

Audit Report

Office of Internal Audit

Louisville Metro Government

2008 Payroll Activity

April 2009



Louisville Metro Government

2008 Payroll Activity

Table of Contents

Transmittal Letter 2

 Introduction..... 2

 Scope..... 3

 Opinion 3

 Corrective Action Plan..... 4

 Internal Control Rating 5

 Background..... 6

 Summary of Audit Results..... 6

Observations and Recommendations 8

 Department of Finance and Administration’s Corrective Action Plan..... 12



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

JERRY E. ABRAMSON
MAYOR

MICHAEL S. NORMAN, CIA, CFE, CGAP
CHIEF AUDIT EXECUTIVE

DAVID W. TANDY
PRESIDENT METRO COUNCIL

Transmittal Letter

April 14, 2009

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

Subject: Audit of Louisville Metro Government's 2008 Payroll Activity

Introduction

In accordance with internal auditing best practices, an enterprise-wide review of 2008 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 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 2008 (January 1, 2008 – December 31, 2008) and included the following areas.

- 1) **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 216 employees identified. A sample of earnings was reviewed for appropriateness.

Using the overtime data for the 216 employees identified, a report was prepared for each Metro Department that listed the employees, job titles, earnings, and overtime. Each applicable Metro Director was requested to provide assurance that the overtime was necessary for departmental operations.

- 2) **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 117 employees identified. A sample of earnings was reviewed for appropriateness.
- 3) **Key Personnel Earnings.** Data for gross earnings for key personnel was obtained. Key personnel included all employees having the system security / role of a time keeper. It also included Finance, Human Resources, or Information Technology employees whose job function allows them high-level access to the payroll system. There were a total of 1,132 employees identified as key personnel. A sample of earnings was reviewed for 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 administration of payroll activity needs improvement. The internal control rating is on page 5 of this report. This rating quantifies the opinion regarding the internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the internal control structure were noted. Examples include the following.

- **Policy Compliance.** There were some cases noted in which compensation paid to employees was either not in compliance with, or not addressed in, Louisville Metro Personnel Policies. This included pay for annual vacation payout, terminated compensatory pay, service purchase credit, and additional income.
 - Annual Vacation Payout: 3 employees, total payout \$36,444.
 - Terminated Compensatory Pay: 1 employee, total payout \$1,315.

- Service Time Purchase and Additional Income: 1 employee, total payout \$85,874 and \$3,385 respectively.

There was documented approval for these transactions. However, it does not appear that pertinent authorities, such as the County Attorney or Human Resources, reviewed the activity to ensure its appropriateness. Processing activity that has not been addressed in policy, or reviewed by pertinent authorities, increases the risk of non-compliance with applicable laws, requirements, and guidelines.

- **Processing Mistakes.** There were some cases noted where employee pay was not processed appropriately. This resulted in one employee being overpaid \$27,759, and several cases where Metro overpaid pension costs.

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, Metro Finance's Payroll division is responsible for the accuracy and integrity of payroll expenditures for Louisville Metro Government. Finance 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 Finance to ensure the actions taken are effective to address the issues noted.

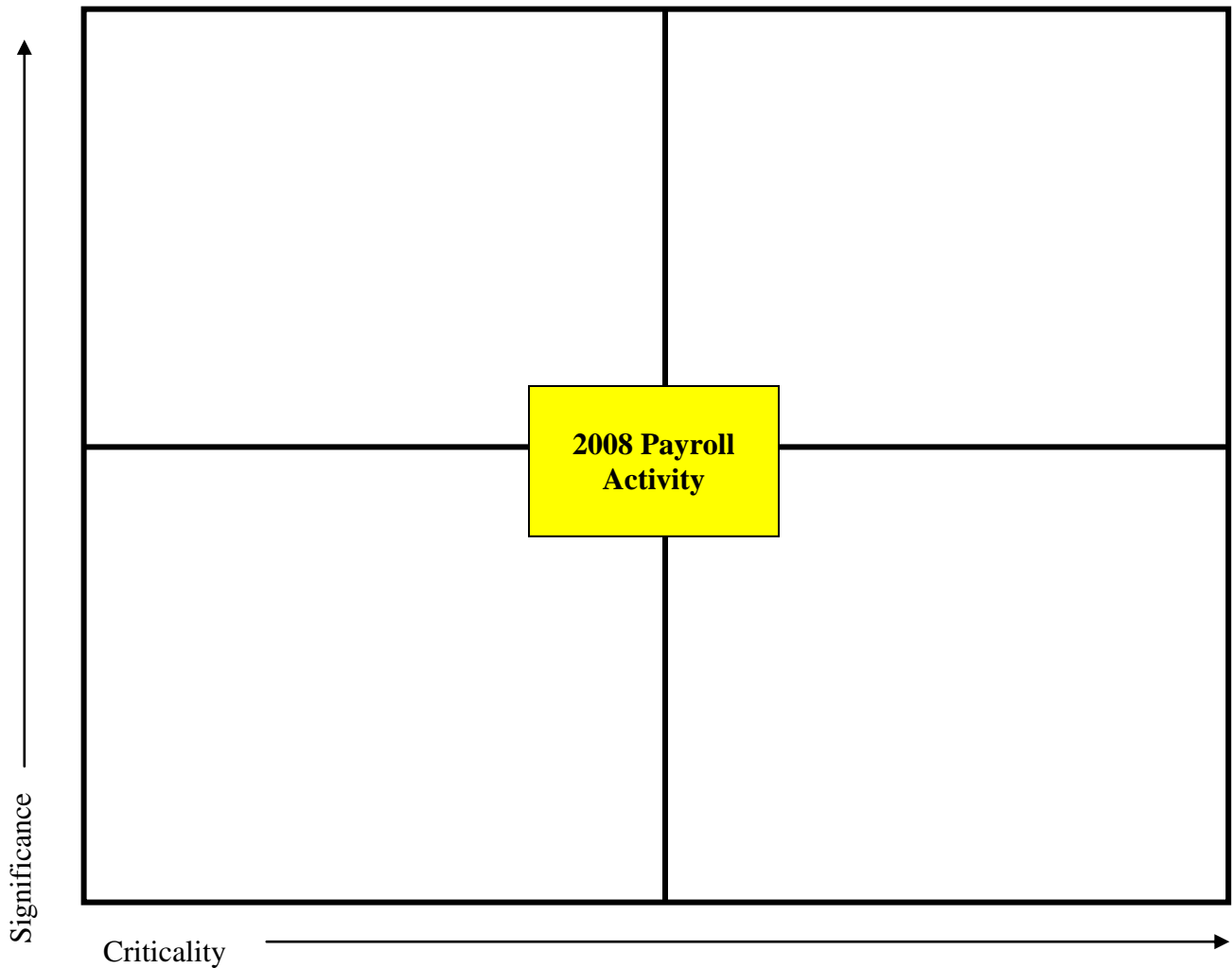
Sincerely,



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

cc: Louisville Metro Council Government Accountability and Audit Committee
Director of Finance and Administration
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 has performed previous annual reviews of Louisville Metro payroll activity but did not opine on the internal controls.

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 Department of Finance and Administration on March 16, 2009. It was determined that a formal exit conference was not necessary.

The views of Finance officials were received on April 10, 2009 and are included

as corrective action plans in the Observations and Recommendations section of the report.

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 Department of Finance and Administration’s response was provided within this required timeframe.

Observations and Recommendations

Scope

An enterprise-wide review of Louisville Metro Government's 2008 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 2008 (January 1, 2008 – December 31, 2008). 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 216 employees identified. A sample of 9 employees was reviewed for appropriateness.

Using the overtime data for the 216 employees identified, a report was prepared for each Metro Department that listed the employees, job titles, earnings, and overtime. Each applicable 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 117 employees identified. A sample of 10 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 Finance, Human Resources, or Information Technology employees whose job function allows them high-level access to the payroll system. There were a total of 1,132 employees identified as key personnel. A sample of 16 employees was reviewed for appropriateness.

Observations

Highest Gross Earnings

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.

- **Policy Compliance.** There were some cases noted in which compensation paid to employees was not in compliance with Louisville Metro Personnel Policies.
 - **Annual Vacation Payout.** There were 3 employees paid a total of \$36,444 in annual vacation payout. Louisville Metro Personnel Policy 5.3(7) states "Upon separation from Louisville Metro Government employment, an employee shall be paid for all accrued unused vacation leave, not to exceed 40 days." In one case, the employee retired and received 40 days of terminated vacation pay on the same check as the 20 days of annual vacation payout. In another case, the employee

received 20 days of annual vacation payout one pay check prior to receiving 40 days of terminated vacation pay. In the third case, the employee is still employed with Metro Government.

- **Terminated Compensatory Pay.** There was one case where an employee was paid \$1,315 for 5 days of terminated compensatory pay. Louisville Metro Personnel Policy 4.4(7) states that “An employee is not paid for accumulated compensatory time upon separation.” The employee retired and received 35 days of terminated vacation pay in addition to the terminated compensatory pay. While approval was documented, there was no explanation of why the employee was paid 5 days of terminated compensatory pay in lieu of 5 days of terminated vacation pay. It appears the employee had an additional balance of 9 vacation days.
 - Louisville Metro paid pension costs of approximately \$178 associated with the terminated compensatory pay that it would not have paid with terminated vacation pay. This could also affect the former employee’s retirement.

While these types of compensation are addressed in various Collective Bargaining Agreements, these cases did not involve employees covered by those agreements. There was documented approval for these transactions. However, it does not appear that pertinent authorities, such as the County Attorney or Human Resources, reviewed the activity to ensure its appropriateness and compliance with applicable laws, requirements, and guidelines.

- **Pay Not Addressed in Policy.** There was one case noted in which compensation paid to an employee was not addressed in Louisville Metro Personnel Policies.
 - **Service Time Purchase and Additional Income.** One employee was paid \$85,874 for service time purchase pay and \$3,385 in additional income. Support documentation indicates that the pays began in April 2008 and will continue for two years.

Processing activity that has not been addressed in policy increases the risk of non-compliance with applicable laws, requirements, and guidelines. There was documented approval for these transactions. However, it does not appear that pertinent authorities, such as the County Attorney or Human Resources, reviewed the activity to ensure its appropriateness and compliance with applicable laws, requirements, and guidelines.

- **Processing Mistakes.** There were some cases noted where employee pay was not processed appropriately.
 - There was one case where an employee was eligible to receive terminated compensatory pay, but it was processed at an incorrect rate. The compensatory balance, which was based on an 8 hour workday, was not converted to the managerial scale (daily rate) when it was paid. Thus, instead of being paid for 10 days, the terminating employee was paid for 80 days. This resulted in an overpayment of \$27,759 in gross pay and Metro pension costs of approximately \$9,402.
 - This mistake occurred in April 2008 but was not detected until this review. Metro Finance has taken the lead role in recovering the overpayment. This could also affect the former employee’s retirement.
 - The annual vacation payout for one employee was erroneously keyed as regular vacation time. As a result, Metro paid pension costs of approximately \$1,198

associated with the vacation pay that it would not have paid with annual vacation payout. This could also affect the former employee's retirement.

- There was one case where an employee was overpaid \$252 for terminated vacation pay. It appears the employee was paid for 2 additional accrual periods after their retirement effective date.

Overtime Review

- There were no issues noted with regards to the overtime earnings. All 8 applicable Metro Directors provided assurance that the overtime for the 216 employees identified was necessary for departmental operations.

Key Personnel Earnings

- There were no issues noted with regards to gross earnings for time keyers or other key personnel.

Recommendations

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

- ✓ Compensation that is not in compliance with, or not addressed in, Louisville Metro Personnel Policies should be reviewed by pertinent authorities, such as the County Attorney and Human Resources, prior to being processed for payment. This will help ensure that the activity is appropriate and in compliance with applicable laws, requirements, and guidelines. The approval by these authorities should be documented and distributed to all applicable processing entities (e.g., Metro Payroll, processing agency) so as to provide a proper trail of the review, approval, and authorization to process. Metro Payroll is ultimately responsible for ensuring payroll activity is appropriate prior to processing.
- ✓ Care should be taken by Metro Payroll, as well as processing agencies, to ensure payroll activity is processed appropriately. Exception reporting should be used to help identify cases where pay may not be appropriate (i.e., gross pay exceeds standard pay by a specific amount / percentage). This will help in the early detection of errors and allow for corrective actions to be taken in a timely manner.
- ✓ Metro Payroll should carefully monitor all compensation paid to employees upon termination with Metro Government (e.g., terminated vacation pay and terminated compensatory pay). Procedures should be in place to verify that pay is calculated appropriately.
- ✓ Metro Finance should continue with their efforts to collect compensation that was 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 earnings statements (i.e., W-2s) to employees.

- ✓ In cases where adjustments are made to retired employees' earnings, Metro Payroll should consult with appropriate personnel in Human Resources. It may be necessary to contact the Kentucky Retirement System regarding cases where employees were inappropriately paid and the compensation affected their retirement gross.

Department of Finance and Administration's Corrective Action Plan

Louisville Metro Finance places great importance on the administration of payroll for the entire government. The Payroll division is responsible for the accuracy and integrity of the largest annual expenditure of Louisville Metro Government.

The report states that the internal control structure is impaired and needs improvements; however, all of the examples cited under Policy Compliance and Terminated Compensatory Pay were appropriately reviewed and approved by Human Resources, Finance, and the Mayor's Office. Documented approval was provided to the auditor during the 2008 Payroll review.

The policy statements cited in the report are correct; however, it is important to note that the Director of Human Resources, at the direction of the Mayor, established the policies referenced in the report and maintains the authority to make policy decisions on a case by case basis.

Finance will continue to document policy exceptions as they were in this report and have been in the past. Furthermore, Finance will ensure the Director of Human Resources provides a written "sign off" on policy decisions that are made.

The processing mistake cited in the report is accurate. Metro Finance is working with the appropriate authorities to recover the amount overpaid to the employee. The processing mistake was made outside of Finance and Human Resources when the department payroll representative that processed the employee's time relied on incorrect information and did not seek the advice of Finance or Human Resource staff when paying out the managerial terminated vacation pay.

Finance and Human Resource departments work throughout the year with departments and agencies to ensure the accuracy of Metro Government's payroll. Both departments continually offer training opportunities to departmental HR/Payroll staff. The goal of the training is to disseminate information to appropriate departmental staff, promote consistency in applying Metro's policies and procedures, and to provide an effective learning environment that allows HR/payroll representatives the opportunity to work directly with Finance/HR staff.

Additionally, Finance, Human Resources, and Metro Technology Services continually work together to identify process improvements that mitigate payroll processing errors. System improvements and increased collaboration between the three departments has resulted in improved processes and increased accuracy. It is important to note that for the year in review, the processing mistake identified in this report represents approximately .0062% (approximately 6 thousandths of one percent) of Metro Government's annual payroll expense.