



Jerry E. Abramson
Mayor

Louisville Metro Council

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Office of Internal Audit

Louisville Metro Government

2009 Payroll Activity

Audit Report

Office of Internal Audit

Louisville Metro Government

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April 2010



Louisville Metro Government

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Transmittal Letter

April 19, 2010

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

Subject: Audit of Louisville Metro Government's 2009 Payroll Activity

Introduction

In accordance with internal auditing best practices, an enterprise-wide review of 2009 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 2009 (January 1, 2009 – December 31, 2009) and included the following areas:

- Overtime Earnings
- Highest Gross Earnings
- Key Personnel Earnings
- Earn Code Analysis

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 is satisfactory. However, there was an issue noted with manual leave tracking. As a result, it is our opinion that the internal controls for manual leave tracking are inadequate. The internal control ratings are on page 5 of this report. The ratings quantify the opinions regarding the internal controls, and identify areas requiring corrective action. Specific results are as follows.

- **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. In addition, independent oversight controls for Fire leave pay do not exist.
- **Payroll Administration.** There were no issues noted with regards to overtime, key personnel earnings, and highest gross earnings.

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 is responsible for the accuracy and integrity of payroll expenditures for

Louisville Metro Government. OMB was 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 to ensure the actions taken are effective to address the issues noted.

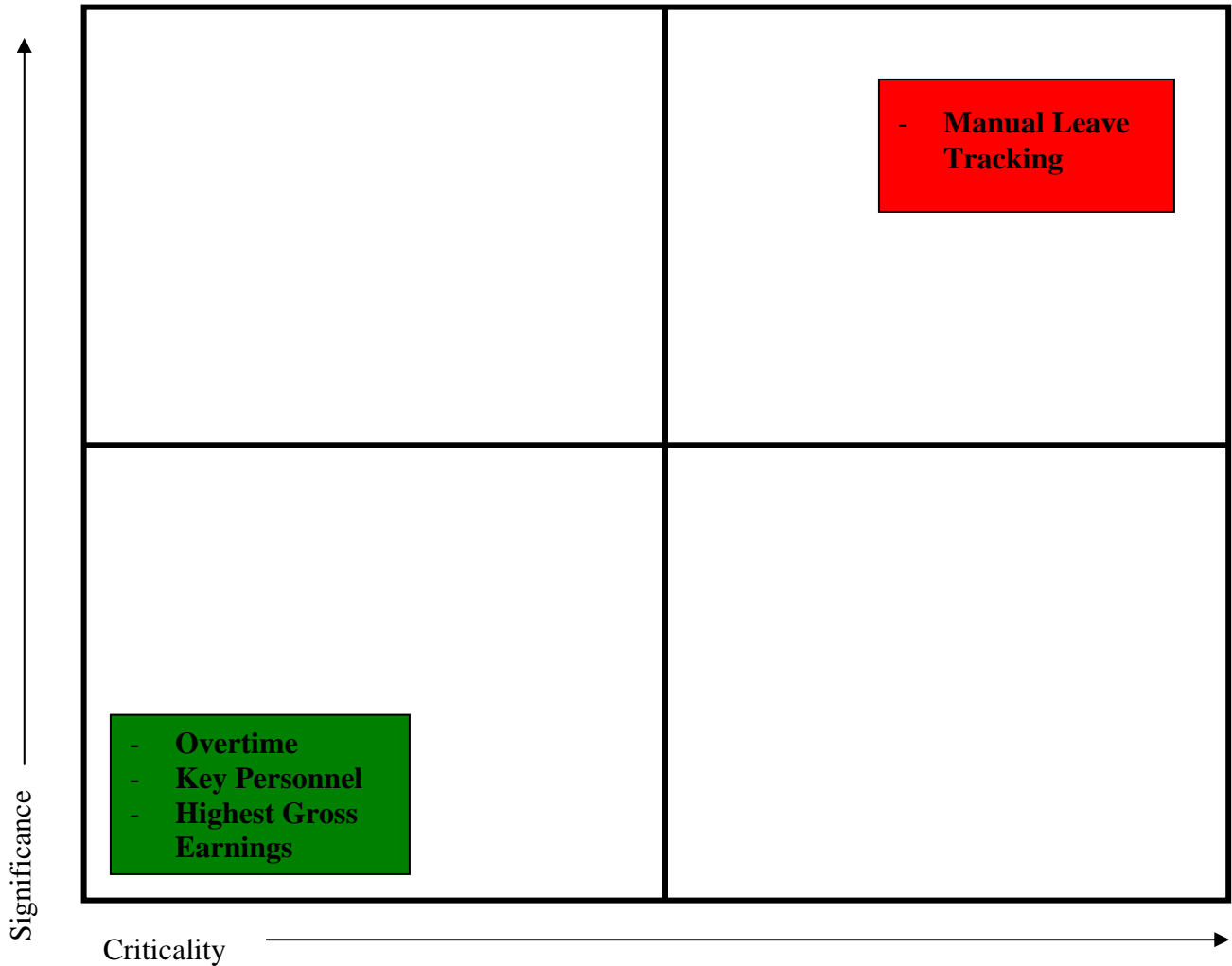
Sincerely,



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

cc: Louisville Metro Council Government Accountability and Oversight 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>	<u>Satisfactory</u> Not likely to impact operations.	<u>Needs Improvement</u> Impact on operations likely contained.	<u>Inadequate</u> Impact on operations likely widespread or compounding.
<i>Controls</i>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<i>Policy Compliance</i>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<i>Image</i>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<i>Corrective Action</i>	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 2008 payroll activity and issued the results in March 2009. 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

A draft report was issued to the Office of Management and Budget (OMB) on March 16, 2010. It was determined that a formal exit conference was not necessary.

The views of OMB officials were received on April 19, 2010 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’s response was provided within this required timeframe.

Observations and Recommendations

Scope

An enterprise-wide review of Louisville Metro Government's 2009 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 2009 (January 1, 2009 – December 31, 2009). 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 \$19,000 or more during the year. There were a total of 309 employees identified. A sample of 11 employees was reviewed for appropriateness.

Using the overtime data for the 309 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 all employees with \$90,000 or more in gross earnings for the year was obtained. There were a total of 136 employees identified. A sample of 11 employees was reviewed for appropriateness.
- **Key Personnel Earnings.** Data for gross earnings for key personnel was obtained. Key personnel included all employees having the payroll system security / role of a time keyer. It also 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 1,638 employees identified as key personnel. A sample of 18 employees was reviewed for appropriateness.
- **Earn Code Analysis.** A list of Louisville Metro earn codes was obtained from the PeopleSoft payroll system. There were approximately 190 active earn codes identified. A sample of 14 earn codes was judgmentally selected for review to ensure appropriateness of activity.

Observations

While the overall opinion for the administration of payroll activity is satisfactory, there was an issue noted with manual leave tracking. As a result, the internal control structure for manual leave tracking is inadequate and its effectiveness impaired. Specific results are as follows.

Earn Code Analysis

- 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 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 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 \$196,200 in terminated vacation pay during the review period.

It should be noted that Metro Technology Services and the Department of Human Resources Benefits division are aware of the manual processes used by Fire to track leave time. Both departments have identified that automating the leave process by using the PeopleSoft system is a task that needs to be explored further.

Overtime Review

- There were eight department Directors that were provided a report on overtime. All of the Directors provided assurance that the overtime was necessary for departmental operations.
- There was one case where the Director could not provide assurance for one employee noted on the overtime report since the employee primarily works on union business per a union side letter agreement.

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.

Earn Code Analysis

- ✓ 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.

- ✓ If it is determined that the PeopleSoft system cannot be used for Fire's leave time tracking due to the complexity of the accrual processes, then compensating oversight measures need to be implemented. This may include Fire sharing their leave records with an appropriate, independent authority (e.g., the Department of Human Resources Benefits division and the Office of Management and Budget Payroll division) for verification purposes. This will help ensure that Fire is maintaining balances properly and that employees are appropriately paid.

Overtime

- ✓ No recommendations needed at this time.

Key Personnel Earnings

- ✓ No recommendations needed at this time.

Highest Gross YTD

- ✓ No recommendations needed at this time.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget (OMB) places great importance on the administration of payroll for the entire government. The Payroll division is responsible for the integrity and accuracy of the largest annual expenditure of Louisville Metro Government.

The Auditor's opinion that the overall administration of payroll activity is satisfactory is confirmation that recommendations from prior year reviews have been satisfied and that overall payroll policies, processes and controls in place within Metro Government are adequate.

OMB and Human Resources have met and discussed the Auditor's recommendation regarding Louisville Fire Department's leave accrual tracking. Both OMB and HR agree with the Auditor's recommendation that the PeopleSoft system should be the primary leave tracking mechanism for the Louisville Fire Department.

At this time, PeopleSoft is not able to track LFD's leave accruals because of LFD's unique 24 hour on / 48 hour off scheduling. This issue has been reviewed in the past; however, PeopleSoft system limitations prevent LFD leave accrual tracking at this time.

OMB, HR, and Information Technology will revisit this during FY 2011 and determine if PeopleSoft can be configured to accurately track LFD accruals.

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