



Audit of Payroll Administration

The City of Denton has established generally effective processes to ensure employees' payroll payments are accurately made. Additional review of adjustments to employees' timecards and Payroll staff activities could further mitigate risk.

Audit Team

City Auditor

Madison Rorschach, CIA, CGAP

Audit Staff

Neeraj Sama, MBA, MS

Table of Contents

Audit at a Glance	3
Introduction	4
Management Responsibility	4
Audit Objectives, Scope, and Methodology	4
Findings & Analysis	6
Payroll Updates Appropriately Processed	7
Employee Time Adequately Approved; Adjustments Not Always Supported	8
Payroll Processes Generally Effective; Calculations Accurate	10
Payroll Payments Generally Authorized Appropriately	12
Review of Payroll Staff Activities in Timekeeping System Could Further Mitigate Risks	14
Appendix A: Management Response Summary	16

Audit at a Glance

Why we did this Audit:

Annually, the City spends about \$129 million on payroll costs for its almost 1,800 employees. As one of the City's most significant single expenses, it is critical that the payroll administration process is effective to ensure these payments are accurate. This audit project was included on the City's fiscal year 2020-21 Audit Plan as approved by the City Council.

What we Recommend:

Recommendation 1

Consider developing a process to periodically verify that employee changes entered into the financial system by Human Resources are accurate based on information received from departments.

Recommendation 2

Require supervisors to comment on all timecard adjustments.

Recommendation 3

Consider rounding employees' pay rates to two decimal places.

Recommendation 4

Consider establishing a process for processing payroll payments with the bank involving two employees.

Recommendation 5

Develop a process to regularly review timekeeping system audit trails.

What we Found:

This audit generally evaluated the City's payroll administration processes including payroll updates, payroll calculations, and payroll payments. Findings about each of these areas are summarized below:

Payroll Updates. In general, the City has established an effective process to update the payroll with employee changes such as new hires, terminations, and pay rate changes. That being said, these changes are entered into the financial system by one person without review for accuracy; increasing the risk of error and fraud.

Payroll Calculations. The City has established a payroll process that generally ensure employees' paychecks are accurately calculated based on their work and leave hours. Under this process employees time is generally approved by their supervisor or timekeeper, who can adjust their employees' hours under certain circumstances. Still, supervisors and timekeepers should be required to provide comments on these adjustments to ensure they are complying with City policy.

Payroll Payment. Final payroll payments are generally authorized appropriately by Finance Department management; however, only one employee is involved in uploading the payroll to the bank, increasing the risk of fraud.

Finally, Payroll staff generally have appropriate access to the City's financial and timekeeping systems; however, regular review of Payroll staff activities in the timekeeping system would further mitigate the risk of fraud.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal¹ of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a performance audit of the City's payroll administration processes. We conducted this performance 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

The Internal Audit Department has completed an audit of the City's payroll administration processes. This report is intended to provide assurance that payroll changes are being recorded properly and employees are being accurately paid in accordance with their terms of employment and applicable regulations and City's policies.

Audit fieldwork was conducted during July and August 2021. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation to develop criteria including industry standards, best practices, policies, and procedures;
- Developed process narratives to identify current control activities in payroll administration, including processing and verification of payroll

¹ The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

updates, payroll review, approval, and calculation, and payroll payment processes that was certified by the Payroll Supervisor, Assistant Director of Finance, and Benefits and Human Resources Information System – or HRIS – Specialist;

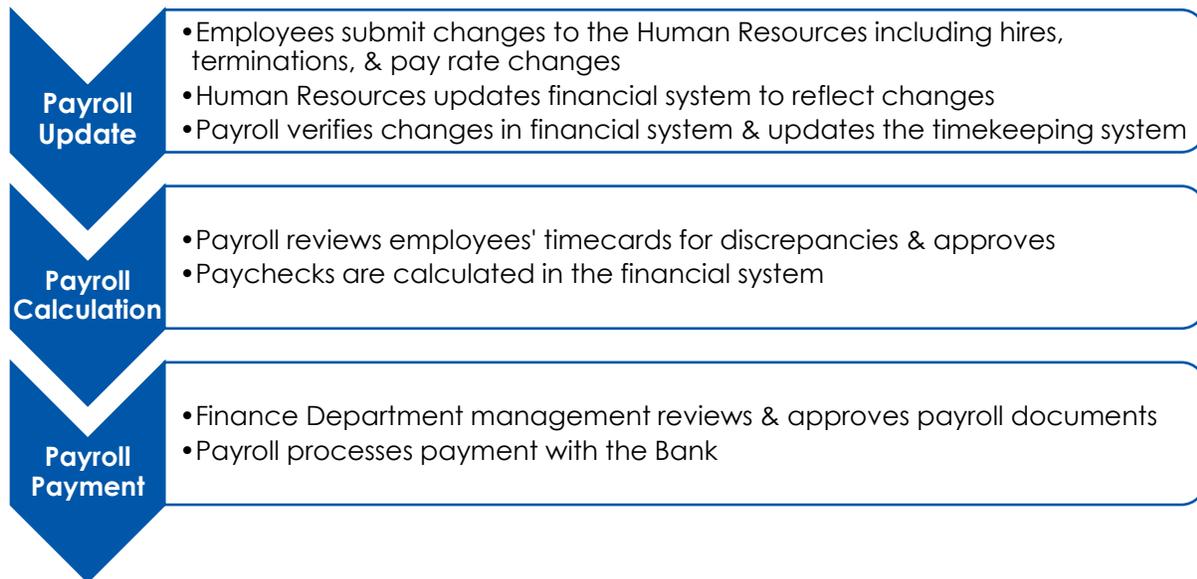
- Interviewed Payroll Supervisor, Benefits and HRIS Specialist, and Finance Department staff and reviewed policies and procedures pertaining to payroll administration;
- Reviewed a statistical sample² of 383 paychecks issued between July 17, 2020, to July 16, 2021, to verify the effectiveness of payroll processes and ensure employees are accurately paid for their time worked;
- Reviewed a judgment sample of 60 payroll changes including new hires, terminations, and pay rate changes to verify that they were appropriately recorded and processed as part of payroll administration;
- Reviewed supervisor approval reports for a judgmental sample of three pay periods to verify that employee timecards are regularly approved by a supervisor or timekeeper;
- Recalculated overtime payments for a judgement sample of 30 paychecks to verify the accuracy of overtime time payments and compliance with City policies;
- Reviewed the payroll documentation and records to evaluate the appropriateness of record keeping; and
- Reviewed user access to the City's financial and timekeeping systems to verify that access to these systems is appropriately granted to administer payroll activities.

² This sample size provides with 95 percent confidence that the true population mean is within ± 5 percent of the sample estimate.

Findings & Analysis

The City of Denton’s annual payroll cost amounts to about \$129 million. The Payroll Division of the Finance Department is primarily responsible for administering and processing the City’s bi-weekly payroll. In general, payroll administration includes updating the payroll’s employee records, verifying and calculating paycheck amounts, and making the payroll payment as illustrated in Figure 1 below:

Figure 1: Bi-Weekly Payroll Administration Process



This audit generally evaluated the City’s payroll administration processes, including processing payroll updates, employees' timecard adjustments and approvals, overtime payments, tax payments, payroll review and approval procedures, record-keeping, and payments processing.

Payroll Updates Appropriately Processed

Recording and processing payroll updates is critical to ensuring the City is paying its employees accurately. Specifically, a process should be established to ensure that new employees are correctly paid for their time worked, terminated employees are not paid after their termination, and existing employees' pay rate changes are applied accurately.

What We Found

- The payroll update process allows for appropriate separation of duties.
 - Payroll updates are initiated by the City's supervisors and managers based on submitted Employee Status Sheets or through the new hire process.
 - These updates are entered into the City's financial system by the Human Resources Department and are forwarded to the Payroll Division for verification as part of the Pay Period End Report.
 - Based on the Pay Period End Report, the Payroll Division creates profiles in the City's timekeeping system for any new hires. The Payroll Division is not able to change employee pay rate information.
- Based on review of a judgement sample of 60 payroll changes, the payroll update process appears to be effective. Specifically:
 - All new hires were correctly paid per the terms of employment listed in their offer letter and Employee Status Sheet.
 - All pay rate changes were correctly processed, and employees were appropriately paid according to their new pay rate; and
 - No payments were made to terminated employees after their final payment was issued.
- That being said, payroll updates were only entered into the City's financial system by one Human Resources staff member without job rotation which increases the risk of error and fraud.
- In addition, based on discussion with Payroll staff, supervisors seem occasionally allow new employees to begin work before providing the necessary documentation to Human Resources.
 - Based on review of two instances of this, these new employees were paid in the next pay period based on their supervisors account of their time worked. This increases the risk that employees receive pay for work not performed as they are unable to use the timekeeping system

to track their time; however, the Fair Labor Standards Act requires the City to pay employees for their hours worked.

- Payroll should ensure that if this occurs in the future, the Human Resources Department is notified to ensure that these new employees are appropriately set up in the financial system for the next pay period and any involved supervisors are appropriately informed of the City's onboarding procedures.

Why It Matters

An effective process has been developed for updating the payroll with employee changes. That being said, a single employee records these changes in the financial system, increasing the risk of error and fraud. Developing a process to periodically verify that these updates were appropriately authorized would help to mitigate this risk.

Recommendations:

1. Consider developing a process to periodically verify that employee changes entered into the financial system by Human Resources are accurate based on information received from departments.

Human Resources Department Comments: Since May 2021, the HRIS & Benefits Specialist has been cross training the Talent Acquisition Coordinator to assist with and act as the back-up for the HRIS & Benefits Specialist. This ensure the rotation of tasks between two employees.

Action: To augment the authorization/verification process in place and to decrease the risk of error and fraud, on a quarterly basis, a sample of 10 status sheets from throughout the quarter will be pulled and audited to ensure the proper verifications were conducted at the HR level and the changes were entered accurately in JDE.

Employee Time Adequately Approved; Adjustments Not Always Supported

The Fair Labor Standards Act requires employers to keep accurate records on wages and hours worked. In general, City policy requires employees to keep track of their work hours; however, supervisors or timekeepers can enter or adjust non-exempt employees' timecards under the following circumstances:

- An employee forgets to clock in or clock out in the automated time system;
- An employee is sick; or

- A timeclock malfunctions.

In addition, best practices suggest that supervisors should review and approve their employees' timecards to ensure they are accurate.

What We Found

- As part of the established payroll process, supervisors or timekeepers must review and approve their respective employees' work hours in the City's timekeeping system for each pay period.³
 - Based on review of the Timecard Sign-off Request and Approval Report for three pay periods, supervisors and timekeepers generally approve employees' time records as required.
- City policy does not require supervisors and timekeepers to add comments when adjusting employees' timecards.
 - Based on review of about 400 timecard adjustments made by supervisors and timekeepers during the last three pay periods,⁴ about 71 percent were not supported with comments clarifying the reason for the adjustments.
 - Using the City's current timekeeping system, it is difficult to verify whether timecard adjustments made by supervisors and timekeepers are allowed under the policy without a detailed review. In addition, it is generally not feasible to require Payroll staff to perform a detailed review of these adjustments given the payroll administration processes time constraints.
 - The Payroll Division does provide quarterly training for supervisors and timekeepers. According to this training, comments should be added to clarify any corrections to an employee's timecard.

Why It Matters

An effective process is in place for approval of City employees' timecards by supervisors which provides assurance that employees are only paid for actual hours worked.

Separately, City policy allows supervisors or timekeepers to enter or adjust their respective employees' time for certain purposes; however, they are not required

³ Larger Departments generally have a timekeeper who is authorized to review and approve employee timecards.

⁴ The pay periods reviewed ended on July 23, August 6, and August 20, 2021.

to add comments clarifying why the adjustment was made. Without these comments it is not clear why an adjustment was made without performing a detailed review. Requiring supervisors or timekeepers to clarify the reason for an adjustment could improve their awareness of the City's policy and help the Payroll Division ensure time adjustments are made appropriately.

Recommendation:

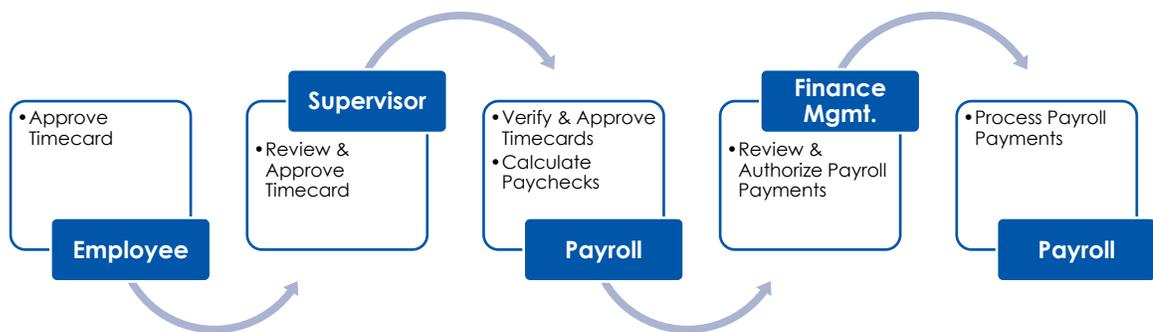
2. Formally require supervisors and timekeepers to comment on any corrections made to employees' timecards in the City's timekeeping system.

Finance Department Comments: The Finance Department concurs with this recommendation. Each year, the Payroll Team hosts quarterly payroll trainings that include instructions and requirements for adding comments to employee's timecards. In response to this recommendation, the Finance Department plans to continue the city-wide trainings and develop a standard operating procedure (SOP) outlining the requirement to add comments when making changes to timecards. It is important to note that department supervisors and managers play an important role in ensuring compliance with this recommendation.

Payroll Processes Generally Effective; Calculations Accurate

Effective payroll processes ensure that employees are accurately paid for the time worked including any authorized overtime or leave. In order to ensure that the payroll is accurately processed, adequate verification and approval procedures should be in place for payroll payments, and payroll documentation should be recorded and stored appropriately. The City's payroll review and payment process is illustrated Figure 2:

Figure 2: Simplified Payroll Process



In addition, the Fair Labor Standards Act requires employers to pay non-exempt employees one and a half times their regular pay rate for each hour worked over 40 during a work week.⁵

What We Found

- Based on the review of a statistical sample of 383⁶ employee paychecks issued during the last 12 months, the established payroll process appears effective. All reviewed employees were appropriately paid based on their recorded work hours and leave.
 - Effective verification and approval procedures are in place to ensure each payroll is appropriately processed and the employees are accurately paid.
 - Payroll-related records and documentation, including approvals, reports, and registers created during each biweekly payroll process, are appropriately stored in a central, electronic repository on the City's shared network.
 - The City's timekeeping system effectively interfaces with the financial system to accurately import employees' work and leave hours into the financial system for payroll processing.
 - Payroll staff members appear to be appropriately instructed and provided with knowledge and guidance to follow the established payroll process effectively.

- Based on review of 30 judgmentally selected paychecks, overtime hours are correctly recorded, and overtime pay is appropriately calculated.
 - For five of the paychecks reviewed, there was a difference of about one cent between the overtime amount actually paid to the employee and the overtime amount recalculated as part of the audit. This issue appears to be due to rounding errors as the City's pay rates are rounded to three decimal places.
 - According to the Payroll Supervisor, this pay rate rounding practice occasionally hinders staff when trying to verify employee retirement and tax payments.

⁵ Exempt employees are not eligible for overtime pay except in emergency cases with the written approval of their supervisors. In addition, civil service employees are eligible for overtime under different circumstances.

⁶ Records for 30 pay stubs could not be verified in the timekeeping system because of employees' separation from the City.

- Required taxes, including federal, FICA, and MCR taxes calculated during the payroll process, appear to be appropriately paid to the U. S. Department of Treasury by the City.

Why It Matters

The City appears to have implemented effective processes and information systems for recording, verifying, and approving employees' hours and calculating the various payroll payment and contribution amounts. Rounding employees pay rates to two decimal places could further facilitate this process by minimizing rounding discrepancies.

Recommendation:

3. Consider rounding employees' pay rates to two decimals places instead of three decimal places to facilitate calculating deductions, contributions, and taxes.

Finance Department Comments: The Finance Department partially concurs with this recommendation. This recommendation will require additional research to ensure employees' salaries are not negatively impacted before implementing. If pay rates are rounded to two decimal points, Finance recommends implementing this change in conjunction with annual pay increases (i.e. cost of living adjustment). Since the cost of living adjustment is already in process for FY 2021-22, Finance and Human Resources Department staff will work together to implement this recommendation in FY 2022-23.

Payroll Payments Generally Authorized Appropriately

Generally, payroll payments constitute a significant portion of the City's annual budget. In order to ensure that the City's funds are appropriately used, payroll payments should be properly reviewed and authorized. Best practices suggest that the duties of processing the payroll should be appropriately segregated to ensure that no individual has more than one of the following duties:

- Prepare the payroll;
- Authorize the payroll; and
- Create payroll payments.

What We Found

- As part of the payroll administration process presented in Figure 2 (page 10), the Payroll Division sends the payroll documents, including pay registers and

other verification reports to Finance Department management, for review to authorize the payment.

- Based on the review of six pay periods' payroll documentation, Finance management authorized all of the final payroll payments.
- Additionally, all payroll payments were accurately processed based on the payroll documents authorized by Finance Department management.
- Once authorized, the Payroll Supervisor processes the payroll payment with the bank by uploading a separate, text file generated by the financial system to the bank's website. Allowing one individual to upload the payroll payment without approval increases the chance for fraud as the text file can be easily manipulated.
- The bank acknowledges the payroll payment amount to be credited via an email to Payroll staff and Finance Department management. Once received, the Payroll Supervisor verifies the total amount acknowledged by the bank with the total amount indicated in the pay registers.
 - Based on a comparison of acknowledgements received from the bank to the authorized pay register, no discrepancies were observed for the six reviewed pay periods.
 - In addition, Accounting staff perform a monthly bank reconciliation to verify that paycheck direct deposits are appropriately debited in the City's bank account.

Why It Matters

Review and approval of payroll payments by Finance Department provides assurance that the City employees' payroll payments are processed accurately. That being said, allowing a single employee to generate and upload the payroll payment to the bank increases the risk that the payroll is manipulated. While verifying bank acknowledgements and performing monthly bank reconciliations provides some assurance that payroll bank transactions are appropriately executed, there is still risk that the payroll could be manipulated.

Recommendation:

4. Consider establishing a process for processing payroll payments with the bank involving two employees.

Finance Department Comments: The Finance Department concurs with this recommendation. The Payroll Team currently has two employees verifying the bank file prior to it being uploaded to the bank. However, only one person is allowed to upload the file to the bank. The Finance Department

plans to rotate this responsibility moving forward to ensure accuracy. The new process will be outlined in a new standard operating procedure (SOP).

Review of Payroll Staff Activities in Timekeeping System Could Further Mitigate Risks

Access to the City's timekeeping and financial systems for processing payroll should be properly controlled to ensure that access is granted to only the staff who need the access to perform payroll administration duties.

Additionally, Government Accountability Office's Federal Information System Controls Audit Manual's best practices for government entities suggest that:

- Information systems access should be limited to users with a valid business purpose and should be related to the users' duties and responsibilities; and
- Transactions executed by employees in an information system should be controlled through formal and active supervision.

What We Found

- The Payroll Division uses the payroll module of the City's financial system to process the City's biweekly payroll.
 - Based on review of the user list, access to the financial system's payroll module has been appropriately granted to Payroll staff members to perform payroll-related activities. Payroll staff do not have the ability to grant or remove user access to the payroll module.
 - One staff member from Finance Department management inappropriately had access to the payroll module; this access was terminated during the audit. Based on this employee's current responsibilities this inappropriate access did not pose a significant risk to the City.
- Access to the City's timekeeping system generally appears to be appropriate.
 - Each employee has access to their profiles in the timekeeping system to record their work and leave hours.
 - Supervisors and timekeepers are granted access to review and approve their relevant employees' timecards.
 - The Payroll staff have superuser access rights in the timekeeping system to perform their functions, including managing pay codes, employees' profiles, and timekeepers' access.

- No formal process is in place to regularly review and monitor the hours' adjustments or other activities performed by the Payroll staff members in the timekeeping system.
- The Payroll Division does not have a procedure for adding or deleting access rights for superusers or timekeepers. As informed by the Payroll Supervisor, timekeeping system access rights are granted to timekeepers based on submitted financial system access requests.

Why It Matters

Role-based access rights granted in the financial system's payroll module and timekeeping system ensure City staff can perform their assigned functions effectively. Still, superuser access rights granted to Payroll in the timekeeping system staff allow them to modify employees' hours worked. Without regular review of Payroll's activities in the timekeeping system, there is an increased risk of error or fraud as the system stores sensitive data and is the basis for payroll payments.

Recommendation:

5. Develop a process for regular review of audit trails of activities performed by the Payroll Specialist in the timekeeping system to ensure the accuracy and appropriateness of entries and adjustments made.

Finance Department Comments: The Finance Department concurs with this recommendation. Currently Payroll Specialists process payroll for specific departments. This process works well, however, staff plans to implement a process to cross-check work and ensure accuracy. The Finance Department plans to develop a standard operating procedure (SOP) outlining this new procedure. The SOP will be complete during the first quarter of FY 2021-22.

Appendix A: Management Response Summary

The following summarizes the recommendations issued throughout this report. The auditors found that staff and the Department were receptive and willing to make improvements where needed. Management has provided their response to each recommendation.

1	<p><i>Consider developing a process to periodically verify that employee changes entered into the financial system by Human Resources are accurate based on information received from departments.</i></p>	Concur	<p>Expected Completion: 12/31/2021</p>
<p>Human Resources Department Comments: To augment the authorization/verification process in place and to decrease the risk of error and fraud, on a quarterly basis, a sample of 10 status sheets from throughout the quarter will be pulled and audited to ensure the proper verifications were conducted at the HR level and the changes were entered accurately in JDE.</p>			<p>Responsibility: Human Resources Department</p>
2	<p><i>Formally require supervisors and timekeepers to comment on any corrections made to employees' timecards in the City's timekeeping system</i></p>	Concur	<p>Expected Completion: Sep. 2022</p>
<p>Finance Department Comments: The Finance Department concurs with this recommendation. Each year, the Payroll Team hosts quarterly payroll trainings that include instructions and requirements for adding comments to employee's timecards. In response to this recommendation, the Finance Department plans to continue the city-wide trainings and develop a standard operating procedure (SOP) outlining the requirement to add comments when making changes to timecards. It is important to note that department supervisors and managers play an important role in ensuring compliance with this recommendation.</p>			<p>Responsibility: Payroll Division</p>
3	<p><i>Consider rounding employees' pay rates to two decimal places instead of three decimal places to facilitate calculating deductions, contributions, and taxes.</i></p>	Partially Concur	<p>Expected Completion: FY 2022-23</p>
<p>Finance Department Comments: The Finance Department partially concurs with this recommendation. This recommendation will require additional research to ensure employees' salaries are not negatively impacted before implementing. If pay rates are rounded to two decimal points,</p>			<p>Responsibility: Finance and Human Resources Departments</p>

Finance recommends implementing this change in conjunction with annual pay increases (i.e. cost of living adjustment). Since the cost of living adjustment is already in process for FY 2021-22, Finance and Human Resources Department staff will work together to implement this recommendation in FY 2022-23.

<p>4 <i>Consider establishing a process for processing payroll payments with the bank involving two employees.</i></p>	<p>Concur</p>	<p>Expected Completion: March 2022</p>
<p>Finance Department Comments: The Finance Department concurs with this recommendation. The Payroll Team currently has two employees verifying the bank file prior to it being uploaded to the bank. However, only one person is allowed to upload the file to the bank. The Finance Department plans to rotate this responsibility moving forward to ensure accuracy. The new process will be outlined in a new standard operating procedure (SOP).</p>		<p>Responsibility: Payroll Division</p>
<p>5 <i>Develop a process for regular review of audit trails of activities performed by the Payroll Specialist in the timekeeping system to ensure the accuracy and appropriateness of entries and adjustments made.</i></p>	<p>Concur</p>	<p>Expected Completion: March 2022</p>
<p>Finance Department Comments: The Finance Department concurs with this recommendation. Currently Payroll Specialists process payroll for specific departments. This process works well, however, staff plans to implement a process to cross-check work and ensure accuracy. The Finance Department plans to develop a standard operating procedure (SOP) outlining this new procedure. The SOP will be complete during the first quarter of FY 2021-22.</p>		<p>Responsibility: Payroll Division</p>