responsibilities are summarized below.

- Payroll Supervisor
 - Oversees all payroll activities and processes
 - Files Form 941
 - Creates Form W-2
- Payroll Staff Accountant (2)
 - Processes payroll, corrections and adjustments
 - Processes deductions/garnishments, retiree payout, sick leave sellback and donations, and federal tax deposits
 - Verifies W-4 forms and direct deposits
 - Approves time records in Kronos for the following departments:
 - Airport
 - Community Planning and Development
 - Community Services
 - Fire
 - Handitran
 - Parks
 - Police
 - Public Works
 - Municipal Court
 - Water Utilities
- Payroll Assistant
 - Enters W-4 form and direct deposit information into Lawson
 - Reviews employee deductions
 - Processes payment authorizations
 - Approves time records in Kronos for the following departments:
 - City Attorney's Office
 - City Auditor's Office
 - Convention Center
 - Economic Development
 - Financial and Management Resources
 - Information Technology
 - Judiciary
 - Library
 - Workforce Services
- Lead Data Entry Operator
 - Records retiree payments
 - Maintains status inbox and termination and status change spreadsheet

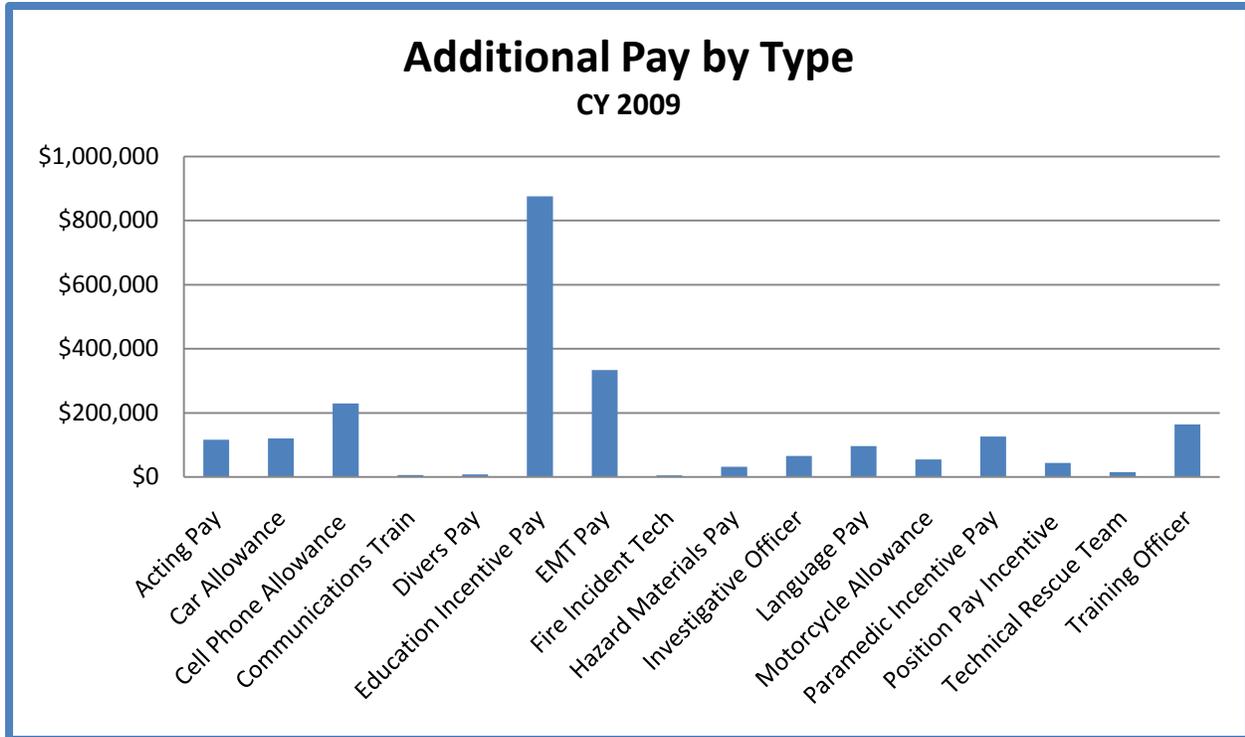
As seen in the following chart, each year Payroll processes over 75,000 payments. During payroll year 2009, 83,517 payments totaling \$107,888,829 were issued to City employees.



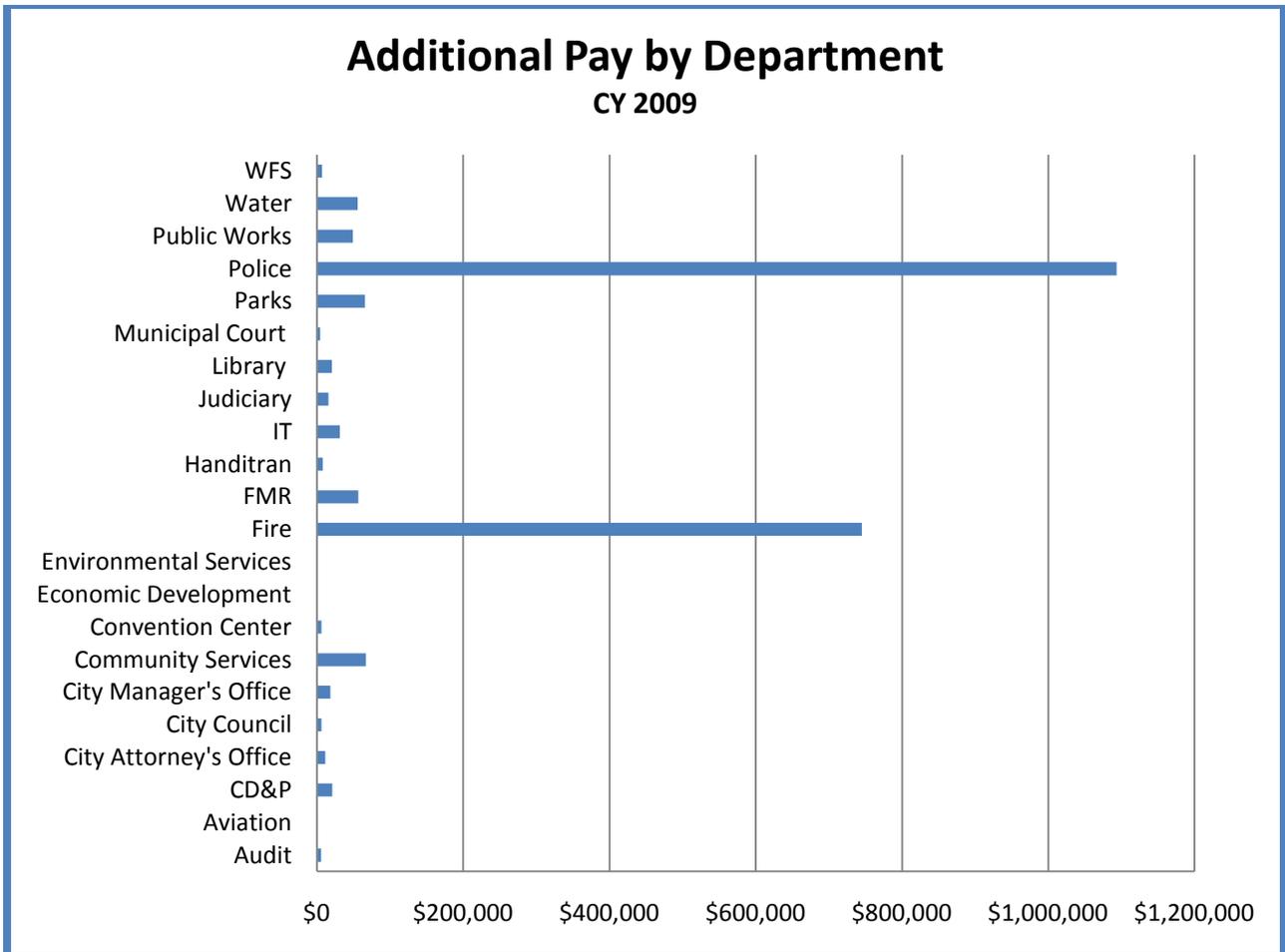
Source: Lawson Financial System

Payroll processes checks in one of two types of check runs, normal or supplemental. Normal check runs occur biweekly and produce payments for all City employees. Supplemental check runs are done outside of the normal, biweekly schedule. According to Payroll procedures, supplemental checks are only processed for employees experiencing great hardship due to the loss of a paycheck or when a significant number of hours were left off the employee's time records resulting in material underpayment. All other corrections and pay adjustments are made to the employee's pay in the next normal pay check run.

The City's payroll is generally made up of three types of pay: regular pay, additional pay and terminal pay. Regular pay consists of all regular employee wages including sick, vacation, holiday and overtime. All regular paychecks are direct deposited into employee bank accounts biweekly. Additional pay is incentive pay given to qualifying employees in addition to their regular pay and is paid each pay period on the same check as regular pay. Examples include language pay and educational incentive pay. As seen in the following chart, the City has 16 categories of additional pay, the largest being Education Incentive Pay and EMT Pay. While additional pay is provided to City employees in various departments, the majority of additional pay is within the Police and Fire Departments. The final type of pay is terminal pay. Terminal pay consists of the employee's final check that includes regular wages along with any sick and/or vacation time owed to the employee at the time of resignation, retirement or dismissal. Terminal payments are manual checks normally printed at the same time as paychecks and are mailed by Payroll or held for pick up by the employee.



Source: Lawson Financial System



Source: Lawson Financial System

Detailed Audit Findings

1. Internal controls over the additional pay process can be improved.

Sound business practices suggest that supervisors should authorize the pay received by their employees since supervisors are responsible for the activities and budget within their department/division. Control activities, including supervisor approval, help ensure that management directives are carried out and that identified risks are adequately addressed.

To initiate additional pay, current payroll procedures require that an additional pay form be completed and sent to the "Status Authorization" email box. The Position Control Coordinator reviews the forms for completeness and records the additional pay information in Lawson. Although procedures do not require that supervisors complete, approve and send the additional pay forms, the Position Control Coordinator indicated that the forms are generally received from supervisors, with the exception of certain departments that have delegated that authority to payroll coordinators.

The City Auditor's Office tested additional pay transactions and noted that the Position Control Coordinator processed requests for additional pay in accordance with established procedures. However, Lawson lacks automated controls that prohibit the recording of an additional pay record without supervisory authorization. In addition, there are no field edit controls for additional pay records that would prohibit or limit the amount of additional pay that can be entered by the Position Control Coordinator. The Lead Data Entry Operator, within the Payroll Division, also reviews the forms sent to the "Status Authorization" email box and compares the forms to the information recorded in Lawson by the Position Control Coordinator. While this review will identify input errors, it would not identify if the Position Control Coordinator recorded additional pay information in Lawson without receiving a form in the "Status Authorization" email box. Since field edit controls do not exist for additional pay in Lawson, a review by Payroll staff prior to processing payroll would reduce the risk of unauthorized changes in additional pay. The City Auditor's Office noted that a Lawson table exists that can be queried to identify additional pay changes made by the Position Control Coordinator.

Monitoring is a key component of internal control that assesses the quality of performance over time. While FMR staff provides payroll registers to departments for review after payroll has been processed, FMR does not receive positive confirmation or verification that management has actually reviewed the registers. Departments already provide this confirmation indirectly through the annual budget process and review of biweekly payroll registers. However, City management may feel that a periodic positive confirmation (similar to that provided for asset inventories or cell phone allowances) is necessary.

The City Auditor's Office noted that additional pay amounts did not exceed the authorized limits established by City and/or departmental policy. In addition, the City Auditor's Office conducted limited testing of public safety employees that transferred to non-public safety departments over the past five years. No instances were found where an employee erroneously continued to receive additional pay for an ineligible position. However, auditor review of additional pay records for negative amounts over the past two calendar years indicated that 16 employees received additional

pay for as many as 78 weeks for which they were subsequently determined to not be entitled. Another 13 employees returned additional pay granted in error for calendar years 2007 and 2008. Testing revealed that a former employee received educational incentive pay after the employee was rehired, even though the employee's new position was not eligible for the additional pay. After nineteen weeks, the City deducted the amount of the erroneous additional pay received from the employee's future paychecks. The City has discontinued additional pay authorizations in Lawson for terminated employees.

Recommendation:

The Director of Financial and Management Resources should update policies and procedures to require that documentation of Department Head/Supervisor approval of additional pay be retained, including documentation of any delegation of that responsibility.

Management's Response:

Concur. The Position Control Coordinator, under the supervision of the OMB Coordinator, will update the policies and procedures to require this documentation. Departments will be notified of the policy in a memo from FMR.

Target Date: March 31, 2011

Responsibility: April Nixon, Director of Financial and Management Resources

Recommendation:

The Director of Financial and Management Resources should require that a Payroll staff member identify and confirm that additional pay entries recorded in Lawson by the Position Control Coordinator are complete and properly supported.

Management's Response:

Concur. Currently the Lead Data Entry Operator confirms that all additional pay entries supported by authorized Additional Pay Forms are correctly recorded into Lawson. The Payroll Supervisor will take additional steps to develop a procedure to reasonably identify additional pay entries that may be entered in Lawson but are not properly supported by an authorized Additional Pay Form.

Target Date: March 31, 2011

Responsibility: Sherry Wright, Assistant Director of Financial Operations

Recommendation:

The City Manager should consider requiring that department directors periodically (at least annually) confirm that employees receiving additional pay are still eligible.

Management's Response:

Concur. To assist in this effort, the Payroll Supervisor will send a complete list of employee additional pay records to each department director on an annual basis. The list will be accompanied by instructions directing each department head to review the additional pays

and inform the Payroll Division of any ineligible recipient. The Payroll Division will then take any necessary corrective action.

Target Date: June 30, 2011

Responsibility: Sherry Wright, Assistant Director of Financial Operations

2. The City did not seek collection of tuition reimbursement owed by a terminated employee.

According to the City's Personnel Policies chapter 307.03 section F, the "City offers regular full-time employees who have successfully completed their initial probationary period reimbursement for tuition and applicable fees for courses taken for credit that directly relate to an employee's present position or to a position of possible promotion, or where there is reasonable expectation that the employee will have an opportunity to move into that career field." The policy stipulates that an employee must maintain employment with the City for two years or repay the amount reimbursed by the City.

WFS indicated that they have a process in place to determine if terminated employees owe the City for tuition reimbursement. WFS reviews an Excel spreadsheet received from Payroll that includes a list of terminated employees each pay period. The spreadsheet is updated by WFS to indicate whether the terminated employees owe tuition reimbursement. If the total amount owed cannot be deducted from the final paycheck, WFS drafts a letter to the employee, stating any remaining balance owed. A copy of the letter is also sent to the City Attorney's Office to begin the collection process. The educational assistance program is currently a part of the City's challenge grant program. Therefore, funding for the program may not continue after fiscal year 2011. However, there will still be a need to identify employees that terminate before the two year employment requirement.

The City Auditor's Office conducted testing that indicated the City did not seek collection of \$2,500 in tuition reimbursement from one employee who was terminated prior to the two year requirement. WFS explained that Fair Labor Standards Act (FLSA) guidelines prevented them from deducting the \$2,500 from the employee's final check, but failed to notify the City Attorney's Office so collections procedures could begin. Although deductions may generally not reduce final wages below the federal minimum wage, FLSA guidelines provide exceptions for voluntary wage assignments. City employees complete forms authorizing tuition repayment to be deducted from the final paycheck if for any reason employment is terminated within two years after receiving tuition reimbursement. However, since a tuition repayment deduction would have brought the employee's paycheck below minimum wage, the deduction was not taken. FMR staff indicated that they have since consulted with the City Attorney's Office concerning the appropriate amount to withhold from final checks. In addition, WFS staff stated that proper steps would be taken to begin the collections process.

Recommendation:

The Deputy City Manager over Workforce Services should ensure that tuition repayment is sought from employees terminating employment within two years after receiving tuition reimbursement.

Management's Response:

Concur. Process improvements were implemented to ensure 100% compliance.

Target Date: Completed.

Responsibility: Lisa Coburn, Workforce Services Manager