



Performance Audit: Payroll Processing

Human Resources and Finance Departments

Durham County Internal Audit Department

July 31, 2012



COUNTY OF DURHAM

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July 31, 2012

Michael M. Ruffin, County Manager:

Internal Audit has completed its audit of internal controls related to payroll processing. Our methodology was to review the process from the time an employee is hired until they are paid and any pay changes such as salary increases. Additionally, we looked at the processes to assure that payroll payments were only being made to legitimate employees.

Audit results showed that internal controls of the Finance Department and Human Resources are reasonable; however, inherent risks exist because many of the processes are manual. We did not find significant errors in the process but we made a recommendation for HR to (1) periodically remind departmental staff to be mindful of their processes and (2) clarify and implement performance appraisal policy.

The Human Resources Department recognizes the need for a policy revision and plans to include it in its revised handbook. That handbook is scheduled to be completed and approved by year end.

I appreciate the courtesy and cooperation provided by Finance, Human Resources, and SAP staff in assisting with this audit.

Richard Edwards
Internal Audit Director

XC: Cora Wilson, Director, Human Resources
George Quick, Director, Finance

July 31, 2012

Highlights

Internal audit report to the County Manager

Why we did this audit

This audit was conducted to determine if the County's payroll processes employ effective controls to reasonably assure employees are paid accurately, timely, and to legitimate County employees.

The specific questions were:

1. Are all paid employees documented by HR?
2. Are controls and procedures adequate to assure payments are based on the approved pay?
3. Are controls and procedures adequate to detect payroll errors?
4. Are there indications of overtime abuses?

What we recommend:

1. HR periodically remind departmental timekeepers to review military leave procedures, and
2. Management review the Appraisal Policy, revise as needed and implement it consistently throughout the County.



For more information, please contact Richard Edwards, Internal Audit Director by phone at 919-560-0042 or by email at rcedwards@durhamcountync.gov.

PAYROLL PROCESSING – FINANCE AND HUMAN RESOURCES DEPARTMENTS

Payroll Controls are Adequate to Provide Reasonable Assurance that Payroll Payments are Proper

What We Found

We did not find significant payroll errors although inherent risks of errors exist. Risks exist because many of the basic steps are dependent upon manual processing. These risks will continue to exist; however, with diligence and adherence to procedures, risks are largely mitigated.

For example, manual error was at fault in allowing an employee on official military leave to collect sick leave payments authorized in error. The manual process required the employee's department to complete a form advising HR that the employee was in a military leave status; however, the form was not completed and submitted. Information on the form would have triggered automated flagging of improper payments. As it was, SAP flagged the situation when the employee's sick leave was exhausted; contrary to the timekeeper's authorization. Additionally, although we did not find examples in our survey, it was reported that incorrect pay is granted occasionally because of manual entry errors but the errors are discovered through both manual and SAP editing processes.

Overall, the system worked well. As discussed below under Summary of Results, answers to the objective questions showed controls are in place to reasonably assure payroll accuracy.

SUMMARY OF AUDIT RESULTS

There were no individuals on the payroll that were not documented in Human Resource records.

Our comparison of HR's fiscal year 2011 database of 2,156 employee records agreed with the Finance Department's payroll records. For additional assurance that we did not have undocumented employees on the payroll, we compared bank direct deposit files with HR's database and those files were in agreement as well. In summary, the result of our sample review was that all salary and wage payments were made to legitimate employees.

Controls are adequate to assure payroll payments are appropriately approved and authorized.

A combination of manual and automated controls working together provides reasonable assurance that payments are approved and authorized according to established procedure. Several actions take place to ensure appropriate pay. HR enters employee data such as employee schedules, working areas, and compensation into the SAP system. Subsequent changes to this data, such as raises, are entered into SAP by HR employees as well. After data is entered into SAP, it undergoes several reviews; once by the original data entry person, another HR Technician, and finally, the supervisor. Before payroll payment is made, the Finance Department's payroll staff runs several reports to verify their data outputs match HR inputs.

Introduction

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.

Scope and Methodology

We reviewed payroll processes from when employees were hired and initial paperwork submitted by the department and HR's development of the employee profile in SAP through payroll payments made by the Finance Department payroll processing staff. We reviewed 180 of 2658 employee payroll records for the 18-month period July 1, 2010 through December 31, 2011.

During our review process, we:

1. Interviewed HR and Finance Department staff,
2. Observed HR and Finance Department payroll processes,
3. Reviewed employee records and files, including military leave,
4. Cross-referenced employee salaries with pay grade classifications,
5. Cross-referenced payroll data with the employee data file,
6. Reviewed SAP authorization for HR and Finance Department Payroll staff, and
7. Reviewed overtime pay.

Results of our sample analysis showed that employees were properly paid; payments were appropriately approved and made according to the approvals. To draw our conclusion, we reviewed 180 of 2,658 HR employee records over the 18-month period July 1, 2010 through December 31, 2011. We did not identify any irregularities during our review of the sample cases.

Controls and procedures are reasonably adequate to detect payroll errors but risks remain.

We did not find undetected errors during our review of procedural controls; however, one erroneously authorized sick leave pay error was brought to our attention. As discussed previously, the timekeeper did not complete the necessary personnel action form regarding the employee's status; allowing the employee to receive unauthorized sick leave pay of about \$1,409. The County's policy allows 120 hours of paid military leave. If more is needed, employee status can be changed to "military leave without pay" which allows drawing down vacation pay.

Controls in SAP would not have allowed payment if the form had been completed and entered into SAP. In this example, SAP error messages led administrators to identify the error and make corrections. The employee will be asked to reimburse the County upon return to active work status.

To determine the frequency of the occurrence of this situation, we asked departments to provide us with a list of employees that had taken military leave. We reviewed the records of those employees to determine if any took sick leave after using their allotted 120 hours of military leave. Of the eight employees that used 120 hours, we did not find other cases of sick leave use. However, we recommend that HR periodically remind departmental time keepers to review military leave procedures.

Overtime was heavy in one department but the circumstances were justifiable.

Overtime abuses were not identified as a payroll issue. However, in FY 2011, approximately 13.7% of payroll in the EMS department was overtime pay. The top five overtime users increased their wages by 38.6 to 68.8 percent; however, we did not find abuse was a factor. The reason for the overtime was that the number of full time personnel was not sufficient to meet the shift requirements and that problem was exacerbated by leave, training, and time off for illness and injury. The highest participants of overtime were more available or willing to work than others and the matter was recognized and addressed by the Budget Department.

Overtime in EMS, has been a concern for several years. The FY 2013 budget includes positions for eleven additional FTE's.

When we compared Durham County's rate to other EMS operations in the state, Durham County's EMS overtime as a percentage of wages was lower when compared to Wake County which has an overtime rate of 33 percent. Other counties, for example, Person and Wilson, had overtime rates of 6.4% and 5.4%; respectively. However, we do not know what factors attribute to their lower rates.

Background

In fiscal year 2011, the County made payroll of approximately \$83,813,531 to 2156 employees. Payroll is bi-weekly and is deposited directly into each employee's designated banking account. The Enterprise Resource System (SAP) system is the mechanism by which pay checks are issued. Durham County's payroll function (Payroll) incorporates the Finance and Human Resources (HR) Departments as well as each department that keeps time, makes hires, or recommends dismissals and discipline, and salary increases. Together these units provide and enter information into SAP that ultimately generates paychecks. Payroll information is retained by HR in regards to the employee profile as well as the Finance Department. At the Finance Department, employee records including changes are reviewed before paychecks are cut and deposited into employee accounts.

What is a Performance Audit?

A performance audit is an engagement that provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

Behind EMS, the level of overtime use was 3.9 percent ranging down to less than one percent for Legal, Cooperative Extension, and Criminal Justice. Overall, 19 of 29 departments used overtime in fiscal year 2011 at a cost of \$1,216,962 or 1.5% of the County's total payroll.

Related Issue: Rate of delinquent employee evaluations is high.

Since January 2000, County policy requires timely completion of performance evaluations and prescribes a penalty for late submissions. According to the current policy, adherence to the policy would be reflected by timely completion and submission to HR within 15 calendar days of the employee's anniversary date. According to information provided by an HR representative, twenty-five of fifty-nine or approximately 42.4% of employee evaluations were delinquent for employees with anniversary dates during the pay period May 14 through 27, 2012.

The effect of untimely submissions is that payroll is not accurate especially if the performance evaluation results in an employee pay increase. For the sample data provided, eighteen out of the twenty-five would result in a change in pay. Additionally, at the end of the year, the risk of errors increases because the Finance Department has to make manual entries to the payroll system for financial statement purposes.

HR pointed to a process change revised in April 2012 that may have contributed to number of delinquent evaluations during the period for which we have information. That change requires evaluations on an initial 12-month evaluation cycle; instead of the previous 18-month cycle.

As stated earlier, the policy has a penalty for late submissions; however, we did not find evidence that the penalty had been enforced. Because the language in the penalty section of the policy is unclear, exactly how the penalty should be applied is uncertain.

Because the policy has not been fully implemented and is unclear regarding the penalty, we recommend management (1) review the policy and revise as needed and (2) implement it consistently throughout the County.

We appreciate the excellent cooperation from Finance, Human Resources, and SAP management and staff while conducting this audit.



COUNTY OF DURHAM
FINANCE DEPARTMENT

To: Richard Edwards, Internal Auditor

From: George K. Quick, Chief Financial Officer

Subject: HR/Payroll Audit

Date: July 23, 2012

I have reviewed the draft audit report and I am satisfied with the results. I agree that inherent risks exist because of the manual nature of some processing functions. I pledge that the Finance Department will continue to be vigilant in regards to (1) verifying information we receive, (2) verifying our inputs, and (3) abiding by our procedures in order to mitigate these risks.

Thank you for the thorough job you and your assistant did in conducting this audit.



COUNTY OF DURHAM
HUMAN RESOURCES DEPARTMENT

To: Richard Edwards, Internal Auditor
From: Cora S. Wilson, Human Resources Director *CW*
Subject: Human Resources/Finance Audit
Date: July 24, 2012

The audit recommendations regarding the Performance Management policy were discussed at the Management Team Meeting on 24 July 2012. The Management Team concurs with the recommendations. Implementation is targeted for the second quarter of this fiscal year.