April 1, 2004

Internal Audit Report 2004-5
Municipal Payroll Review
Employee Relations Department

Introduction. The Municipality of Anchorage has a complex payroll system that includes nine unions, a wide variety of work schedules and leave plans, and serves about 2,800 Municipal employees. 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 have exemptions from the standard time sheet requirements and their employees may not be required to complete their own time sheets; rather, the time sheets 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 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 whether payroll transactions were valid and were supported by properly authorized documentation. This audit included a review of payroll transactions from the pay period beginning December 29, 2002, and ending June 29, 2003.

Specifically, we randomly selected 123 employee pay advices and verified their accuracy. We also verified dependent care contributions and reimbursements, health plan deductions, pay rates and regular hours worked. In addition, we haphazardly selected 149 leave slips to determine if the leave slip data was correctly entered into the PeopleSoft system. Finally, for selected pay periods, we reviewed overtime documentation at the Anchorage Police Department, Anchorage Water and Wastewater Utility, and Project Management and Engineering Department (PM&E).

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 was performed during the period of September through December 2003. The audit was requested by the Administration.

Overall Evaluation. Our testing of various payroll transactions identified several weaknesses. Specifically, we found that PeopleSoft, in some instances, incorrectly calculated Fair Labor Standards Act overtime pay rates resulting in overpayments to employees. In addition, we identified several errors affecting employees' pay balances such as incorrect injury leave payments and data input errors. Also, we found conflicting or inadequate supporting documentation for some of the payroll transactions we tested. Further, there was no assurance that dependent care contributions and deductions were accurately calculated. The lack of an official Payroll Clerk's Manual and the lack of payroll training directly contributes to the payroll issues listed in this report. Finally, the Payroll function may be organizationally misplaced and PM&E needs to improve its payroll function.

FINDINGS AND RECOMMENDATIONS

1. Overtime Pay Rates Incorrect.

a. Finding. Pay rates involving Fair Labor Standards Act overtime calculations were sometimes incorrectly calculated by PeopleSoft, resulting in overpayments to

employees. According to the Payroll Supervisor, these overpayments have not been recovered due to lack of time and resources. However, P&P 40-15, Recovery of Overpayments, states that "Any payment made in excess of that authorized, for any reason, shall be recovered from the employee." For example, during a two-week period, one employee worked 13.5 overtime hours the first week and another 13.5 overtime hours the second week. For the 13.5 hours of overtime worked the first week, PeopleSoft calculated $67.99 per hour as the overtime pay rate, and for the 13.5 hours worked the second week, PeopleSoft calculated $59.43 per hour as the overtime pay rate, a difference of $8.56 per hour. According to the Payroll Supervisor, PeopleSoft frequently miscalculated overtime pay rates when earnings during the pay period also included double overtime pay. In the summer of 2003, Payroll addressed this problem and minimized the PeopleSoft errors, but did not entirely eliminate the errors.

Further review of all employees in one department that had double overtime from January through June 2003 revealed that 87 of 206 employees had at least one instance where their hourly overtime rates differed from the first to the second week by as much as $9.91. When we asked the Payroll Supervisor, the PeopleSoft technical staff, and the department payroll clerk to explain these overtime pay rates, they were unable to give us an adequate explanation and did not provide us with the formulas PeopleSoft used to calculate the overtime rates.

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

1) Request the PeopleSoft Manager to research and correct the formula used by PeopleSoft to calculate Fair Labor Standards Act overtime rates.

2) Ensure that all overpayments are recovered according to P&P 40-15.

c. **Management Comments.** Management stated, "We concur with the recommendations made by Internal Audit. Employee Relations is aware that the current version of PeopleSoft is unable to properly calculate FLSA overtime rates for all employees in every instance. Employee Relations has asked that this problem with People Soft version 7.5 be corrected in the past and will again request that this be corrected within the software program.

"In the short term, and at the direction of Management, the Payroll Section has taken action to minimize the errors identified and to ensure that any errors that are unavoidable would be in favor of the employee. This ensures that the MOA does not violate the FLSA and minimizes the cost of grievances, back pay, etc. until a complete resolution of the problem is available. Any overpayments occurring as a result of FLSA will be collected pursuant to P&P 40-15.

"Several recent audits have recommended, and the Payroll Supervisor has begun, a complete overhaul of the 472 distinct earnings codes and 4,484 Workgroup Time Reporting Codes as a means to simplify the earning code structure and time reporting code structure. A complete resolution will branch out into FLSA settings, special accumulators, deduction subsets, and other Payroll setup parameters. This project will eventually require several full months of dedicated effort to perform properly; the current staffing level and higher-priority demands have forced a delay in the continuation of this effort.

"Finally, the Internal Audit Department statement that the technical staff is 'unable to give us an adequate explanation and did not provide us with the formulas PeopleSoft used to calculate the overtime rates' is in part due to the fact that shortly after PeopleSoft implementation, outside consultants were hired to correct the same types of FLSA rate errors as are found today. After several months of customization, the project was apparently abandoned. There is inadequate documentation of the final results of that effort and whether any customization to the PeopleSoft-delivered

code was ever put into use in the Pay Calculation process. While the Payroll Supervisor has been able to duplicate the results of PeopleSoft FLSA calculations for individual checks and compare those results to the correct rates that should have been paid, the process is exceedingly time-consuming and it cannot be automated over a large scale."

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

2. Errors Affecting Pay Balances.

a. **Finding.** Our review and testing of 123 selected employee pay advices revealed errors affecting employees' pay balances. Specifically, we found problems with injury leave computations and other miscellaneous pay errors.

1) **Injury Leave Overpayments -** According to the Payroll Supervisor, injury leave overpayments for some Municipal employees have been occurring since at least mid-2001, in part due to errors in a formula previously used to calculate injury leave payments. However, the formula was corrected in September 2003, but has not been fully implemented by all departments. Injury leave is designed to supplement the workers' compensation payment received by employees who are temporarily disabled by an injury received at work. For example, the Payroll Supervisor estimated that one employee had received about $4,000 in overpayments. According to the Payroll Supervisor, not all injury leave overpayments have been recovered even though P&P 40-15 states that "Any payment made in excess of that authorized, for any reason, shall be recovered from the employee."

2) **Miscellaneous Pay Errors -** We found three payroll errors that appear to be data input errors or oversights. As a result of these exceptions, one employee was underpaid and two employees were overpaid. For example:

- One employee should have received a longevity bonus of 17.5 percent. However, in PeopleSoft the bonus had been adjusted to 15 percent.

- One employee worked 29 hours of overtime during a pay period, but received overtime pay for 33 hours.

- One employee on long-term disability received $7,315.38 in overpayments. According to payroll records, the employee died in July 2003, but continued to receive disability payments through December 2003. In addition, between January 2001 and December 2003, on five occasions this employee received disability payments twice a month instead of once. At the time this audit was concluded, the overpayment had not yet been recovered.

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

1) Require that all overpayments are recovered from employees as required by P&P 40-15.

2) Ensure departments use the corrected formula to calculate injury leave so employees are correctly paid.

c. **Management Comments.** Management stated, "We concur with the recommendations made by Internal Audit. Employee Relations agrees that departments should use the corrected formula to calculate injury leave so employees

are paid correctly in the future. Although the Injury Leave provision is difficult to administer in its present form, all identified errors over the past two years have been or are in the process of being recovered, with the exception of APDEA.

"Employee Relations has met with APD to implement the corrected injury leave formula and discussion is taking place on collecting overpayments to APD employees. In October 2003, a spreadsheet was developed for APDEA Injury Leave to assist the APD payroll clerks in calculating the proper amount to deduct from pay for injured APDEA employees receiving workers' compensation benefits. The use of this spreadsheet will eliminate future overpayments to APDEA employees receiving Injury leave benefits, but to date the APD administration has instructed the APD payroll staff to disregard the Payroll Supervisor's instruction on this matter.

"The Payroll Supervisor feels that a complete audit of APD Injury Leave activity should be performed and that management support a requirement for APD employees who have been overpaid to reimburse the Municipality. This action is required by P&P 40-15, it is consistent with action taken with members of all other bargaining groups, and it is consistent with action taken with APDEA members in the past when similar errors were made."

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

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

a. **Finding.** Supporting documentation was conflicting or inadequate for some of the payroll transactions tested. Specifically, we found incomplete or inaccurate leave slips, overtime not approved, unsigned or unapproved time sheets, and unsupported workers' compensation earnings. Without adequate supporting documentation, employees' time may not be properly recorded and management may not be

appropriately controlling employee work schedules. Similar errors were found in Internal Audit Report 2003-05, Municipal Payroll Review.

1) **Incomplete or Inaccurate Leave Slips -** We found 11 of 149 leave requests that were either incomplete, inaccurate, or did not match the time sheet. Specifically, we found leave codes for six leave slips did not match leave codes entered in PeopleSoft. For example, one leave request was coded ANL (Annual Leave), but PeopleSoft showed ASL (Annual Sick Leave). In other cases, employees used multiple leave codes for the same leave and left it to the payroll clerk to decide which code to use. However, according to a memo from the Employee Relations Director, "The employee is responsible for selecting the time code . . . that tells the Payroll Clerk, which leave bank to use when submitting a leave slip."

   In addition, we found five leave slips did not match the amount of leave recorded in PeopleSoft. For example, one employee's leave slip showed three hours of annual leave used, but only one hour was entered into PeopleSoft. In another case, an employee's leave slip showed eight hours of leave used, but nothing was entered in PeopleSoft.

2) **Overtime Not Approved -** We found three cases where supporting documentation for overtime worked was either missing or not properly signed. Specifically, we found two instances where the overtime request was missing, one instance totaled 32 hours and the other instance totaled 12.5 hours. In the third instance, the overtime request form was not properly signed by the department head. P&P 40-9, Documenting and Approving Overtime, requires supporting documentation and appropriate approval of overtime.

3) **Unsigned or Unapproved Time Sheets -** We identified two instances where the time sheets were not properly signed by supervisors. P&P 24-10 states that " . . . all time cards or time documents [should] be approved by the responsible employee prior to submission for compensation."

4) **Unsupported Worker's Compensation Earnings -** We could only verify 3 of 27 workers' compensation earnings amounts due to inadequate documentation maintained in the employees' medical files. In addition, we found two instances where no backup documentation could be found for workers' compensation earnings amounts in the employees' medical files. Finally, we found medical information placed in the wrong employee's medical file. Problems with file maintenance could worsen since the Employee Relations Department eliminated the file room clerk position.

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

1) Require supervisors to properly complete approvals for items affecting payroll, such as time sheets, leave requests, and overtime requests.

2) Ensure the central personnel files are adequately maintained.

c. **Management Comments.** Management stated, "We concur with the recommendations proposed by Internal Audit. Employee Relations will require Payroll Clerks to implement a regular review of all supporting documentation as a part of their biweekly time entry procedure. In addition, Employee Relations will consider revising its policies on documentation of overtime to accommodate electronic time entry and online supervisory approval of overtime and leave."

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

4. Tracking of Dependent Care Deductions and Reimbursements Needs Improvement.

a. Finding. The spreadsheet used to ensure dependent care deductions and reimbursements are accurate was not adequately maintained by the Benefits Section. Money is transferred from each paycheck to an account for each employee participating in the dependent care program. Withdrawals are then made from this account for reimbursement of dependent care expenses. Benefits staff used a spreadsheet to track dependent care account activity. Although the spreadsheet problems we found, by themselves, may not be significant, when analyzed as a whole they indicate significant weaknesses with the dependent care spreadsheet. As a result, there is no assurance that dependent care contributions and deductions are accurately calculated. Specifically, we noted the following problems with the dependent care spreadsheet:

1) **Inaccurate Deductions -** Although four different employees requested to discontinue their participation in the dependent care program beginning in January 2003, six deductions were still made. For example, $338 was deducted from one employee's pay check before the error was corrected. In another case, $125 was incorrectly deducted from another employee's paycheck, but was never reimbursed.

2) **Inaccurate Reimbursements -** Two employees received overpayments when requesting reimbursement for dependent care expenses. One employee had an overpayment of $192.30. This error was caught by the employee. To compensate for the error, the employee received no payment the next month. In the second case, the employee contributed $780 for dependent care expenses; however, the employee was reimbursed $900 for these expenses, $120 beyond the amount of the contribution.

3) **Inaccurate Spreadsheet Entries -** Data entered into the dependent care spreadsheet was not entered correctly. For example, in one instance, the spreadsheet showed $192.30 being paid to an employee in June 2003, but this payment belonged to a different employee. In addition, from January 2003 through the beginning of May 2003, nearly all submitted bills were entered in the spreadsheet in the wrong pay period. For example, one employee sent a $286.62 bill that was received on January 16, 2003, requesting reimbursement. However, the bill was recorded in the January 12, 2003, pay period instead of the January 26, 2003, pay period. Finally, some employees were listed on the spreadsheet improperly. For example, one employee found on the spreadsheet had no dependent care deductions or reimbursements from January to June 2003 because the employee had terminated employment with the Municipality on January 12, 2002.

Some of these problems occurred when the responsibility to maintain the dependent care spreadsheet was transferred to an employee who had not previously maintained it. However, most of these problems could have been avoided if the Benefits Section had established appropriate controls, procedures and supervision over the dependent care spreadsheet. Ensuring that data maintained on the dependent care spreadsheet is accurate will become increasingly important when this benefit is extended to other Municipal employees beginning in 2004.

b. **Recommendation.** The Personnel Director should establish appropriate controls and supervision over dependent care deductions and reimbursements.

c. **Management Comments.** Management stated, "We concur with the recommendation made by Internal Audit. To help implement the recommendation, the Benefits Division has asked that the Dependent Care module of PeopleSoft be activated to streamline the processing of the Dependent Care benefits."

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

5. Payroll Process Not Adequately Controlled.

a. **Finding.** The Payroll Section does not have the authority to manage or control the payroll process. We found the Payroll Section essentially processes and troubleshoots the bimonthly payroll by focusing on daily crises as they occur. With the possibility of the Municipality implementing an electronic time card system that may diminish the controls payroll clerks now provide, it becomes increasingly important to have a strong control structure within the Payroll Section.

In addition, many of the problems identified in our audit may have been avoided if the Payroll Clerk's Manual had been up-to-date. The Payroll Clerk's Manual has been in draft form since April 2000 and needs to be revised and finalized to reflect current payroll procedures. In our previous audit, Internal Audit Report 2003-05, we recommended the Employee Relations Department should: (1) update and finalize the Payroll Clerk's Manual, and (2) provide adequate and ongoing training to payroll clerks to help ensure that proper payroll procedures are followed and payroll documents are adequately maintained. In response to this recommendation, Employee Relations stated that they planned to create a Payroll Clerk's Manual in 2003 for the central payroll office, but not for other departments. However, the manual was not created. They further stated that ". . . since there is no central point of responsibility for these areas in the central payroll office, we cannot direct . . . " the actions of other departments.

b. **Recommendation.** We encourage the Employee Relations Director to:

1) Establish an effective control process that ensures the accuracy and integrity of Municipal payroll.

2) Take the lead in producing a standardized, current Payroll Clerk's Manual for Municipal payroll clerks.

c. **Management Comments.** Management stated, "We concur with the recommendations made by Internal Audit. The Payroll Section has been subject to an array of crises that have delayed many of the process improvement projects desired. Adequate staffing, with the commitment of sufficient technical resources to resolve issues like the FLSA rate errors, is essential to controlling the payroll process.

"In addition, the Payroll Supervisor will update the Payroll Clerk's Manual and use it to provide a regular training program. The Payroll Supervisor has been working with the PeopleSoft department to develop a regular series of training sessions for Payroll Clerks in a small classroom environment where the clerks can enter time and run processes in a test environment."

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

6. Payroll Function May Be Organizationally Misplaced.

a. **Finding.** In our opinion, the Municipal payroll function may not be organizationally placed in the appropriate department. The Municipal Payroll function is currently located organizationally in the Employee Relations Department in the Records, Benefits and Payroll Division. The Payroll Section was moved from the Finance Department, Controller Division, after the Municipality implemented PeopleSoft Financial and HR/Payroll systems several years ago. However, Title 6 of the Anchorage Municipal Code shows Payroll under the Controller. In addition, in a management study performed in 2002, KPMG, the Municipality's external auditors, recommended that the Payroll function should be moved back under the Controller.

They stated that in every government organization they surveyed, the payroll function reported to the Finance and Controller areas because the nature of payroll was more closely related to the finance area.

b. **Recommendation.** The Chief Fiscal Officer should consider organizationally moving the Payroll function under the Controller, in compliance with Anchorage Municipal Code Title 6.

c. **Management Comments.** Management (Chief Fiscal Officer) stated, " . . . we concur with the finding that the Payroll function is organizationally misplaced and should report to the Controller Division.

"Action taken to correct deficiency: in order to correct the organizational reporting deficiency, we:

a. Created and presented a detailed proposal summarizing problems within Payroll and recommending that Payroll staffing be enhanced and that reporting be restructured to the Controller Division.
b. Prepared and submitted a First Quarter Budget revision that, if accepted, would reclassify Payroll (and its related costs) to the Controller Division, add one additional Payroll Accountant position, create an enclosed office space within the Controller Division area, and provide funds for one-time consulting services. The proposed effective date of the change is July 1, 2004.
c. Met with the Municipality's Payroll staff to discuss the proposed change.
d. Agreed to be part of the interview team for the vacant Payroll Supervisor position."

Management (Employee Relations Department) stated, "Employee Relations supports whatever decision the Administration makes in locating Payroll either in Employee Relations or in Finance, and will assist in whatever way possible to make

such a move a success. The organizational placement of the Payroll Section is possibly of less consequence than the appropriate resolutions to other issues identified in the audit. The Payroll Section works closely with both Finance and Employee Relations on a daily basis. Payroll was located in Employee Relations when People Soft was implemented for business reasons that deemed the location of Payroll within Employee Relations appropriate at that time. Employee Relations believes there is rationale to support Payroll remaining located within Employee Relations because of the multiple daily interactions with Records and Benefits staff, daily use of Personnel Records housed within Employee Relations and the cross reliance on each division's data information in processing the payroll outcomes. If Payroll were to remain within Employee Relations, an ordinance modifying the Code could be developed to correct that point."

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

7. PM&E Department Payroll Needs Improvement.

a. **Finding.** The payroll function at PM&E needs improvement. During our review of pay advices, overtime requests, and leave slips for two pay periods beyond our original scope, we found that payroll records were not always adequately maintained, properly completed, and approved. Specifically, we found the following:

1) **Leave Slips Not Properly Completed -** A review of 65 leave slips submitted during the two pay periods found that two were not properly signed by the supervisor, nine had not been dated by the supervisor, and 40 of the leave slips did not indicate if the leave was scheduled or unscheduled. In addition, we found one leave slip that did not match hours entered into PeopleSoft. Also, several leave slips did not support leave indicated on the time card

since the leave had been crossed out on the leave slip. Finally, some leave slips were not in the appropriate file and were difficult to locate.

2) **Overtime Not Pre-approved -** During our review we noticed some overtime requests were approved after the overtime had been worked. Without advance approval, overtime can be abused and management may not be appropriately controlling employee workload. P&P 40-9 states, "It is the policy of the Municipality that overtime be kept to an absolute minimum, that all scheduled overtime be authorized in advance, and that those responsible for approval are clearly identified."

3) **Unconfirmed Overtime Hours -** It was difficult to match approved overtime hours to hours recorded on the time sheet because overtime request forms included regular work hours. For example, we could not verify overtime hours worked by one employee, even after discussing it with the payroll clerk.

4) **Acting Pay Not Approved -** One form we tested, allowing four hours of acting pay, had not been approved by the Department Director.

b. **Recommendation.** The PM&E Director should ensure that:

1) Payroll records are adequately maintained, properly completed, and approved.

2) Documentation for payroll transactions such as time sheets and leave slips are properly filled out and signed.

3) Overtime requests are approved in advance.

c. **Management Comments.** Management (PM&E) stated,

"1. We concur with the audit findings in the departmental payroll section."

"2. Corrective action has been taken to ensure that payroll records and all related documentation are adequately maintained, properly completed, and approved."

"3. A bi-weekly Payroll Checklist (example attached) will be prepared and signed by the payroll clerk to ensure:" (See ATTACHMENT A)

"a. Leave Slips:
   i. Are signed and dated by the employee.
   ii. Are approved/disapproved and dated by the supervisor.
   iii. Indicate if the leave was scheduled or unscheduled.
   iv. Support the timecard.

b. Overtime Requests:
   i. Are pre-approved and turned in on the same day timecards are due.
   ii. Are approved and dated by the supervisor.
   iii. Unforeseen and unscheduled overtime worked during weekends is approved on the first scheduled work day.
   iv. Support the timecard.

c. Unconfirmed Overtime Hours:
   i. Eliminate the difficulty of matching approved overtime to hours recorded on the timecards by having employees who regularly work overtime during the summer and fall months revert to a 5/8 work week during that time.

d. Acting Pay Requests:
   i. Memo is signed and dated by the supervisor.
   ii. Pay Request is signed and dated by the supervisor.
   iii. Pay Request is approved/disapproved and signed and dated by the Director.
   iv. Support the timecard."

"4. All deficiencies were corrected immediately."

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

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on February 12, 2004.

Audit Staff:
Birgit Arroyo
Mike Chadwick

Bi-Weekly Payroll Checklist

Pay Period Ending: _____

1)Timecards

a) _____ Signed by Employee
b) _____ Signed by Supervisor
c) _____ All changes are initialed

2)Leave Slips

a) _____ Signed and dated by Employee
b) _____ Approved/ Disapproved and dated by Supervisor
c) _____ Leave indicates if it was Scheduled or Unscheduled
d) _____ Leave slip supports the Timecard

3)Overtime Request

a) _____ Turned in with Timecard
b) _____ Approved and dated by the Supervisor
c) _____ Overtime request supports the Timecard

4)Unscheduled Overtime

a) _____ Turned in on 1st scheduled work day
b) _____ Approved and dated by the Supervisor

5)Acting Assignment

a) _____ Memorandum is signed and dated by Supervisor
b) _____ Acting Pay request form is signed and dated by Supervisor
c) _____ Approved/disapproved and dated by the Director
d) _____ Acting pay request form supports the Timecard

Payroll Clerks Initials_____

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ATTACHMENT A
Internal Audit Report 2004-5; April 1, 2004
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