



Payroll Audit

City of Minneapolis
Internal Audit Department
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Executive Summary

As part of our annual Audit Plan approved by the Audit Committee, the City of Minneapolis Internal Audit Department conducted an audit of the City's payroll processes. The objective of this audit was to evaluate financial and operational key payroll process risks and the design adequacy and operating effectiveness of controls to mitigate those risks.

As public servants, it is our responsibility to safeguard taxpayer dollars in the most effective and efficient manner while adhering to laws, regulations and City policies governing payroll processes. Internal controls are placed at various points in payroll processes to ensure financial, operational and other key risks, including risk of fraud, are appropriately managed. The audit scope and approach, testing results, and conclusion are discussed below, followed by a description of the City's payroll processes in the Background section and a detailed description of observations and management's action plans in the final section.

Audit Scope and Approach

The scope of this audit included the processes listed below for two full years of pay cycles from January 1, 2016 through December 31, 2017. The audit approach included:

- Payroll Policies and Procedures
 - Reviewed the Payroll Narrative to ensure key roles and responsibilities are described and consistently followed.
- Payroll Master File
 - Reviewed employee master file to ensure the information is complete and accurate (i.e., no duplicate or missing information) while focusing on potential red flags such as duplicate payments, payments to non-existing/wrong addresses, ghost employees and multiple payments to the same employee during the same pay period.
- Payroll Timekeeping/Testing
 - Leveraging the testing performed by the State Auditors during their annual review of the City's Financial Statements, reviewed recorded time to ensure employees' time was accurately recorded and approved by supervisors prior to payment.
- Payroll Calculations
 - Reviewed the process in place to ensure that pay rates and deductions (i.e., garnishments, union dues, etc.) are accurately processed.
 - Reviewed the process in place to ensure that manual overrides are performed by authorized personnel and approved by someone who does not have access to perform them.
- Payroll Processing and Distribution

- Reviewed a sample of vouchers to ensure they were approved by an authorized person in PeopleSoft Human Resources and payroll processing system (HRIS) prior to payment by Accounts Payable.
- Reviewed a sample of reconciliations of ACH confirmations from Wells Fargo to Payroll Breakdown from HRIS to ensure that Treasury consistently and adequately performs this reconciliation and electronic payroll payments are accurately and completely distributed to employees.
- Reviewed a sample of reconciliations of total manual checks printed in a payroll cycle to the dollar amount of manual checks provided by Central Payroll to ensure that Treasury consistently and adequately performs this reconciliation and physical payroll checks are accurately and completely distributed to employees.
- Reviewed a sample of replacement checks to ensure appropriate review and approval (i.e., cancellation of previously-issued check or direct deposit; approval of newly-issued check by someone other than the preparer) before being reissued.
- General Ledger (GL) Recording
 - Reviewed payroll processing reconciliation to the GL for accuracy, completeness and timeliness (i.e., proper accounting period).
- System Access and Segregation of Duties
 - Reviewed system user roles and responsibilities for appropriate segregation of duties.

Results and Summary of Issue Ratings

As a result of this audit, five (5) issues were identified:

1. Payroll register is not reconciled to the general ledger (MOD)
2. PeopleSoft user access roles and responsibilities documentation is incomplete to ensure appropriate segregations of duties in payroll processes (MOD)
3. Significant manual overrides and adjustments are not independently reviewed (MOD)
4. Documentation is missing from employee files (MOD)
5. The Payroll Narrative is not up to date (LOW)

Table 1 below contains the overall evaluation of the severity of the risk and the potential impact on operations. There are many areas of risk to consider including financial, operational, compliance, and reputation when determining the relative risk rating. Issues are rated as High, Moderate, or Low.

Table 1

Payroll Audit Summary of Observations and Issue Ratings

High	Moderate	Low
	Payroll register is not reconciled to the general ledger	
	PeopleSoft user access roles and responsibilities documentation is incomplete to ensure appropriate segregations of duties with payroll	
	Significant manual overrides and adjustments are not independently reviewed	
	Documentation is missing from employee files	
		The Payroll Narrative is not up to date

- **High Risk:** Some key controls do not exist or are not properly implemented and control environment is impaired; high risk improvement opportunities require immediate corrective action
- **Moderate Risk:** Adequate control environment in most areas; moderate risk improvement opportunities identified which require corrective action
- **Low Risk:** Satisfactory overall control environment; small number of lower risk improvement opportunities identified which do not require a management action plan

The details of these observations are included within the *Observations and Management’s Action Plan* section of this report, beginning on page 7.

Conclusion

Overall, the Payroll financial and operational processes are adequately designed and operating effectively. However, Internal Audit noted a limited number of non-critical control deficiencies, and opportunities for improved processes and implementation of best practices.

The City of Minneapolis Internal Audit team would like to acknowledge the cooperation, time and effort put forth by staff from Finance, Payroll, Treasury, Human Resources, and Information Technology departments.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. 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.

Background

Payroll Processing Across Departments

Salaries and wages make up 25% of the City's 2018 budget. The Payroll, Human Resources (HR), Treasury, and Information Technology (IT) departments all play a role in payroll processing. HR maintains employee data and ensures information on employees, pay statuses, deduction elections and requirements, and addresses are up to date in HRIS. Treasury monitors and manages the payroll bank account and processes payroll electronic fund transfers and payments. IT maintains City software systems that are relied on to securely maintain data required for payroll processing, to ensure accurate payroll calculations, and to produce payroll processing reports.

Timekeeping

The City's bi-weekly payroll process begins with employees submitting their time. Payroll time is either entered by employees via HRIS, by a departmental timekeeper, supervisor, Central Payroll via timesheets, or interface between Workforce Director (Fire, Police, 911 and the Traffic Control divisions of Regulatory Services report their time via Workforce Director) and HRIS into the Time and Labor module. Once payroll time has been reported, the system applies work rules (i.e., union contract language and/or Civil Service rules) in programs to produce payable time. Managers or supervisors then approve payable time.

Central Payroll

Each pay period Central Payroll reviews the approved payable time sheets to ensure the City is complying with labor union contracts, Civil Service rules, and federal and state regulations before processing payroll. Payroll technicians review payroll data to ensure deductions are appropriate. HR Benefits staff review benefit and pension withholdings to ensure they are accurate and appropriate.

Central Payroll monitors the payroll process throughout the week prior to pay period close, running various queries and reports to ensure integrity and accuracy of payroll data. On Friday mornings before payroll is closed, Central Payroll reviews and confirms payroll data for accuracy then runs various payroll jobs to close/confirm payroll. The following Friday, employees are paid. On Monday following payroll close Friday, confirmed payroll registers are again reviewed for accuracy by a different payroll technician than the payroll technician who initially handled the payroll process the week before. Errors may be identified that can result from timesheets not being submitted, new hires not being entered, or supervisors approving incorrect payable time. Errors are corrected in the payroll register. The Controller Division is responsible for reconciling the payroll register to the general ledger.

Pay Checks

The Treasury Division of the Finance and Property Services Department is responsible for mailing direct deposit advices on the Wednesday preceding pay day Friday, and prepares and mails paper pay checks Thursday immediately preceding pay day Friday. For some pay check corrections, such as change in address, a replacement pay check may be printed and disbursed by Treasury after the original payment has been canceled with the bank.

Observations and Management's Action Plans

ISSUE #1

Payroll register is not reconciled to the general ledger

Observation

Payroll processing is not reconciled to the general ledger. In addition, the payroll system automatically generates some pay and benefits accruals at month end which are not accurately calculated. Throughout the year these accruals are automatically reversed the day following month end. At year-end all system generated accruals are reversed during the reporting cycle and accurate accruals are manually calculated and entered to ensure accuracy in the year-end financial statements. Audit notes the Payroll bank account is reconciled monthly. It is best practice to perform a periodic reconciliation of the payroll register to the general ledger:

- To ensure payroll expenses, withheld taxes, and check amounts are calculated correctly and posted to the right accounts in accordance with Generally Accepted Accounting Principles (GAAP), and
- To identify errors or fraud in a timely manner.

A lack of payroll reconciliation to the general ledger on a regular basis increases risk of misstatement in the financial statements, and can result in errors or fraud going undetected. The currently implemented PeopleSoft financial system is not configured to reconcile payroll processing to the general ledger.

Management Action Plan

A manual payroll register reconciliation process will be implemented.

Target remediation date:	March 31, 2019
Responsible party:	Lyle Hodges, Controller

ISSUE #2

PeopleSoft user access roles and responsibilities documentation is incomplete to ensure appropriate segregations of duties in payroll processes

Observation

Internal Audit did not receive sufficient data on system user roles and responsibilities to reach the conclusion on whether appropriate segregation of duties between Payroll and HR roles existed. Finance and Human Resources (HR) initiated a process to review user access roles in 2017 but were not able to complete the review due to difficulties in obtaining and interpreting user access data from Information Technology (IT). HR, Payroll and IT management do not have a formal process to periodically obtain and review system user access roles in an easy to interpret format to ensure appropriate segregation of duties.

Segregation of duties is a fundamental element of strong internal controls and should be designed to prevent the same person or group from initiating, approving and reviewing the same transaction. Segregation of duties in payroll processing should include:

- Separation of making HR changes to employee status, pay or benefits, from payroll processing duties
- Separation of approving/supervising timekeeping duties from processing payroll, making HR changes, processing disbursements and making general ledger entries
- Within payroll processing, separation of data input duties from authority to approve transactions

Lack of documentation and periodic review of HR and Payroll system user access roles and responsibilities impacting payroll processing can result in inappropriate segregation of duties and errors or fraud going undetected.

Management Action Plan

Payroll, HR and IT management will enhance the ongoing system user role review project to ensure a repeatable process is implemented to review system user roles and ensure periodic review of appropriate segregation of key duties.

Target remediation date:	June 30, 2019
Responsible party:	Lori Johnson, Deputy CFO

ISSUE #3

Significant manual overrides and adjustments are not independently reviewed

Observation

Manual overrides and adjustments that are significant in nature are not independently reviewed. The payroll Director and payroll team are able to record and approve payroll adjustments as required for accurate bi-weekly payroll processing; however, there is no independent review in place of significant manual adjustments processed by the payroll Director.

Significant manual overrides and adjustments to the payroll processing module or general ledger should be reviewed by the appropriate level of management who does not have the ability to perform overrides and adjustments. Lack of appropriate review and approval of significant payroll manual overrides and adjustments increases the risk of misstatement in the financial statements, error or fraud going undetected.

The issue was initially identified and communicated to Management during the 2013 Payroll Audit; the controller at the time indicated that the issue was remediated as of mid-2014 and that a process was now in place to review and document review of overrides. There have since been changes in management and the current management was not aware that the process was not in place.

Management Action Plan

Manual overrides which are significant in nature will be handled by the Payroll Director and Business Application Analysts I & II. Processes will be put in place to review all payroll overrides and adjustments.

Target remediation date: June 30, 2019
Responsible party: Katie Karow, Payroll Director

ISSUE #4

Documentation is missing from employee files

Observation

To ensure changes in employee data (e.g., pay rate change, position change, leave of absence, return from leave, etc.) affecting Payroll were approved and documented, Internal Audit selected 30 employees (26 City employees including 1 Convention Center employee; and 4 Park Board employees) based on our Sampling Methodology in order to review their files. Based on our review:

- 11 out of the 26 City employees we selected for testing were missing supporting documentation from their files.
- 1 out of the 4 Park Board employees we selected for testing was missing supporting documentation from the file.

All changes to employee data should be approved and documented, and documentation should be maintained in the employee file. Missing documentation in employee files can result in errors in mishandling of employee data, breach of confidential and personal data, or errors in payroll processing calculations.

Management Action Plan

Human Resources (HR), in collaboration with City Coordinator and City Clerk's Office, has initiated an Enterprise-wide project to transition the City's paper-based documents and processes to a digital format for over 4,000 City employees. As part of this digitization initiative, workforce-related documents typically stored in decentralized personnel and medical files will gradually be converted to a centralized digital format across all departments. Digitization and centralization of HR files will enable better use of space, decrease document storage costs, improve adherence to record retention standards, and help facilitate more accurate and efficient responses to public record requests.

This project involves reviewing all personnel and medical files to identify and shred records that no longer need to be retained, scanning and filing documents that need to be retained in a central database, identifying missing documentation, and creating new records in a digital format.

To help guide this work, HR is currently piloting the project within the HR department. The HR team will follow the auditing process identified by HR Business Partner Solutions to review select workforce related documents in other departments and capture what they learn to shape and expand the pilot project. The pilot project will be used to guide the work as HR rolls this work out enterprise-wide, and will also help determine project communication and engagement strategies.

Target remediation date: September 30, 2020
Responsible party: Patience Ferguson, Chief Human Resources Officer

ISSUE #5

The Payroll Narrative is not up to date

Observation

Internal Audit noted that the Payroll Narrative (last revised in 2017) does not fully reflect current practices. The Payroll Narrative should reflect current practices so those who rely on it (i.e., State Auditors, Internal Auditors) have accurate information, and to ensure employees can consistently perform payroll processing duties. An outdated Payroll Narrative can result in State Auditors relying on inadequate information to perform their Audit of the City's Financial Statements. This in turn can result in inadequate audit conclusions (i.e., findings and recommendations), or inconsistent performance of payroll processing duties. Management will review and update the payroll narrative on an annual basis going forward.

Management Action Plan

Not required for low risk issues