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Office of Internal Audit

Louisville Metro Government

Direct Deposit Activity

Audit Report

Office of Internal Audit

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July 2008



Louisville Metro Government

Direct Deposit Activity

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Transmittal Letter

July 15, 2008

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Subject: Audit of Louisville Metro Government Direct Deposit Activity

Introduction

An audit of Louisville Metro Government's direct deposit activity was performed. The objective was assessing compliance with Metro policies and the identification of possible "ghost employees." Internal Auditing best practices for fraud detection suggest that reviews of direct deposit activity be routinely performed since it is easier to conceal ghost employees using direct deposit than it is using actual paychecks. Therefore, it is important to obtain assurance that the risks are adequately mitigated through the internal control structure.

The audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

As a part of the review, the internal control structure was evaluated. The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Achievement of business objectives and goals
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

Scope

One focus of the audit was to verify compliance with Metro Government's direct deposit policy. All active employees hired or rehired since April 1, 2006 were identified for verification of direct deposit setup. This included *all* individuals paid through Metro's payroll system since the benefits of direct deposit would be applicable no matter the status of an individual (i.e., employee versus non-employee).

In addition, to identify possible ghost employees, all individuals with direct deposit setup as of May 12, 2008 were reviewed. There were 5,271 employees identified as having direct deposit setup, and 91 bank account numbers were identified as being used by more than one employee. The personnel file for these employees was verified to ensure the person was an actual employee of Metro Government. The employment status was also verified for employees that work within the same agency, use the same bank account, and at least one in the pair has time keying capabilities in the Metro payroll system. It should be noted that determining if employees sharing accounts were related / married, or have supervisory authority over the other, was not an objective of this review.

The review included assessing whether activity was in compliance with policy and was monitored appropriately. The details of the scope and methodology of the review will be addressed in the Observations and Recommendations section of this report. The audit would not reveal all issues because it was based on selective review of data.

Opinion

It is our opinion that the administration of direct deposit activity needs improvement. The internal control rating is on page 5 of this report. The rating quantifies the opinion regarding the internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the direct deposit internal control structure include the following.

- **Policy Compliance.** There were several cases where employees were not in compliance with Metro's direct deposit policy. It appears the policy does not provide sufficient guidance as to everyone it applies to. Also, the policy does not address monitoring responsibilities to ensure compliance.
- **Ghost Employees.** There were no "ghost employees" identified as a result of this review.

The implementation of the recommendations in this report will help strengthen the internal control structure and effectiveness of the administration of direct deposit activity.

Corrective Action Plan

The focus of this review was the Louisville Metro enterprise. Since the Department of Human Resources is responsible for the direct deposit policy, they were asked to provide a corrective action plan for the recommendations specific to policy compliance.

Representatives from Human Resources have reviewed the results and are committed to addressing the issues noted. Human Resources' corrective action plans are included in this report in the Observations and Recommendations section. We will continue to work with Human Resources to ensure the actions taken are effective to address the issues noted.

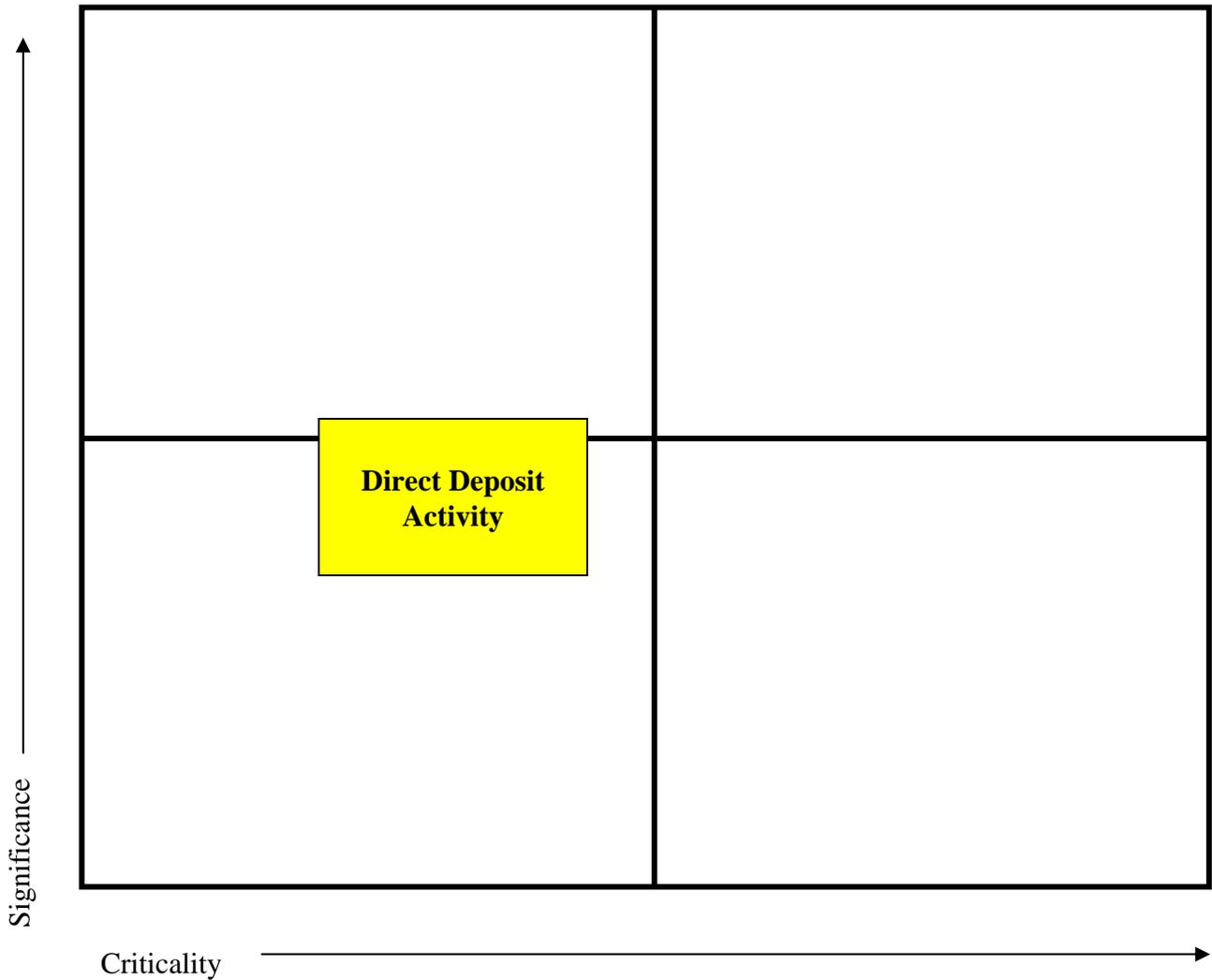
Sincerely,



Michael S. Norman, CIA, CFE, CGAP
Chief Audit Executive

cc: Louisville Metro Council Government Accountability and Audit Committee
Director of Human Resources
Louisville Metro External Auditors

Internal Control Rating



<u>Legend</u>			
<u>Criteria</u>	<u>Satisfactory</u>	<u>Needs Improvement</u>	<u>Inadequate</u>
<u>Issues</u>	Not likely to impact operations.	Impact on operations likely contained.	Impact on operations likely widespread or compounding.
<u>Controls</u>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<u>Policy Compliance</u>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<u>Image</u>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<u>Corrective Action</u>	May be necessary.	Prompt.	Immediate.

Background

Louisville Metro Government implemented a direct deposit of pay policy effective April 1, 2006 (see Appendix). Direct deposit provides a number of benefits to the Government and its employees. There is less risk of a lost check, reduced potential for theft or forgery, and funds are deposited in an individual's bank account on pay days. Direct deposit serves as an efficient tool that helps streamline the distribution of payroll.

Internal Auditing best practices for fraud detection suggest that reviews of direct deposit activity be routinely performed since it is easier to conceal "ghost employees" using direct deposit than it is using actual paychecks. There were approximately 5,300 of 6,500 (82%) Metro Government employees using direct deposit as of May 12, 2008.

This was a scheduled audit.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Office of Internal Audit has not performed any previous reviews of direct deposit policy compliance. However, direct deposit activity for "ghost employees" was previously audited in May 2006. Unless otherwise noted, all prior issues have been satisfactorily addressed.

III. Statement of Auditing Standards

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

An understanding of the internal control structure was obtained in order to support the final opinion.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

The review did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the review that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

VI. Views of Responsible Officials / Action Plan

The focus of this review was the Louisville Metro enterprise. Since the Department of Human Resources is responsible for the direct deposit policy, they were asked to provide a corrective action plan for the recommendations specific to policy compliance. A draft report was issued to the Department of Human Resources on June 12, 2008. It was determined that a formal exit conference was not necessary.

Preliminary views of Human Resources officials were received on July 11, 2008. Final responses were received on July 14, 2008 and are included as corrective action plans in the Observations and Recommendations section of the report. The plans indicate a commitment to addressing the issues noted.

LMCO §30.36(B) requires Louisville Metro Agencies to respond to draft audit reports in a timely manner. It specifically states that

“The response must be forwarded to the Office of Internal Audit within 15 days of the exit conference, or no longer than 30 days of receipt of the draft report.”

The Human Resources’ response was provided within this required timeframe.

Observations and Recommendations

Scope

Louisville Metro's direct deposit activity was reviewed. The focus of the audit was compliance with Metro Government's direct deposit policy and the identification of possible "ghost employees."

Policy Compliance. The direct deposit policy became effective April 1, 2006. As of May 12, 2008, all employees hired or rehired since inception of the policy were identified for verification of direct deposit setup. All active individuals *paid* through Metro Government's payroll system were included in the review. This included regular / temporary employees, full / part-time employees, board members, fiscal agent employees and such. Direct Deposit serves as a tool to help streamline the distribution of payments. Therefore, no individuals were eliminated from this review based on their status of employee versus non-employee.

Ghost Employees. All employees with direct deposit setup as of May 12, 2008 were reviewed. There were 5,271 employees identified as having direct deposit setup, and 91 bank account numbers were identified as being used by more than one employee. The personnel file for these employees was verified to ensure the person was an actual employee of Metro Government. The employment status was also verified for employees that work within the same agency, use the same bank account, and at least one in the pair has time keeping access in the Metro payroll system. It should be noted that determining if employees sharing accounts were related / married, or have supervisory authority over the other, was not an objective of this review.

Observations

Some issues were noted with Louisville Metro's direct deposit activity. As a result, the internal control structure needs improvement and its effectiveness impaired. Opportunities noted to strengthen the controls are as follows.

#1 – Policy Compliance

#2 – Ghost Employees

Details of these begin on the following page.

#1 – Policy Compliance

Louisville Metro Government's personnel policy 3.11 – Direct Deposit of Pay states that effective April 1, 2006 employees hired or rehired are required to be paid by direct deposit unless otherwise exempted from the policy. Some issues were noted with regards to direct deposit policy compliance.

- Of the 1,181 employees hired / rehired since the policy effective date, 240 (20%) were not enrolled in direct deposit. Of these, 108 (9%) were regular employees and 132 (11%) were temporaries.
 - The policy states that temporaries hired to work less than 90 days are exempt from the direct deposit requirement. However, it was not possible to identify these cases based solely on data maintained in Metro's human resources and payroll system. The number of days since the temporary employees had been hired / rehired ranged from 63 to 722 days.
- Departmental representatives were contacted to provide explanations for why employees were not enrolled in direct deposit. Based on the explanations provided, it appears that the direct deposit policy does not provide sufficient guidance as to who the policy does and does not apply to, as well as monitoring responsibilities. In some cases, agency representatives did not provide specific reasons for noncompliance, while in other cases the reasons varied greatly. Examples include the following.

Regular Employees

- No explanation was provided for why direct deposit had not been setup, but employees will be requested to do so.
- Some individuals are perceived as non-employees (i.e., Board Members, Foster Grandparents, Constables).
- Employees are in a part-time status.
- Employees' statuses changed from temporary to regular.
- Employee(s) did not have a checking account or are unable to obtain one.

Temporary Employees

- Employees are temporaries scheduled to work only a particular season.
- Employees are temporaries and may / may not reside the full year of employment within Louisville – Jefferson County.
- Policy is unclear how to handle temporaries when it is uncertain whether they will work over 90 days.
- Employees were under 18 years old when hired.
- Employees were perceived as non-employees (i.e., AmeriCorps Members).
- No explanation was provided for why direct deposit had not been setup, but employees will be requested to do so.

Recommendations

Appropriate personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Human Resources personnel should evaluate Louisville Metro's policy regarding direct deposit of pay. The goal should be determining what additional specifications should be provided within the policy to better guide employees and departments on compliance. For example, a determination should be made as to whether the policy

applies only to Metro employees or to all individuals paid through Metro's system. Ideally, the policy should apply to all individuals paid through Metro's system in order to provide the most benefits.

- ✓ Responsibilities for monitoring compliance with the direct deposit policy should be defined and communicated to the appropriate individuals (i.e., Human Resources personnel or departmental representatives). The tools needed to properly monitor activity and compliance should be developed and provided to these individuals. Human Resources should contact Metro Technology Services for assistance with creating monitoring tools.
- ✓ Any exemptions to the direct deposit policy should be approved by the Human Resource's director or designee, and documentation of exemptions should be maintained by both Human Resources and the applicable department. Exemptions should be routinely monitored to ensure they are still applicable (i.e., the situation warranting exemption still applies).

#2 – Ghost Employees

There were no “ghost employees” identified as a result of this review. This indicates the control structure of the direct deposit procedures, with regards to employees versus non-employees, appears to be functioning as intended.

Recommendations

No recommendations are needed at this time.

Human Resources' Corrective Action Plan

From the inception of this policy we have encountered difficulty in enforcing it across the board. Some employees have resisted it solely on the basis of not being able to manage their checking account and others on the basis that they cannot get a checking account at a bank. We solved the latter problem by contracting with a local bank which will provide checking accounts for our employees.

Related to the issue of enforcement, our implementation of the self-service application in PeopleSoft allowed employees to cancel direct deposit themselves. We have fixed that problem as well and will continue to prevent employees from canceling their own direct deposits.

With respect to the recommendations being made as a result of the audit, we will rewrite the policy to make it more easily understood and more instructive in nature; we will increase our follow-up efforts for new employees so as to enforce the fourteen day time frame new employees have to provide us with their direct deposit information; and we will continue to review other ways of monitoring and enforcing compliance with the policy.

Appendix – Direct Deposit of Pay Policy

Louisville Metro Government
Personnel Policies

Effective 04/01/2006

3.11 Direct Deposit of Pay

- 3.11(1) Direct deposit provides a number of benefits to Louisville Metro Government and its employees. When utilizing direct deposit there is less chance of a lost check, reduced potential for theft or forgery, and funds are deposited in employees' accounts on payday even if they are sick or on vacation. Direct deposit serves as an efficient tool which streamlines the distribution of payroll.
- 3.11(2) Direct deposit payments are available in employees' designated accounts at their financial institution's opening of business the morning of payday, ready for check writing or withdrawal. Employees may receive advice regarding this direct deposit electronically or via hardcopy report.
- 3.11(3) Effective April 1, 2006, each new or rehired employee, at the time of employment or return to payroll, shall be required to be paid by direct deposit unless they are otherwise exempted under this policy. Each employee shall designate within fourteen (14) calendar days of their date of hire a financial institute and associated checking or savings account for the direct deposit of pay according to the guidelines established by Louisville Metro Government for direct deposit.
- 3.11(4) There are certain circumstances for which salary payment by check rather than direct deposit is necessary or suitable. A temporary employee hired for less than ninety (90) days may be exempted. Any other exemption, whether personal or business in nature, will require approval by the Director of Human Resources or designee.
- 3.11(4) Employees who at the time of hire do not have a bank account may be provided the name(s) of a local bank(s) or credit union(s) that may offer them a means of direct deposit in order that they may comply with this policy in a timely fashion.

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