April 23, 2003

Internal Audit Report 2003-5
Municipal Payroll Review
Employee Relations Department

Introduction. The Municipality of Anchorage has a complex payroll system that includes eleven unions and a wide variety of work schedules and leave plans. According to Municipal Policy and Procedure (P&P) 24-10, Approval and Retention of Employee Time and Attendance Records, employees must complete and sign time cards or other approved time documents, noting the hours worked during a pay period, which a supervisor then approves and signs. The department or division payroll clerk then enters all employee time, labor, and leave information into the PeopleSoft Human Resources Time and Labor module (PeopleSoft). Each pay period, when the payroll is processed, the time codes are matched to earning codes in PeopleSoft. These earning codes determine the employee's pay rate for the daily hours entered. Some departments and unions have exemptions from the standard time sheet requirements, and employees are not required to complete their own time sheets; rather, they may be completed by supervisors or the department payroll clerk.

In some cases, employees are paid at rates different from their regular pay rate. Unless there are department or union exemptions, approved backup documentation must be maintained to support overtime pay and any pay rates other than an employee's regular pay rate. Additionally, approved leave request slips are required to support leave time used by employees. Any other payroll transactions affecting employee pay or leave, such as leave adjustments or retroactive pay from transactions occurring in a prior pay period, also require approved supporting documentation.

Objective and Scope. The objective of this audit was to determine the error rate of payroll data entered into the Municipality's payroll system. This audit included a review of payroll transactions

from the pay period beginning October 7, 2002, and ending October 20, 2002.[1] The external audit firm, KPMG, performed a separate audit of the internal controls over payroll during the same period and addressed procedural and internal control issues.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit work was conducted from November to December 2002. This audit was requested by the Administration.

Overall Evaluation. Although our testing found most of the payroll data in PeopleSoft was adequately supported, our testing did reveal some problems. Specifically, our test of randomly selected payroll transactions identified an overall error rate of approximately 6 percent. Two percent of these errors affected or could have affected an employee's pay or leave balances. For example, we identified three instances where time codes recorded on employee time sheets did not correspond with time codes recorded in PeopleSoft. As a result, employees may not have been properly paid. In addition, our testing identified inadequate supporting documentation for 4 percent of the payroll transactions we tested. For example, we identified eight leave requests that were either incomplete, inaccurate, or did not match the time sheet. As a result, management may not have appropriately controlled employee work schedules.

Management Comments. Management stated, "The following audit report highlights weaknesses in the payroll and human resource organizations that have led to errors occurring in time recorded, unsupported pay increases, incorrect leave balances recorded, poor documentation, and inadequate training. Errors occurred as the result of poor documentation, training, a need to improve processes

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[1] For testing purposes, we selected a random sample of 251 payroll transactions. These transactions were selected using an error rate of $\forall 3\%$. In addition, we included all 59 payroll clerks and backup payroll clerks in our sample.

in these areas, and organizational issues. Staffs involved in these areas are generally extremely competent, but have needed a few improvements to allow them to operate to their highest potential.

"As the result of Executive Management's recognition of these needs, numerous improvements have occurred or are in process. A few follow:

(1)   A Payroll Manager has been added, increasing the amount of oversight and senior support to employees in the payroll and Human Resource Management System areas.

(2)   Additional payroll staffing in the Central Office is being pursued. Interviews for a Senior Payroll Accountant have begun. Replacements for a vacant payroll clerk position and a soon to be vacated Functional Analyst position are being advertised. Addition of staff will allow better segregation of duties, increased productivity, initiation of departmental audits, and allowance for improved controls in manual and electronic processes.

(3)   A process improvement initiative has begun. This process will begin with payroll functions, and broaden its reach to include Human Resource functions in the near future.

(4)   From the process improvement phase, a documentation period will occur. Currently, it takes at least three months to fully train high-demand Human Resources and Payroll employees to use the system. As a result, many errors occur as the result of a lack of training / expertise on the system. Since turnover has been high recently, many qualified new employees yield sub-par results because reference materials are not available. A simple desktop procedure manual, organized in a logical order, will shorten this learning curve period.

(5)   An increased commitment to formal training will also broaden the group's talent base and will translate into better performance.

"Organizationally, day-to-day control of the Human Resource Management Systems Group has been transferred to the Payroll Manger. This group includes IT employees matrixed from the IT management team and a Functional Analyst position that formerly reported elsewhere in the

Employee Relations Organization. The goal is to focus all relevant resources toward the common goal of addressing problems such as those highlighted in this audit report. This new team will focus on process improvements, controls and audit programs to lead to an improved over-all organization.

ΑThe payroll organization is actually a group of decentralized organizations. Improved communication and coordination amongst the groups will ultimately lead to better over-all performance. Enhancement of time and labor recording systems in the future will lead to increased accuracy and shortened timeframes required to perform work. Two potential new time and labor recording systems have been evaluated recently; one of these two appears to fit well with many of the Municipality's needs.

"Improved computer system performance can be gained by initiating a data archiving program, moving non-critical data to an inactive status. This would greatly reduce the amount of time required to process a pay run, increasing the time available to ensure that an accurate and thorough job has been performed. A business case has been put in front of the PeopleSoft steering committee and is under review. Finally, completion of testing to confirm the functionality of backup systems is underway. Full confidence in backup and restore procedures are a critical component of our process improvement program.

"In conclusion, many control and accuracy weaknesses currently exist. However, a significant commitment to the resolution of these issues has begun. We expect many improvements are going to be in place by the next audit cycle."

FINDINGS AND RECOMMENDATIONS

1.   **Errors Affecting Pay or Leave Balances.**

        a.   **Finding.** Our testing identified payroll data entry or recording errors that affected or could have affected pay or leave balances for 2 percent of the payroll transactions we

tested. These errors included: 1) unsupported pay increases, 2) incorrect time codes, and 3) annual leave not properly recorded. For example:

1) **Unsupported Pay Increases -** We identified three instances where employees received pay increases without proper documentation or approval. Although P&P 40-10, Employee Pay Variances, requires payroll clerks, department heads, and the Records and Benefits section to review pay rate exception reports, these errors were not identified by the individuals responsible for review. In each instance, the payroll clerk had manually entered unauthorized override pay rates into PeopleSoft for these pay increases.

- *Performance Evaluation Missing -* On October 29, 2001, a payroll clerk manually entered an override pay rate to increase her base salary from $17.21 per hour to $18.76 per hour. This employee, who completed her probationary period, did not, and still has not, received a performance evaluation prior to the pay increase. Probationary pay increases require a performance evaluation. In addition, according to Anchorage Municipal Code (AMC) 3.30.081, a written performance evaluation should have been completed before the completion of the probation period. As of the audit date, this employee continues to receive an override pay rate.

- *Performance Evaluation Missing -* A Non-Represented (not affiliated with any union or bargaining unit) employee received a pay increase from $28.47 per hour to $29.85 per hour without receiving a written performance evaluation. AMC 3.30.125 specifically required a written performance evaluation before the pay increase became effective for this employee.

- *Merit Increase on Incorrect Date -* One employee did not receive his merit pay increase on the correct date. According to PeopleSoft data, the employee should have received the merit increase on May 22, 2002, his merit anniversary date. However, the merit increase was not applied as an override rate until July 1, 2002. The pay increase was an annual merit increase from $23.39 per hour to $24.57 per hour, for an AMEA (Anchorage Municipal Employees Association) employee.

The reason that override rates were used in these instances was that a Personnel Action form had not been submitted for any of these employees. According to the Employee Relations PeopleSoft Payroll Manual, all of these pay increases required a Personnel Action form to be submitted. This form includes information such as the employee's salary data and any changes that are to be made. This form must be signed by the employee's division manager, department head, and the records supervisor in the Employee Relations Department.

2) **Incorrect Time Codes -** We identified three instances where time codes recorded on employee time sheets did not correspond with time codes recorded in PeopleSoft. Although pay rates were not affected in these examples, many time codes correspond to earning codes which indicate pay rates that differ from an employee's regular pay rate. As a result, an employee could be over-paid or under-paid if time codes are not correctly recorded. Specifically:

- *Regular Time Not Recorded Properly -* An employee's time sheet indicated "REG" for regular time worked; however, the training code, "TRN", had been entered in PeopleSoft.

- *Training Time Not Recorded Properly -* An employee's time sheet showed "TRN" for hours worked on a particular day; however, "REG" was entered into PeopleSoft.

- *Annual Leave Charged in Error -* An employee had requested annual leave for a series of days, but subsequently did not take leave on the last day requested. The employee's time sheet was corrected to show regular "REG" hours had been worked; however, PeopleSoft indicated annual leave "ANL" had been used, and the employee was initially charged annual leave.

3) **Leave Not Properly Recorded -** We identified one instance where an employee's time sheet indicated the employee was working when she was actually on annual leave. This employee had submitted a leave request for 40 hours of annual leave, which was signed and approved by the employee's supervisor. However, both the employee's time sheet and PeopleSoft reflected 40 hours of regular work time instead of annual leave. When asked about the discrepancy, the department's payroll clerk stated the 40 regular work hours were recorded and reported at the direction of the department director. According to the payroll clerk, the director stated the employee made up the time by working additional hours on other days for which she had not been previously compensated. The employee had tracked and recorded these "extra" hours on a personal calendar. However, AMC 3.30.129 does not permit this employee to earn or use compensatory time.

b. **Recommendation.** The Employee Relations Department should ensure that:

1) Payroll Exception Reports are reviewed by payroll clerks, department heads, and the Records and Benefits section as required by P&P 40-10.

2) Supervisors are reminded of the importance of properly recording and reviewing employee time sheet data to ensure daily work hours are correctly recorded and that the correct time codes are entered for the hours worked.

c. **Management Comments.** Management stated, "We concur with the recommendations made by Internal Audit. The review process will be improved to levels required by P&P 40-10. In addition, supervisors will be reminded of the importance of accurately recording and reviewing time sheet data and ensuring that correct codes are entered."

d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Supporting Documentation Not Always Properly Maintained or Completed.**

a. **Finding.** Our testing identified conflicting or inadequate supporting documentation for 4 percent of the payroll transactions we tested. Without adequate supporting documentation, employees' time may not be properly recorded and management may not be appropriately controlling employee work schedules. Many of these deficiencies could have been avoided if procedures existed for the review and verification of payroll transaction. Documentation deficiencies included: 1) incomplete or inaccurate leave slips, 2) unsigned or unapproved time sheets, 3) an overtime request that was not properly approved, and 4) payroll records not being adequately maintained.

1) **Incomplete or Inaccurate Leave Slips -** We identified eight leave requests that were either incomplete, inaccurate, or did not match the time sheet. Specifically, we identified six instances where leave requests for annual leave were not completed or could not be located. Although these leave requests were missing, the leave was still recorded on the employees' time sheets and entered into PeopleSoft. In addition, we identified one instance where the dates recorded on the approved leave request did not match the dates recorded on the employee's time sheet and in PeopleSoft. Finally, we identified one instance where a supervisor had not signed the leave request. The Employee Relations Payroll Manual requires that leave slips be completed and signed by employees, and approved and signed by supervisors.

2) **Unsigned or Unapproved Time Sheets -** We identified three instances where time sheets had not been signed by the supervisor or the employee. In

two of these instances, supervisors had not signed the employees' time sheets or attendance roster. In the third instance, the employee had not signed her time sheet, although it had been signed by her supervisor. P&P 24-10 requires time sheets to be completed and signed by employees, and approved and signed by supervisors.

3) **Overtime Not Approved -** We identified one instance where overtime requests for one employee were not completed or were missing. This overtime, which totaled 15 hours, had been recorded on the employee's time sheet and entered into PeopleSoft. P&P 40-9, Approving and Documenting Overtime, requires supporting documentation and approval of overtime.

4) **Payroll Records Not Adequately Maintained -** Payroll records for one department were not maintained in an organized or secure manner. Specifically, time sheets and other payroll documents had not been filed and were observed to be in a large stack near the payroll clerk's desk. As part of our testing, we asked the payroll clerk to provide four employee time sheets. The payroll clerk stated she would need one hour to find the time sheets. In addition, an authorization for acting pay that had been completed for one employee (although not required) could not be located. Our request should not have required an extensive amount of research to locate and provide the documents.

b.   **Recommendation.** The Employee Relations Department should:

1) Remind supervisors to properly complete approvals for items affecting payroll such as leave requests, overtime requests, and acting pay authorizations.

2)   Remind Department Directors that payroll records should be maintained in a secured and organized manner to help ensure they are adequately retained and can be easily obtained.

c.   **Management Comments.**   Management stated, "We concur with the recommendations proposed by Internal Audit. We will remind supervisors to properly complete approvals for items affecting pay, such as leave slips, overtime requests, and acting pay authorizations. In addition, we will remind Department Directors to secure and organize their payroll records adequately."

d.   **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3.   Payroll Clerk Manual Outdated and Training Insufficient.

a.   **Finding.** Many of the problems identified in our audit may have been avoided if the Payroll's Clerk Manual had been up to date and adequate training had been provided. Specifically, the Payroll Clerk's Manual has been in draft form since April 2000 and needs to be revised and finalized to reflect current PeopleSoft payroll procedures. For example, there is no procedure requiring a secondary review of the Approve Time Query run by payroll clerks to verify that payroll data entered into PeopleSoft is accurate. This query is run after all payroll data has been entered into PeopleSoft for comparison to employee time sheets and backup documentation. This query should be reviewed by a second individual, such as a supervisor, and initialed to indicate review. In addition, the manual focuses mainly on computer entry procedures, and does not adequately address other daily tasks that payroll clerks are required to perform, such as proper completion of paperwork for new hires. Finally, an adequate training program was not in place for payroll clerks. Payroll clerks felt they only had the minimum payroll training required to enter payroll information into PeopleSoft.

b.   **<u>Recommendation</u>.** The Employee Relations Department should:

1)   Update and finalize the Payroll Clerk's Manual.

2)   Provide adequate and ongoing training to payroll clerks to help ensure that proper payroll procedures are followed and payroll documents are adequately maintained.

c.   **<u>Management Comments</u>.** Management stated, "Our plan is to create a Payroll Clerk's Manual this year for the central payroll office. If managements at the respective off-site / Enterprise entities wish to develop related manuals for their processes, the Central Office is prepared to offer guidance.

"However, since there is no central point of responsibility for these areas in the central payroll office, we cannot direct their actions.

"Training, cross-training and employee skills development will be heavily emphasized this year. Our goal will be to improve the talent pool available in the payroll, Human Resources and HRMS areas."

d.   **<u>Evaluation of Management Comments</u>.** Management comments were responsive to the audit finding and recommendation. However, we encourage the Employee Relations Director to take the lead in producing a standardized, current Payroll Clerk's Manual for Municipal payroll clerks, even though he may not directly supervise them. The Payroll Clerk's Manual has traditionally provided detailed procedures on how to compile, document, and enter payroll data into the Municipal payroll system.

<u>Discussion With Responsible Officials.</u> The results of this audit were discussed with appropriate

Municipal officials on February 14, 2003.

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