



CITY OF GARLAND, TEXAS

PAYROLL CHECK-OFF AUDIT

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Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY	1
INTRODUCTION	
Authorization	5
Scope and Methodology	5
Overall Conclusion	6
Background	7
OPPORTUNITIES FOR IMPROVEMENT	8

EXECUTIVE SUMMARY

OBJECTIVES:

- To determine if any City paychecks are going to fictitious or nonexistent employees.
- To determine if effective internal controls exist to remove terminated employees from the monthly payment to the health insurance providers.

OVERALL CONCLUSION:

While the procedures followed in this audit were not part of Payroll Audit #0711, it was apparent that a payroll check-off audit was needed. The City has not had an audit in a number of years. The payroll process is a cooperative effort between the City departments, Human Resources, and Financial Services. Overall, the payroll process is well run. This audit provides Opportunities for Improvement.

We did not identify any funds lost to payroll fraud. We were able to confirm the existence and identity of all City employees in the sample we tested. Additional test for payroll fraud using the personnel and payroll databases and investigations of anomalies in these records also did not identify instances of payroll fraud.

OPPORTUNITIES FOR IMPROVEMENT:

We found twenty-one employees who were not receiving paychecks yet remained in an active status in the payroll system.

Recommendation: We Recommend management should terminate every employee who has not worked in the last thirty work days unless there is a specific reason for keeping them active, such as leave without pay, short-term disability, or family medical leave.

The City Manager should review and approve any request to keep an employee active when they are not actually working.

Human Resources should monitor employees who do not receive checks but remain active in the payroll system. The department managers would be notified when an employee is not receiving a check and that City Manager approval is required to keep the employee on an active status.

Management Response:

Human Resources and Financial Services will monitor the existence of employees who do not receive checks but remain active in the system and follow-up with the departments where these employees are being kept on active status. Also, Human Resources and Financial Services will provide guidance on this matter at the quarterly PAF rep meetings.

We found the City paid insurance for two terminated employees for one month after termination.

Recommendation: We Recommend Human Resources further investigate the billing question and determine if the action is a standard practice or an error in billing. If we are billed in error, Human Resources should review the 2007 billings and calculate the amount of overcharge and request a refund of the charges.

Management Response:

In January, Financial Services took over responsibility for the payment of the various insurance premiums. The reason for this action was to insure the proper payment of premiums to insurance vendors and to eliminate reconciling differences between payroll deductions and vendor premium payments. The discrepancies noted in the audit should be pursued since they occurred in September and October, 2007.

Policies and procedures are missing for disbursement of payroll checks and direct deposit advisements; The City should consider on-line payroll check stubs; Finance payroll directives should be updated.

Recommendation: We Recommend Human Resources develop a directive that establishes a standard citywide policy for distributing and securing paychecks and direct deposit advisements.

Additionally, we recommend Financial Services undertake a campaign to encourage all employees to participate in the direct deposit program. In lieu of printing paychecks and direct deposit advisements, Human Resources should undertake advertising the availability of the online access program for employees wanting to view their personnel and payroll information. The online process would eliminate the need for a new directive on distributing checks and advisements, printing checks and advisements, and manually distributing and securing the pay documents. Human Resources should investigate the possibility of allowing employees to access the online system from their home computer.

Financial Services should update Finance Directives 2 and 3 to reflect the current practice of releasing checks and advisements to department representatives. Additionally, the list of employees authorized to pick up paychecks and advisements should be updated.

Management Response:

All new hires are required to participate in direct deposit of payroll. Also, in the near future Human Resources and Financial Services will be testing the use of Stored Value cards. The Stored Value Card program is an electronic method of paying the current employees that do not participate in direct deposit.

Financial Services will update Finance Directives 2 and 3 to reflect the prescribed payroll distribution procedures.

Access to payroll personnel on payday Fridays needs improvement.

Recommendation: We Recommend Financial Services should move the deadline for notifying Payroll of an error from 10:00 a.m. to 12:00 noon. The revision will allow the departments more time to distribute their checks and find any errors in the checks.

Financial Services should revise the telephone answering process so the departments are not penalized in getting a check corrected or an employee is delayed in getting his check because Payroll does not answer the telephone.

Management Response:

Experience has shown that Financial Services must have a 10:00 a.m. cutoff for the reporting of payroll errors. There are too many circumstances which can jeopardize the proper creation and reporting of checks when there is a later cutoff time. Departments actually have until 10:00 a.m. of the next business day subsequent to payroll distribution date to request corrections for payroll errors.

Financial Services will present alternative error notification procedures at the quarterly PAF rep meetings. These procedures will ensure that error notifications are being addressed promptly. Primarily, departments will be instructed to provide written information to Financial Services as soon as the payroll error is known. Financial Services is able to act upon written information in a timely manner; verbal information communicated by telephone is insufficient support to execute a payroll correction.

Auditor Comment:

All employees would like to get payroll corrections completed promptly. This is particularly so when the employee is owed money. Whether it is by phone or e-mail, it must be provided to Financial Services by 10:00 a.m. on payday. This can be difficult for departments; especially those that need more time to distribute their checks and find errors in the checks. Departments, such as Parks and Recreation, Firewheel, Water and Sewer, and GP&L have remote operations. This requires more time to get the checks to the employees. Subsequently, more time is needed to notify Financial Services when an error is encountered.

We want to thank management and staff for their assistance in this audit. Their assistance was essential for the successful completion of our work.

Authorization

We have conducted a performance audit of the City of Garland's payroll distribution process. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Audit Committee of the Garland City Council.

Scope and Methodology

We conducted the audit in accordance with Generally Accepted Government Auditing Standards, with the exception that no peer review has been performed on this Audit entity in the last three years. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that produces a reasonable basis for our findings and conclusions based on our audit objectives. These included procedures assessing management controls, such as authority to pick up paychecks, distribution process policies and practices, reconciling terminated employees and insurance premiums, and departmental safekeeping practices. Selected Managing Directors were asked to personally verify a list of all employees assigned to their department. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit covered the period for the November 21, 2007 pay date and subsequent periods related to our testing involving the verification of employee identities.

While we report to the Mayor and City Council and present the results of our work to the Audit Committee, we are located organizationally outside the staff or line management functions we are auditing. Therefore, this Audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to those charged with governance.

The objectives of our audit were:

- To determine if there are any City paychecks are going to fictitious or nonexistent employees.
- To determine if effective internal controls exist to remove terminated employees from the monthly payment to the health insurance providers.

To adequately address the audit objectives, we:

- Reviewed laws, directives, policies, and procedures related to preparing the paychecks and distributing them to the employees.
- Reviewed policies and procedures for removing terminated employees from the "active" status in the Human Resources, payroll, and accounts payable systems.

- Reviewed the processes related to printing and reconciling the paychecks to control registers and the bank transfers.
- Prepared a statistical sample of the approximately 2,200 active employees that was used to verify the employee physically exists. The sample had a 98% confidence level with a margin of error of 5%.
- Additional employees were added to the test sample if their employee records show the home address as a post office box, if multiple employees live at the same address and have different surnames and multiple employees with same bank account and have different surnames.
- To verify employee identities, we formed eight teams that went to forty-eight offices to contact 203 employees. This process took approximately three weeks to complete.
- Handed out the pay check or direct deposit advisement to the employees identified in the sample. We went to each worksite to deliver the checks and advisements.
- Examined the Human Resources database to locate any employees with duplicate Social Security numbers.
- Reconciled the number of checks and direct deposits issued to the employees and the number of documents prepared by the Payroll Technician.
- Examined a sample of employee reimbursement checks to determine if the City was paying an employee's insurance premiums outside of the normal payroll cycle.
- Evaluated the process of removing terminated employees from the monthly health insurance premium billings.
- Analyzed the monthly insurance premium billings to determine if the City was paying the premiums for terminated employees and/or the active employees who had not received a current pay check.

Overall Conclusion

While the procedures followed in this audit were not part of Payroll Audit #0711, it was apparent that a payroll check-off audit was needed. The City has not had an audit in a number of years. The payroll process is a cooperative effort between the City departments, Human Resources, and Financial Services. Overall, the payroll process is well run. This audit provides Opportunities for Improvement.

We did not identify any funds lost to payroll fraud. We were able to confirm the existence and identity of all City employees in the sample we tested. Additional test for payroll fraud using the personnel and payroll databases and investigations of anomalies in these records also did not identify instances of payroll fraud.

Background

The City Council adopted the Fiscal Year 2008 operating budget that includes \$165.2 million in personnel expenditures for all City departments. These expenditures are second behind the expected charges for fuel, energy, and demand charges of \$166.0 million in the approved budget. The City had approximately 2,200 employees during the November 21, 2007 pay date.

From January 5, 2007 through November 21, 2007, Human Resources and Financial Services processed approximately 64,560 pay checks and direct deposits for City employees.

Managing the expenditures is a cooperative effort of Human Resources, Financial Services, and user departments. Through a segregation of duties, Human Resources and Financial Services maintain the personnel databases and prepare the bi-weekly payrolls.

Much attention to the “ghost employees” question has been created by recent national newspaper articles and television broadcasts. Dallas Independent School District has experienced problems related to extra-duty pay, stipends, and fictitious employees on their payroll. We are examining our systems and processes so we can identify any problem areas and “ghost” employees.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

1. *We found twenty-one employees who were not receiving paychecks yet remained in an active status in the payroll system.*

In testing the November 21, 2007 and February 1, 2008 pay dates we found twenty-one active employees who did not receive a pay check and had no time entered in the pay period. The employees had not received a pay check for several pay periods. The periods ranged from December 24, 2003 through February 1, 2008.

When an employee's scheduled job has ended, the employee should be terminated from the Human Resources and Financial Services systems. The user department is to send a personnel action form to Human Resources to remove the employee from their active status and stop the possibility of issuing a pay check to an employee who no longer works for the City.

If an employee remains active in the payroll system, a person who has authority to enter and approve time can enter the hours, approve the entry, and retrieve the pay check with no supervisor oversight. The person can control the transaction from start to finish. The situation by-passes the internal controls that prevent a fictitious employee from being entered into the Human Resources and payroll systems.

Most of the employees identified are seasonal or temporary workers. Their employment period has ended and due to a management oversight, the employee has not been removed from the system. Some managers have elected to keep the employees active for occasional special projects.

We Recommend that management terminate every employee who has not worked in the last thirty work days unless there is a specific reason for keeping them active, such as leave without pay, short-term disability, or family medical leave.

The City Manager should review and approve any request to keep an employee active when they are not actually working.

Human Resources should monitor employees who do not receive checks but remain active in the payroll system. The department managers would be notified when an employee is not receiving a check and that City Manager approval is required to keep the employee on an active status.

Management Response:

Human Resources and Financial Services will monitor the existence of employees who do not receive checks but remain active in the system and follow-up with the departments where these employees are being kept on active status. Also, Human Resources and Financial Services will provide guidance on this matter at the quarterly PAF rep meetings.

2. We found the City paid insurance for two terminated employees for one month after termination.

In testing terminated employees and insurance premiums, we found two employees who terminated in September 2007 and were still on the October 2007 billings. They were on the FiServe and Cigna billings even though they only had Cigna insurance. The costs associated with the transactions are \$881.58 for Cigna and \$126.57 for FiServe. The Benefits Clerk had removed the employee from the City's records. She has contacted FiServe in regards to the billing question but to date they have not answered her question about the employees being on both billings.

We Recommend Human Resources further investigate the billing question and determine if the action is a standard practice or an error in billing. If we are billed in error, Human Resources should review the 2007 billings and calculate the amount of overcharge and request a refund of the charges.

Management Response:

In January, Financial Services took over responsibility for the payment of the various insurance premiums. The reason for this action was to insure the proper payment of premiums to insurance vendors and to eliminate reconciling differences between payroll deductions and vendor premium payments. The discrepancies noted in the audit should be pursued since they occurred in September and October, 2007.

3. Policies and procedures are missing for disbursement of payroll checks and direct deposit advisements; The City should consider on-line payroll check stubs; Finance payroll directives should be updated.

A) A part of our verification process was to discuss the practices used by departments when paychecks and direct deposit advisements are distributed to the employees. Our concern with the process is securing the paychecks and advisements so they are not lost or delayed in being delivered to the employee. Employees' personal information and earnings are recorded on the check stubs and advisements. This information is available to other employees who are not authorized to view the information.

We found there are no standard policies and procedures for securing and distributing checks and advisements. Each department handles the process in their own manner.

B) Approximately 350 employees or 16% of the 2,200 employees receive paper paychecks each pay period. The process of printing direct deposit advisements and paychecks consumes paper and time resources. When an employee is not available to receive his advisement or paycheck, there is a possibility of losing the paper document. The industry standard for payroll check distribution is direct deposit.

C) Finance Directives 2 and 3 states that checks and advisements will be available after 3:00 p.m. on every other Thursday. The current practice is to release the checks and advisements after 8:00 a.m. on payday Friday morning. Additionally, the list of employees authorized to pick up paychecks and advisements from Finance has not been updated since April 2006. A number of the authorized employees are no longer employed by the City.

We Recommend Human Resources develop a directive that establishes a standard citywide policy for distributing and securing paychecks and direct deposit advisements.

Additionally, we recommend Financial Services undertake a campaign to encourage all employees to participate in the direct deposit program. In lieu of printing paychecks and direct deposit advisements, Human Resources should undertake advertising the availability of the online access program for employees wanting to view their personnel and payroll information. The online process would eliminate the need for a new directive on distributing checks and advisements, printing checks and advisements, and manually distributing and securing the pay documents. Human Resources should investigate the possibility of allowing employees to access the online system from their home computer.

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Financial Services will update Finance Directives 2 and 3 to reflect the prescribed payroll distribution procedures.

4. Access to payroll personnel on payday Fridays needs improvement.

Departments have to notify Payroll by 10:00 a.m. on payday Friday if a check is incorrect. Payroll is to reissue the new check for the employee.

The department representative picks up the checks at 8:00 a.m., returns to their worksite, and distributes the checks and advisements. If a check is incorrect, the notice has to be made by 10:00 a.m.

During our verification process, we were told that an extension of the 10:00 a.m. deadline would help because the department representative cannot always reach Payroll because the telephone is not answered. This has lead to delays and the employee is late in receiving his check.

We Recommend Financial Services should move the deadline for notifying Payroll of an error from 10:00 a.m. to 12:00 noon. The revision will allow the departments more time to distribute their checks and find any errors in the checks.

Financial Services should revise the telephone answering process so the departments are not penalized in getting a check corrected or an employee is delayed in getting his check because Payroll does not answer the telephone.

Management Response:

Experience has shown that Financial Services must have a 10:00 a.m. cutoff for the reporting of payroll errors. There are too many circumstances which can jeopardize the proper creation and reporting of checks when there is a later cutoff time. Departments actually have until 10:00 a.m. of the next business day subsequent to payroll distribution date to request corrections for payroll errors.

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Auditor Comment:

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