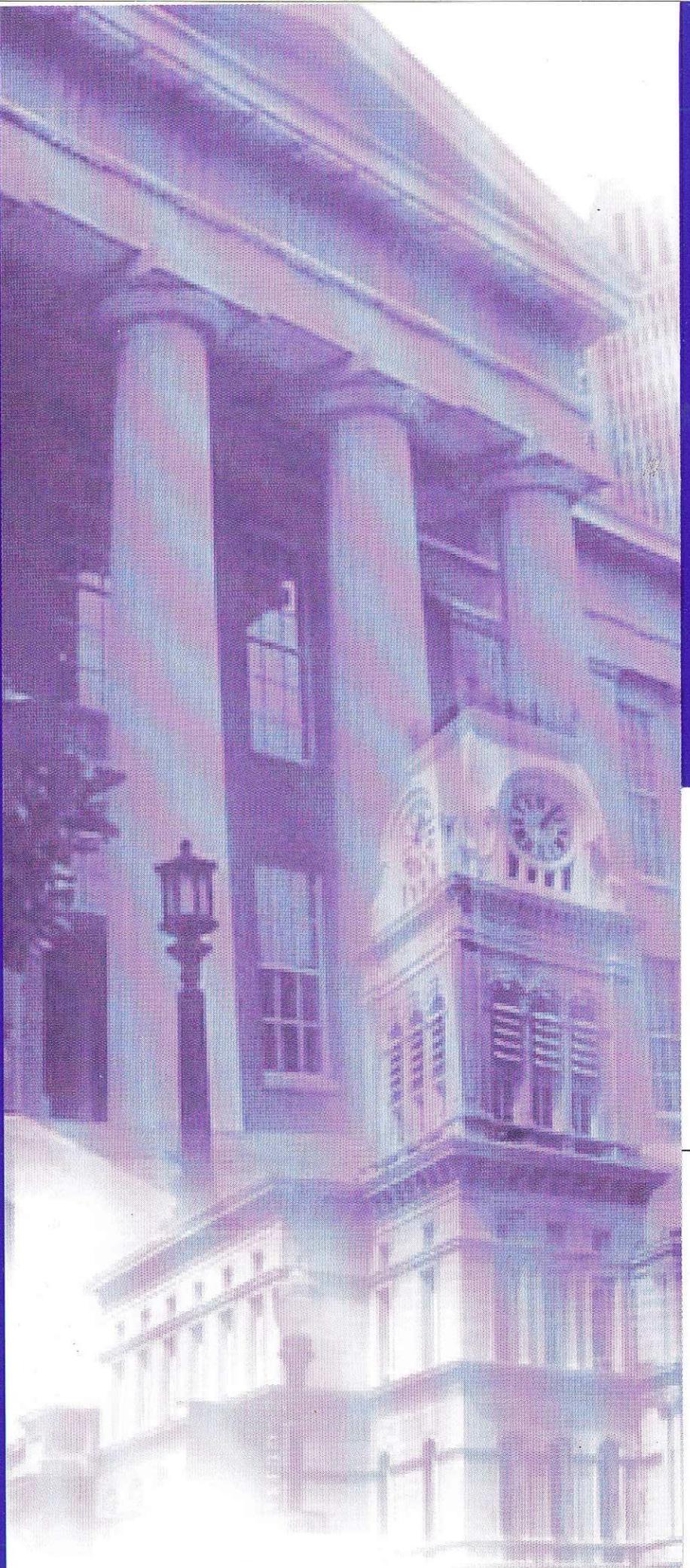




Greg Fischer
Mayor

Louisville Metro Council

The Office of Internal
Audit provides independent,
objective assurance and
consulting services
that adds value to and
improves Louisville
Metro Government.



Office of Internal Audit

Louisville Metro Government

2010 Payroll Review

Report

Louisville Metro Government

2010 Payroll Review

October 2011



Louisville Metro Government

2010 Payroll Review

Office of Internal Audit

Table of Contents

Executive Summary 2

Transmittal Letter 3

 Introduction..... 3

 Scope..... 4

 Opinion 4

 Corrective Action Plan..... 5

 Internal Control Rating 6

 Background..... 7

 Summary of Audit Results..... 7

Observations and Recommendations 9

 Office of Management and Budget’s Corrective Action Plan 13

 Human Resources’ Corrective Action Plan 14

PROJECT TITLE

Louisville Metro Government - 2010 Payroll Review

OBJECTIVE AND SCOPE

The objective was to obtain assurance that operational risks are adequately mitigated through the internal control structure of enterprise wide payroll. The primary focus of the review was the fiscal and operational administration of Louisville Metro Government's payroll activity. This included how activity is processed, recorded, and monitored. This was a planned audit.

Testing included activity occurring during calendar year 2010 (January 1, 2010 to December 31, 2010). The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report.

INTERNAL CONTROL ASSESSMENT

Needs Improvement

RESULTS

Earn Code Analysis. Sampled earn codes were reviewed for appropriateness of use.

- Leave balances for Louisville Metro Fire Department (Fire) employees are manually maintained by Fire personnel. Manual tracking of leave data is inefficient and increases the risk for errors.

Pay Adjustments. Payments outside of normal payroll disbursements were reviewed for appropriateness.

- Several cases were noted where the expected payment to the employee differed from the actual payment by Louisville Metro.

FICA. Employees were sampled for review of appropriateness of deduction status.

- In one case an employee was found to have been incorrectly set up to not be subject to the deduction of FICA upon rehire.



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

GREG FISCHER
MAYOR

INGRAM L. QUICK, CIA, CFE
INTERIM DIRECTOR -CHIEF AUDIT EXECUTIVE

JIM KING
PRESIDENT METRO COUNCIL

Transmittal Letter

October 26, 2011

The Honorable Greg Fischer
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Subject: Audit of Louisville Metro Government's 2010 Payroll Activity

Introduction

In accordance with internal auditing best practices, an enterprise-wide review of 2010 payroll activity was performed. The objective was to obtain reasonable assurance that payroll activity was processed appropriately and that internal controls were effective in mitigating certain risks. This was achieved by performing high-level reviews and analyses of payroll data. Individual employee time records were not reviewed. An additional benefit of this review was the opportunity to provide Louisville Metro Directors with information that helps in managing their human resources.

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

The review period covered calendar year 2010 (January 1, 2010 – December 31, 2010) and included the following areas:

- Overtime Earnings
- Highest Gross Earnings
- Key Personnel Earnings
- Earn Code Analysis
- Leave Balances
- Pay Adjustments
- FICA Deductions

Activity from each area was reviewed to ensure appropriateness. 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 identify all issues because it was based on selective review of data.

Opinion

It is our opinion that the overall administration of payroll activity needs improvement. The internal control rating for each area reviewed is on page 6 of this report. These ratings quantify our opinion on internal control, and identifying areas requiring corrective action.

- **Manual Tracking of Leave.** Leave balances for Louisville Metro Fire Department (Fire) employees are manually maintained by Fire personnel. Manual tracking of leave data is inefficient and increases the risk for errors. *This was noted in a prior review.*
- **Pay Adjustments.** Payments outside of normal payroll disbursements (*i.e. furlough repayments*) were reviewed for appropriateness and accuracy. There were some cases noted in which the reimbursement for furloughed days was repaid at an hourly rate that differed from the rate of pay that the employee earned at the time of the furlough days.
- **FICA.** Employees who did not have FICA deducted from their paychecks were reviewed for appropriateness of their deduction status. There was one employee who upon rehire was incorrectly set up in the payroll system as being exempt from the deduction of FICA.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of payroll activity.

Corrective Action Plan

The focus of this review was the Louisville Metro enterprise, not an individual department. Each Louisville Metro department is responsible for ensuring its payroll activity is appropriate. In addition, the Office of Management and Budget's (OMB) Payroll division and Human Resources (HR) are responsible for the accuracy and integrity of payroll expenditures for Louisville Metro Government. OMB and HR were asked to provide a corrective action plan for the recommendations in this report. The corrective action plans are included in the Observations and Recommendations section of this report. We will continue to work with OMB and HR to ensure the actions taken are effective to address the issues noted.

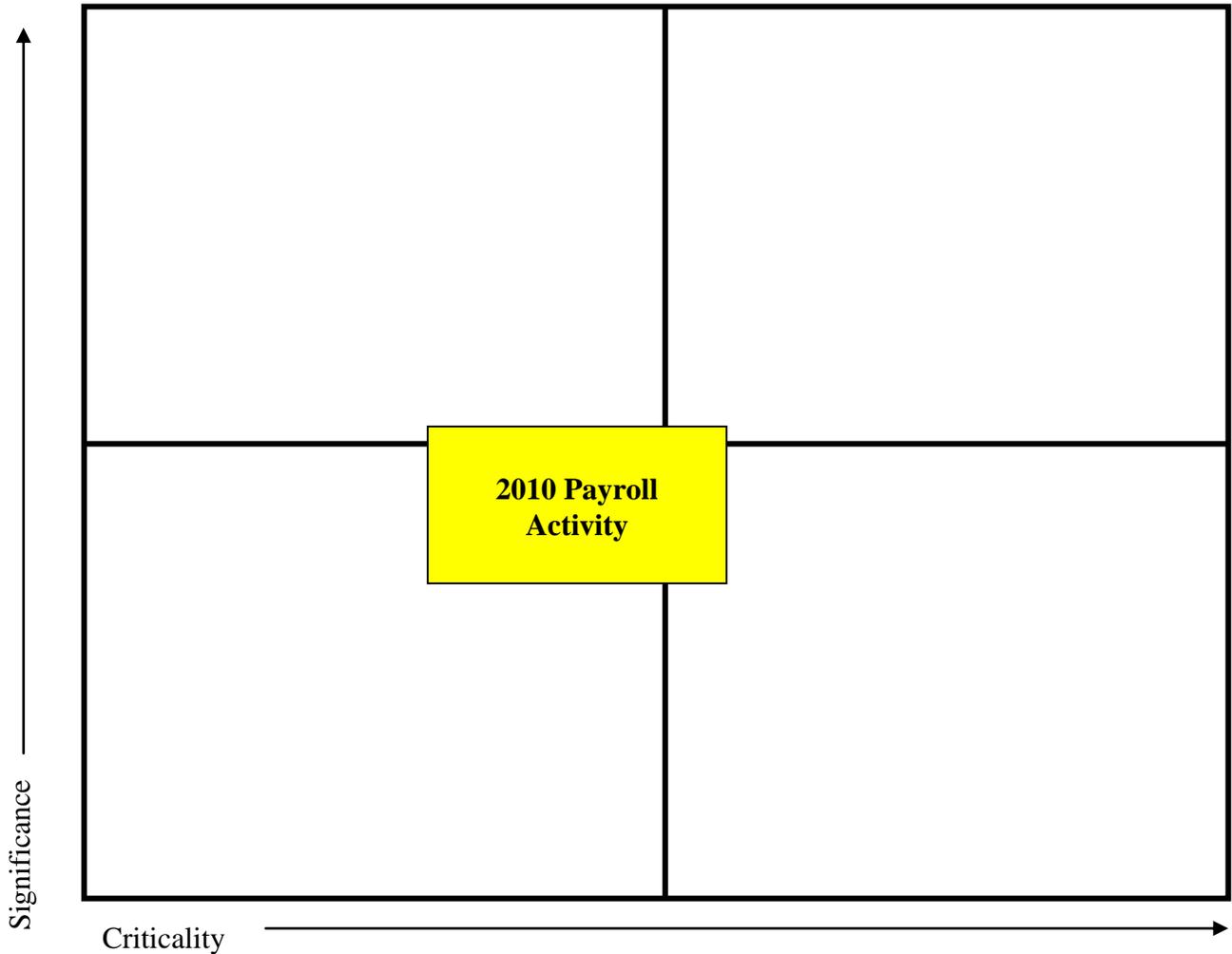
Sincerely,



Ingram Quick, CIA, CFE
Interim Director of Internal Audit

cc: Louisville Metro Council Government Accountability and Ethics Committee
Director of Office of Management and Budget
Director of Human Resources
Louisville Metro External Auditors

Internal Control Rating



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

Background

Personnel costs are normally one of the largest operating budget items for departments. It is imperative that proper controls are in place to provide accountability for the funds expended. In accordance with internal auditing best practices, routine reviews of payroll activity can help in obtaining reasonable assurance that payroll activity is processed appropriately and that internal controls are effective in mitigating certain risks.

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 performed a prior review of Louisville Metro 2009 payroll activity and issued the results in April 2010. 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 audit did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the examination 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 views of the Office of Management and Budget and Human Resource officials were received on October 20, 2011 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 Office of Management and Budget and Human Resources’ responses were provided within this required timeframe.

Observations and Recommendations

Scope

An enterprise-wide review of Louisville Metro Government's 2010 payroll activity was performed. The objective was to obtain reasonable assurance that payroll activity was processed appropriately and that internal controls were effective in mitigating certain risks. This was achieved by performing high-level reviews and analyses of summarized payroll data. Individual time records were not reviewed. The review would not reveal all issues because it was based on selective review of data.

The review period covered calendar year 2010 (January 1, 2010 – December 31, 2010). The population for each area reviewed was as follows.

- **Overtime Earnings.** Data for employees whose overtime pay equaled or exceeded 25% of their total gross pay was obtained. The overtime amounts did *not* include scheduled overtime or overtime on special pay earnings. The data included all employees earning \$20,800 or more during the year. There were a total of 223 employees identified. A sample of 12 employees was reviewed for appropriateness.

Using the overtime data for the 223 employees identified, a report was prepared for each Metro Department that listed the employees' names, job titles, earnings, and overtime. Each applicable Louisville Metro Director was requested to provide assurance that the overtime was necessary for departmental operations.

- **Highest Gross Earnings.** Data for employees with \$100,000 or more in gross earnings for the year was obtained. There were a total of 215 employees identified. A sample of 8 employees was judgmentally selected for review to ensure appropriateness of activity.
- **Key Personnel Earnings.** Data for gross earnings for key personnel was obtained. This included Office of Management and Budget, Human Resources, and Information Technology employees whose job function allows them high-level access to the payroll system. There were a total of 24 employees identified as key personnel. A sample of 6 employees was judgmentally selected for review to ensure appropriateness of activity.
- **Earn Code Analysis.** A list of Louisville Metro earn codes was obtained from the PeopleSoft payroll system (PeopleSoft). There were approximately 192 active earn codes identified. A sample of 15 earn codes was judgmentally selected for review to ensure appropriateness of activity.
- **Leave Balances.** Data for employees with accrued vacation time in excess of 60 days was obtained. Per Metro Personnel Policies, an employee cannot accrue more than 60 hours of vacation time. There were 181 employees identified. The employees were reviewed to ensure that the accruals of time were appropriate.
- **Pay Adjustments.** Data for employees who received payments outside of normal payroll disbursements (*i.e. furlough repayments*) was obtained. There were 4,201 employees identified. A sample of 25 settlement payments was judgmentally selected for review to ensure appropriateness of activity.

- **FICA.** Data for employees who did not have the FICA payroll tax deducted was obtained. There were 1,001 employees identified. The employees were reviewed to ensure appropriateness of activity.

Observations

Some issues were noted with the administration of payroll activity. As a result, the internal control structure is impaired and needs improvement. Opportunities noted to strengthen the controls are as follows.

Earn Code Analysis

- **Manual Tracking of Leave.** Leave balances for Louisville Metro Fire Department (Fire) employees are manually maintained by Fire personnel. Due to the complexity of the rules related to Fire's leave accruals, leave tracking has not been fully converted to an automated process (i.e., leave time is not accrued and balances are not maintained via the PeopleSoft system). Manual tracking of leave data is inefficient and increases the risk for errors. In addition, independent oversight controls for Fire leave pay do not exist since the Office of Management and Budget's Payroll division is not able to validate the pay through standard system exception reporting.
 - The Office of Internal Audit attempted to validate terminated vacation pay amounts paid to Fire employees. Though the amounts paid appeared to reflect the conversion processes described by Fire personnel, a validation of leave hours was not performed since Fire manually tracks this data. There were 30 Fire employees paid a total of approximately \$200,600 in terminated vacation pay during the review period. *This was noted in a prior review.*

It should be noted that in January 2011 Metro Technology Services and the Metro Human Resources Benefits division began using the PeopleSoft payroll system to document Fire employee leave time. Leave balances were loaded into PeopleSoft. July 2011 was the target start date for PeopleSoft to automatically begin accruing leave time; thus, manual calculations will no longer need to be completed.

Pay Adjustments

- Repayments of furloughed days were made to a number of Metro employees covered by a collective bargaining agreement.
 - Four employees received furlough repayments which were more than the original amount furloughed. The employees' pay rate increased between the time the employees were furloughed and when the furloughs were repaid. The employees were repaid at their current rate of pay rather than their rate of pay at the time of the furlough.

FICA

- FICA is a federal tax deducted from an employee's gross income used to fund Social Security. Since 2006, all Metro employees are subject to the deduction unless historically they have not been subject to the deduction under the terms of their collective bargaining agreement.
 - One employee was incorrectly setup in the PeopleSoft payroll system as being exempt from the FICA deduction. Employees can be setup in the payroll system as either being exempt or subject to the FICA deduction. The

employee was originally in a position where they were properly exempted from the deduction. Upon rehire, the employee's status in the payroll system stayed as exempt rather than defaulting to being subject to the deduction.

Leave Balances

- There were no issues noted with regards to employees' leave balances.

Overtime Review

- There were nine department Directors that were provided a report on overtime. All of the Directors provided assurance that the overtime was necessary for departmental operations.

Key Personnel Earnings

- There were no issues noted with regards to gross earnings for key personnel.

Highest Gross Earnings

- There were no issues noted with regards to highest gross earnings.

Recommendations

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

Manual Tracking of Leave

- ✓ Fire should continue to work with Metro Technology Services and the Department of Human Resources Benefits division to automate their leave accrual processes. Ideally, the PeopleSoft system, Louisville Metro's primary leave tracking mechanism, should be programmed to handle this type of activity for Fire. The efforts taken to automate this process should be given a high priority, especially considering the current inefficiencies, risk for errors, and volume of activity associated with Fire leave accruals.

Pay Adjustments

- ✓ Metro Payroll should carefully monitor any pay adjustments (e.g., furlough repayments) made to employees during the normal payroll process. Procedures should be in place to verify that the pay is calculated appropriately.
- ✓ Office of Management and Budget should determine the feasibility of collecting the portion of furlough repayments that were paid to employees in error. Appropriate adjustments should be made to system records for collections received to ensure

employee earnings are properly reflected. It may also be necessary to issue amended earning statements (i.e., W-2s) to employees.

FICA

- ✓ Care should be taken by the Metro Human Resources Benefits division to ensure Metro employees are appropriately set up in the PeopleSoft payroll system as being exempt from the FICA deduction. Exception reporting should be used to help identify cases where exemption to the deduction may not be appropriate (i.e., non-hazardous employees exempt from FICA deduction).

Leave Balances

- ✓ No recommendations needed at this time.

Overtime Review

- ✓ No recommendations needed at this time.

Key Personnel Earnings

- ✓ No recommendations needed at this time.

Highest Gross Earnings

- ✓ No recommendations needed at this time.

Office of Management and Budget's Corrective Action Plan

Pay Adjustments

The Office of Management and Budget (OMB) places great importance on the administration of payroll for the entire government.

Pay adjustments are administered by departmental payroll representatives. When the decision was made to repay furlough days, Human Resources sent out explicit instructions on the proper processing of the repayment, including spreadsheets that identified the employee, the date the furlough was taken, and the hourly rate at that time.

All furlough adjustments were keyed into PeopleSoft Time and Labor by departmental payroll representatives during normal payroll processing. Prior to confirmation of payroll, departmental payroll staff received data files that would include override rates for the department to verify the accuracy of the time entered. OMB relies on the data file verified by the departmental payroll representative prior to issuing pay checks.

To avoid future incidents of this nature, OMB Payroll is working with Metro Information Technology to develop a report that compares current rate of pay to past rates of pay based on select criteria.

OMB has determined and HR concurs that the recovery of the overpaid funds would require written permission from each affected employee. The recovery is not feasible because the gross amount that would be recovered would be less than the administrative cost that would be incurred through the collection process.

Human Resources' Corrective Action Plan

Manual Tracking of Leave

Metro Technology Services and the Department of Human Resources – Benefits division are aware of the manual processes used by Fire to track leave time. Automation of the process using the PeopleSoft system for housing balances of leave time has been introduced into PeopleSoft for phase one as of January 2011. Phase two of the automation began July 2011 in which the system began calculating accrued time.

FICA Analysis

The one employee whose FICA was incorrect was due to the fact that the employee was FICA exempt at the time of retirement and was later rehired. The delivered PeopleSoft default for “rehiring” employees is to bring forward all the previous employment data into the rehire record, therefore, bringing forward the previous FICA status. As a result of how “rehired” employees are handled by PeopleSoft, Human Resources began working with Metro Technology Service in April 2009 to develop coding for changing the way FICA is handled for rehired employees. The FICA status for newly hired employees defaults to “subject”, which allows for FICA to be deducted from the paycheck. The solution for FICA is to have the same thing occur for “rehired” employees while keeping some of the other defaults intact. As a result, new coding was implemented into PeopleSoft production on September 2009, that prevents the FICA status from defaulting from the previous record, but instead defaults the status to “subject” upon Hire and Rehire of employees. Therefore, this issue has been resolved and solution has been implemented to prevent the error from occurring instead of using query to resolve to problem. However, queries are used as a tool to spot check and make sure the system is still handling the FICA setups correctly.

Report

Louisville Metro Government

2010 Payroll Review

October 2011

