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**Office of the City Auditor**

**Audit Report**

**AUDIT OF PAYROLL AND
PAYROLL RELATED ACTIVITIES**
(Report No. A07-016)

**August 3, 2007**

**City Auditor**

Craig  D. Kinton

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## Executive Summary

This report presents the results of the audit[1] of payroll and payroll related activities for the City of Dallas.  The City's payroll system is very complex and is under extreme time constraints with an extensive amount of payroll processing required every week.  Payroll related activities involve 13,200 active employees.

We evaluated internal controls to ensure that employees receiving salary payments are valid and authorized, to ensure required data in the payroll system is complete and accurate, and to ensure that salary and other payments to employees, and employee deductions are properly calculated, authorized, and timely processed.

The City timely processed payroll, system reports were used to resolve various payroll problems, and there were no "ghost" employees, someone who does not work for the City, but receives pay; however, to avoid fines, adverse publicity, and damage to constituent confidence, the City needs to establish fundamental controls to prevent:

**Some employee time and attendance entries not being approved and pay changes not being documented.**

- The City has an accepted management practice that allows employees to be paid even if the employees' managers/supervisors do not approve their employees' time and attendance. As a result, we estimate the City paid a minimum $19.6 million in 2005 and will pay a minimum of $21.1 million in 2007 to employees even though the employees' time and attendance were not approved.

- Authorizations for employee salary and pay rate changes were not always in the employees' official personnel files. Transactions that are not properly authorized are indicators of potential fraud.  For example, two employees, without adequate documentation for pay increases, also have the ability to make changes to employee accounts in the payroll system.

**Some non-compliance with selected federal and state employment laws.**

- The City did not always comply with federal and state laws to provide information about all new or rehired employees to the State of Texas Office of the Attorney General.  The City's non-compliance with federal and state employment laws can result in fines and adverse publicity.

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[1] Audit conducted under authority City Charter, Chapter IX, Section 3.

- Employment eligibility verifications were not always completed in accordance with federal law. The City's non-compliance with eligibility verifications can result in fines and adverse publicity.

- The City is not effectively resolving employee Social Security Number (SSN) mismatches received from the Social Security Administration (SSA). Four employees successfully used the SSNs of deceased individuals to obtain employment with the City. The use of any document lawfully issued to a person other than the possessor, including a deceased individual, is unlawful and violates the Immigration Act of 1990.

**Inaccurate wage and tax information being provided to both employees and government agencies.**

- The City has not always correctly withheld Medicare tax and calculated Medicare wages. As a result,

    o Twenty-eight employees owe an estimated $138,811 in Medicare taxes and the City owes the employer's Medicare portion of $138,811 because the City did not deduct Medicare tax for the employees; and,

    o Sixty-six employees have Medicare wage errors greater than $10 each and twenty-nine employees have other minor discrepancies.

- Forty-two employees' federal income tax wages had unexplained errors totaling $21,495 which were inaccurately reported on Form W-2. Payroll personnel cannot yet determine the cause of these errors.

- Form W-2 was not sent to SSA for one employee who had actually received gross wages of $89,802 in 2005. As a result, the Internal Revenue Service (IRS) also would not receive the information.

## Recommendations Summary

**Recommendation 1:**

We recommend the Directors of Human Resources and the Office of Financial Services establish City policies and procedures that require management's approval of employees' time and attendance in the automated system before the payroll is processed and periodically provide reports of departmental non-compliance to both Department Directors and Assistant City Managers.

**Recommendation 2:**

We recommend the Directors of Human Resources and the Office of Financial Services update the processes and procedures to ensure the pay authorizations are properly processed, received, and filed in the employees' official personnel file.

**Recommendation 3:**

We recommend the Director of Human Resources verify that all current employees hired after January 1, 2006 have been properly reported to the Office of the Attorney General.

**Recommendation 4:**

We recommend the Director of Human Resources establish written policies and procedures to ensure information is timely submitted to the State, an audit trail is maintained to show compliance with the new hire reporting requirement, and an annual report on compliance with this law is provided to the Assistant City Managers.

**Recommendation 5:**

We recommend the Director of Human Resources complete the required employment eligibility verifications on the four employees still working for the City.

**Recommendation 6:**

We recommend the Director of Human Resources establish written policies and procedures to ensure all employment eligibility documents are timely and properly completed for all employees, all non-citizen employees have valid working authorizations, an audit trail is maintained to show compliance with the law, and an annual report on compliance with this law is provided to the Assistant City Managers.

**Recommendation 7:**

We recommend the Director of Human Resources establish written policies and procedures to ensure the effective and timely resolution of SSN mismatches and include a requirement that all City employees must timely resolve any SSN issues as a condition of continued employment.

**Recommendation 8:**

We recommend the Director of Human Resources establish a new process to check SSNs of all new hires and any SSN mismatches against the SSA Death Master File.

**Recommendation 9:**

We recommend the Directors of the Office of Financial Services and Human Resources:

- Correct the amount of federal income tax wages, Medicare wages, and Medicare tax for the employees with errors and discrepancies, file accurate payroll reports and Form W-2 with the IRS, SSA, and employees, and work with the City Attorney on how or whether to collect tax owed from employees.

- Implement an effective quality system review and control over the manual payroll process, train the staff on Medicare issues, implement an effective reconciliation process, identify and fix system anomalies that cause payroll calculation processing errors and deficiencies, and implement basic information technology controls to ensure data completeness.

## Management's Response Summary

Agree. The Directors of Human Resources and the Office of Financial Services agree with the nine recommendations and intend to take corrective actions to timely address the issues identified in this report. The complete response is included as Appendix IV to this report.

## Audit Results

The City's payroll system is very complex and is under extreme time constraints with an extensive amount of payroll processing required every week. The City designed the payroll system to issue paychecks weekly: one week paychecks are issued to 8,560 civilian employees and the next week paychecks are issued to 4,640 uniform (fire and police) employees. At the end of each two-week pay period, management must approve time and attendance which is interfaced with the payroll system. Then, approximately twenty payroll reports are generated which Human Resources and Payroll personnel must review to make any payroll adjustments within the same day. For example, one recently issued payroll report showed over 130 errors which had to be resolved. The number of errors on this report is typical of the errors that need to be resolved each week.

The City timely processed payroll, system reports were used to resolve various payroll problems, and there were no "ghost" employees, someone who does not work for the City, but receives pay. The City, however, needs to establish fundamental controls to ensure management approval of time and attendance and adequate documentation for employee's pay changes, compliance with selected employment laws, and accurate wages and tax information is provided to both employees and government agencies.

I. **Some employees' time and attendance entries were not approved and pay changes were not documented.**

   The City has two major automated time and attendance systems – Self-Evident Application (SEA) and Kronos. Individual department managers should approve time records entered and submitted by employees. By the end of each pay period, data entered from the automated systems is interfaced with the City's payroll system, where payroll payments are processed. Payroll generates a report with the details of employee numbers, names, pays, and approval status. To ensure the employees are paid, the Payroll Section must approve and process time records if managers do not approve employees' time records.

   A. **Some employees' time cards were processed without supervisor approval.**

      We estimate the City paid a minimum of $19.6 million in 2005 and will pay a minimum of $21.1 million in 2007 to employees even though the employees' time and attendance were not approved. The City has established an accepted management practice that results in employees being paid even if the employees' managers/supervisors do not approve

the employees' time and attendance.  This is caused by the City not having any written procedures requiring management approval of entries on the automated time and attendance systems, the payroll system being designed so managers'/supervisors' approval are not required in order for employees to be paid, and department management and Assistant City Managers not being provided any information showing the departments that are not approving employees' time and attendance.

- **SEA system.**  We found that 86,635 of 408,176 hours in three pay periods in 2005 (21%) and 99,773 of the 448,344 hours in three pay periods in 2007 (22%) were not approved by management. The SEA users are only required to input leave taken and compensatory time or overtime earned and managers should electronically approve their time. Based on the number of hours and the pay rate for the employees in the sampled pay periods, we estimate approximately $19.6 was paid in 2005 and approximately $21.1 million will be paid in 2007 without proper management approval.

  Appendix II shows the ten departments with the most hours that were not approved by managers/supervisors for the three sample periods in 2005 and in 2007.

- **Kronos system**.  We reviewed the management approval summary report and found managers were not approving employees' time and attendance.  Because of limited information, we could not quantify the dollar amount of employees' pay that was not approved.  The Kronos system keeps track of the actual daily working time and leave taken. Managers should approve the time entries at the end of each pay period.  Our analysis showed the percentage of employees' time processed without manager approval actually increased when comparing calendar years 2005 and 2007 for the three pay periods sampled each year.

  o For each sampled pay period for 2005, there were 1,421 to 1,492 Kronos users' times processed without approval.  This represents 52% to 55% of the approximately 2,700 employees that used this system in 2005.

  o For each sampled pay period for 2007, there were 1,552 to 1,704 Kronos users' times processed without approval.  This represents 58% to 62% of the approximately 2,700 employees that use this system in 2007.

The approval of employee time is a fundamental management control.  Systems that allow employees to record time electronically and send time

and attendance data directly to payroll processing save considerable time, but can also eliminate a critical control, such as management approval.

Without adequate review and approval, there could be inaccurate entries to the automated payroll system and employees could be receiving incorrect pay and leave. If entries to the payroll system are not reviewed, there is potential for unauthorized changes to the automated payroll system.

### Recommendation 1:

We recommend the Directors of Human Resources and the Office of Financial Services establish City policies and procedures that require managements' approval of employees' time and attendance in the automated system before the payroll is processed and periodically provide reports of departmental non-compliance to both Department Directors and Assistant City Managers.

### Management's Response

Agree. As indicated in the Executive Summary, the City's payroll system is very complex and is under extreme time constraints with an extensive amount of payroll processing required every week. Payroll related activities involve 13,200 active employees. The American Payroll Association's 2003 and 2004 benchmarking studies indicate that companies participating in the studies generate payroll on a bi-weekly basis. This practice provides these organizations at least a week to reconcile payroll entries and ensure accuracy prior to processing payroll and issuing paychecks and vouchers. The City, however, processes payroll every week alternatively for civilian and uniformed employees and paychecks/vouchers are issued the next day immediately following payroll processing. The City's practice does not allow adequate time to analyze and review time entries and other payroll related information. Adjustments and corrections, therefore, are made after the payroll cycle.

Administrative Directive 3-8, regarding Human Resources Records Processing, is being revised to include the following changes for enhanced internal controls of current payroll procedures and processes.

1. In the absence of a supervisor's signature for payroll approval, the Human Resources Department shall require the Department Director's or other executive designee's signature for final authorization.

2. To further assist departments in the accountability and management of their payroll processes and time card approvals,

Human Resources will begin distributing Payroll Accountability Reports to Department Directors. These reports will provide directors the names of managers and supervisors in their department who have not approved employee time cards within each pay period. Reports will be issued to directors on a bi-weekly basis; Assistant City Managers will be provided quarterly reports.

3. Human Resources will recommend to Lawson Incorporated that they enhance their human resources/payroll software to enable supervisors to approve time cards both with and *without* time entry pay code exceptions.

The City is also evaluating the feasibility of the following options:

- Change the day that paychecks and vouchers are distributed from Thursday to Friday, the City's official payday. This will allow additional time for staff to analyze data and time entries and make adjustments prior to the distribution of payroll funds.

- Change the City's payroll closing day for departments from Tuesday to Monday, allowing additional time for staff to analyze data and time entries and make adjustments prior to processing payroll.

## B. Pay change authorizations were not always in the personnel file.

Payroll Change Authorization Forms are used to make changes in the records of an active employee. These forms are usually initiated by the individual departments, but require the approval of the Human Resources Department and verification by the City Controller's Office. The documentation for the authorized pay rates are to be maintained in the employee's official Human Resources personnel file.

Our review showed that authorizations for salary and pay rate changes were missing in 21% of the sampled employees official personnel files (21 of 98 employees).

City procedures for records processing have not been updated since 1995 and there are no processes to ensure the forms are received, processed, and filed by Human Resources. This weakness in internal controls presents unnecessary risks for the City and transactions that are not properly authorized are indicators of potential fraud. For example, two of the 21 employees who work in Human Resources also have computer access to change or modify payroll data in the system.

**Recommendation 2:**

We recommend the Directors of Human Resources and the Office of Financial Services update the processes and procedures to ensure the pay authorizations are properly processed, received, and filed in the official personnel file.

**Management's Response**

Agree. The payroll change authorizations for the two Human Resources payroll employees have been placed in the file. Pay change authorizations for the other identified employees will also be filed appropriately.

Administrative Directive 3-8, Human Resources Records Processing, is being revised for citywide review and eventual publication. Other measures taken to improve controls and integrity of records management and processing include the following Human Resources internal procedures:

- Human Resources will date-stamp documents upon receipt;

- Human Resources payroll staff will submit required personnel documents to the File Room within 60 days of final action; and,

- File Room staff will check files for completeness before filing them.

In addition, internal controls will be implemented to prevent Human Resources Payroll staff from making entries or changes to their personal pay rate or that of any other Human Resource Payroll employee within the Human Resources Information System (HRIS). The Payroll Supervisor shall enter all pay rate changes for Human Resources Payroll staff.

## II. Some non-compliance with selected federal and state employment laws.

The City's current processes need improvement to ensure compliance with selected federal and state employment laws and to detect the use of invalid or fraudulent SSNs. When a person is employed by the City, a number of documents are required by law or regulation to be completed and transmitted to various government agencies. One essential piece of information common to these documents is the individual's SSN.

### A. Non-compliance with new hire reporting requirement.

The City hired 1,052 civilian employees between January 1, 2006 and July 19, 2006. Federal and state laws require employers in Texas to provide information about all new or rehired employees to the Office of the Attorney General within twenty days of the effective hire date. The information provided includes the employee's SSN because the purpose of the verification is primarily to track parents who owe child support and to reduce fraud under various social programs, including unemployment benefits. Non-compliance with the reporting requirements may subject the employer to penalties of $25 per non-compliant employee and $500 for conspiracy.

We randomly selected 30 newly hired employees and requested the Attorney General's Office verify the City's compliance with the new hire reporting requirement. We were informed that the City had correctly reported information for 26 employees, but had not reported information for 13% (four of 30) of the new hires. Based on these test results, we estimate the City did not properly report 140 of the 1,052 civilian employees hired between January 1, 2006 and July 19, 2006. As a result, the City's non-compliance with federal and state employment laws could result in fines of $3,500 and adverse publicity.

The City properly includes the new hire reporting document as part of the employment package given to each employee; however, the City does not keep any records to ensure that employees return the completed document to Human Resources or that the documents are timely sent to the State. Further, we did not identify any written procedures that provide guidance on processing the documents or require management to report on compliance with the law.

### Recommendation 3:

We recommend the Director of Human Resources verify that all current employees hired after January 1, 2006 have been properly reported to the Office of the Attorney General.

### Management's Response

Agree. As required by law, Human Resources submitted, via United States (U.S.) mail, the New Hire Reporting form for the referenced employees in this report; however, copies of these forms were not retained and the State does not have the evidence of the documentation. Human Resources is in the process of automating this process to ensure both timeliness and documentation. Pending automation, staff will continue to send new hire reporting forms to the State via U.S. mail;

however, staff now retains copies of the New Hire Reporting forms (for employees' files) and sends the originals, via certified mail, to the State.

We have generated a report of all current employees who were hired after January 1, 2006 and will review each employee's file to ensure that it contains a copy of the New Hire Reporting form. Periodic internal reviews will be performed and documented to ensure integrity of the new hire reporting process.

### Recommendation 4:

We recommend the Director of Human Resources establish written policies and procedures to ensure information is timely submitted to the State, an audit trail is maintained to show compliance with the new hire reporting requirement, and an annual report on compliance with this law is provided to the Assistant City Managers.

### Management's Response

Agree. Human Resources submits new hire and rehire reports to the Attorney General Office (OAG) on a weekly basis thru the traditional U.S. postal mail system. This manual and paper intensive process does not allow efficient tracking or indication that the OAG received the information. To that end, the Human Resources Department has implemented several enhancements to assure better tracking to include the following:

1. File Room procedures have been revised to include steps for completion and submission of the new hire reporting information to the State.

2. In an effort to automate and ensure timely compliance, Human Resources has submitted an application to the State of Texas' for approval to transmit new hire information in an electronic format. Upon approval, the City will begin sending new hire information to the Office of Attorney General, electronically, every fourteen days. Automated e-mail responses will confirm the success or failure to each report sent to the state. These reports will be archived along with the state's confirmation of receipt for ready retrieval.

3. Pending the State's approval of the City's request, staff will continue to send new hire reporting forms to the State by certified mail and maintain copies in employees personnel files.

### B. Non-compliance with employment eligibility verification.

Our review showed that employment eligibility verification was not completed for about 11% (five of 46) of the employees randomly sampled. Four current employees have worked for the City from three years to nine and one-half years and one terminated employee had worked for the City for over two years.

Federal law requires an employer to (1) ensure all employees hired after November 6, 1986, complete a Form I-9 Employment Eligibility Verification, and (2) examine evidence of employee identity and employment eligibility within three business days of employment. The Department of Homeland Security United States Citizenship and Immigration Services (USCIS) also requires employers to verify employee's employment eligibility on or before the expiration date of a non-citizen's employment authorization document.

To evaluate compliance with the federal law, we randomly selected 60 official personnel files for civilian employees. We found that 13 employees were not required to file the form because they were hired before November 6, 1986, one personnel file of a retiree could not be located, and the remaining 46 personnel files included the Form I-9; however, further analysis showed that:

- Four employees' employment verification documents were not reviewed, verified, and certified by City personnel to establish identity and employment eligibility. The following shows the department, hire date, and current employee status for the four employees:

  - Park and Recreation – June 8, 1999, Active Full Time;
  - Public Works and Transportation – June 25, 2003; Voluntary Separation (August 16, 2005);
  - Dallas Water Utilities – November 12, 2003, Active Full Time; and,
  - Equipment and Building Services – January 21, 2004, Active Temporary.

- One currently employed non-citizen's employment authorization expired November 2, 1997. The City did not verify and update the employee's renewal status and there was no evidence to show the employee is still authorized to work.

The employer review and verification issues that we identified can be attributed to the employment eligibility document being maintained in the

employee official personnel file, the City not having written procedures for ensuring the proper review, validation and updating of the document, and the City not having procedures to monitor the small number of non-citizen employees. While there is no regulation mandating where the documents must be maintained, an industry "best practice" is to keep the documents separate from the personnel file to make it easier to ensure compliance with the law.

Non-compliance with the Form I-9 record keeping requirements can result in civil fines of $100 to $1,000 and adverse publicity for the City. Penalties for hiring each unauthorized non-citizen range from $250 to $2,000 for a first offense, $3,000 to $10,000 for a third offense. In addition, employers hiring unauthorized employees could face criminal penalties if a pattern or practice of violations occurs.

## Recommendation 5:

We recommend the Director of Human Resources complete the required employment eligibility verifications on the four employees still working for the City.

## Management's Response

Agree. The employment eligibility verifications for these four employees have been completed and copies of the required documents have been placed in the employees' files. The Department of Homeland Security's instructions regarding Employment Eligibility Verification state that employers "…must reverify employment eligibility of their employees on or before the expiration date…" recorded in the employee's I-9 form. To ensure compliance, Human Resources staff will maintain a separate file of work permits provided by non-citizen employees and will verify currency of the work permits. Both the employee and Department Director will be notified prior to the expiration date of the employee's work permit.

In July 2004, the City began participating in the Basic Employment Verification Pilot program, under the authority and direction of the Social Security Administration (SSA) and the Department of Homeland Security. This is a pilot program in which the employment eligibility of all newly hired employees are confirmed after the Employment Eligibility Verification Form (Form I-9) has been completed. Authority for this program is found in Title IV, Subtitle A, of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA), Pub. L. 104-208,110 Stat. 3009.

The internal controls inherent in the revised hiring process checklist, the new on-boarding process and continued participation in Basic

Employment Verification Pilot program will help ensure timely verification and documentation of all employment eligibility.

## Recommendation 6:

We recommend the Director of Human Resources establish written policies and procedures to ensure all employment eligibility documents are timely and properly completed for all employees, all non-citizen employees have valid working authorizations, an audit trail is maintained to show compliance with the law, and an annual report on compliance with this law is provided to the Assistant City Managers.

## Management's Response

Agree. Policies and procedures shall be reviewed to enhance internal controls to ensure accuracy and timeliness of employment eligibility documentation. The review will include revisions to Administrative Directive 3-4, regarding Employment Procedures, Hiring Process Checklist, and the Personnel Change Action Checklist. Newly hired employees will be asked to sign an agreement informing them that all required employment eligibility documentation shall be submitted to Human Resources within seven days of their first day at work to avoid the risk of termination. Periodic internal audits will be conducted and documented to ensure compliance with Administrative Directive 3-4.

The new on-boarding process will enhance our ability to obtain required employee information by streamlining information flow and establishing process continuity. In this process, new hire packets are sent to new employees two weeks prior to their first day of work. The packets include all the forms employees are obligated to complete and provide the City. Employees will be instructed to bring the competed forms along with required picture identifications to the New Employee Orientation (NEO) Registration, which serves as the first day of City employment. Capturing all required documentation at NEO eliminates follow-up inquiries and additional steps required to locate employees. The need to provide completed information will be further emphasized during the two-day NEO program.

We will review with the City Attorney's Office legalities of not allowing employees to report to their assigned work stations if information is not provided at NEO.

## C. Current processes to resolve invalid SSNs mismatch issues are not effective and will not detect fraudulent use of SSNs.

The SSA is required by law to maintain records of employee wages. When the employee name and SSN combination on the Form W-2, Wage and Tax Statement, issued by the employer cannot be matched to SSA records, the employer receives a "mismatch" document to assist in correcting the discrepancy. Although there are legitimate reasons for a "mismatch" (including clerical error and name change), it also can be caused by using fraudulent SSNs or using an SSN assigned to someone other than the employee. The City is provided a list of SSN mismatches in October.

The City is not effectively resolving employee SSN mismatch issues and is not identifying the fraudulent use of SSNs. The City had 150 employee SSN mismatches in 2005 and 114 employee SSN mismatches in 2006; however,

- Seventy-three SSN mismatches on the October 2005 list were also on the October 2006 list;

- Seventy-eight SSN mismatches on the October 2006 list were not resolved as of March 20, 2007; and,

- Four SSN mismatches were caused by employees using the SSN of deceased individuals. These four employees either have or currently worked for the City from two years to over six years. Human Resources notations on the mismatch list show the status for two of these employees as "Corrected" or "Verified".

**Resolving SSN mismatches.** After the mismatch list is received from SSA, Human Resources assistants verify that social security cards are in the personnel file and check the accuracy of the information in the personnel/payroll system. If the mismatch was caused by inaccurate information being entered into the system, the Human Resources assistant will make the corrections.

If, however, the official personnel file and personnel/payroll system has the same information, but it is different from the SSA, the Human Resources Department will request the employee to resolve the discrepancy with the SSA. The employees are requested to submit a new social security card after the issue is resolved with SSA so the City's personnel/payroll system can be updated; however, we were advised that employees frequently do not provide Human Resources with the information requested and the mismatch is not resolved because the City

has no specific personnel policy to ensure valid SSNs are provided by employees.

**Preventing identity fraud.** The City has hired individuals who used the SSN of deceased individuals. We matched all City employees' SSN against the SSA Death Master File and identified four employees who used the SSNs of deceased individuals to obtain employment with the City. The current SSN mismatch process does not identify the use of deceased individuals' SSN and the City does not verify information against the SSA Death Master File.

### EXHIBIT 1 – EMPLOYEES USING DECEASED INDIVIDUALS' SSN

| Employee | Hire Date | Current Employee Status | Length of Employment* |
|---|---|---|---|
| Employee A | November 24, 2004 | Active Full Time | 2 years, 5 months |
| Employee B | September 4, 2002 | Terminated ( Voluntary) | 4 years, 4 months |
| Employee C | April 17, 2001 | Active Full Time | 6 years |
| Employee D | March 20, 2000 | Terminated ( Voluntary) | 5 years, 6 months |

*Length of employment was calculated from the hire date to April 30, 2007 for active employees and to the date last worked for the City for all terminated employees.

The SSN mismatch report included Human Resources notations which show the status for the two active employees as "Corrected" or "Verified", even though they were included on both the 2005 and 2006 mismatch list. While we cannot determine what this actually means, our review of the personnel files showed social security cards that appear to be authentic. As a result, these two active full time employees and the other two terminated employees were allowed to work from over two years to at least six years by using the SSNs of deceased individuals.

The accurate reporting of name and SSN combination is critical to enabling the (1) SSA to maintain accurate earnings records, and (2) IRS to verify compliance with the tax laws. Further, the use of any document lawfully issued to a person other than the possessor, including a deceased individual, is unlawful and violates the Immigration Act of 1990.

**Recommendation 7:**

We recommend the Director of Human Resources establish written policies and procedures to ensure the effective and timely resolution of SSN mismatches and include a requirement that all City employees must timely resolve any SSN issues as a condition of continued employment.

**Management's Response**

Agree. Each year the City Controller's Office submits an electronic batch payroll file to the Social Security Administration (SSA) payroll file that includes the name and social security number for each City employee. The City Controller's Office now has the capability to review SSNs of current employees and match those numbers against the SSNs of deceased individuals. As a result of any records that are rejected by the SSA, the City Controller's Office will now require the employee in question to respond to the discrepancy. The City Controller's Office will notify the Department Director, Human Resources Department, and City Attorney's Office of any discrepancies for appropriate action.

The Human Resources Department shall revise Administrative Directive 3-4, regarding Citywide Employment Procedures which will include a mandate that employees shall comply with directives to correct and/or update personnel files. New employees will be required to acknowledge receipt of this mandate via signature/initial sign-off on information provided in their new hire employees' packets.

Employees who commit fraudulent acts such as using SSNs of deceased persons will be investigated by the appropriate authority.

**Recommendation 8:**

We recommend the Director of Human Resources establish a new process to check SSNs of all new hires and any SSN mismatches against the SSA Death Master File.

**Management's Response**

Agree. To prepare for the end of year W2 process, the City Controller's Office generates a city wide SSN report and submits it to the SSA in the fourth quarter of each year. Effective December 2007, the SSA will automatically match the City's (and other organizations) SSN reports against the SSA's Death Master File and will include any death related information in their report to the City.

Additionally, Human Resources will continue to participate in the Basic Employment Verification Pilot program which enables the City to confirm the accuracy of SSN information of all new hires. The program allows the City to confirm the accuracy of SSNs provided by all newly hired employees and the employment authorization of some newly hired employees. As a program participant, the City has direct access to the SSA's website for automated verification and confirmation of employee's employment eligibility within three "Federal Government" work days of the

initial inquiry. New employees will be informed that SSN issue must be resolved (with the exception of individuals who changed their names and are in process of reconciling with the SSA) in order to complete the hiring process and for continuation of employment.

### III. Inaccurate wage and tax information were provided to both employees and government agencies.

The City needs to ensure accurate wages and tax withholdings are provided to the IRS, SSA, and employees. Form W-2, Wage and Tax Statement, is a crucial document that is used by employees to file tax returns, the IRS to track tax obligations, and the SSA to provide social security and Medicare benefits. IRS regulations require City employees hired (or rehired) after March 31, 1986 to have Medicare tax withheld from their wages.

Although the number and amount of the errors identified in our audit comprised only a small part of the total payroll processed by the City each year, the issues we identified may be indications of other payroll issues. The problems that we identified can be attributed to an ineffective quality review process over manual payroll adjustments, payroll reconciliations not being performed effectively, staff not being adequately trained, and payroll system anomalies not being identified and fixed in sufficient time to prevent errors during the payroll process.

### A. Medicare tax not withheld on twenty-eight employees.

We identified 28 employees who were either hired or rehired after March 31, 1986, but did not have the required Medicare tax withheld from $9.6 million in taxable gross wages paid between 1986 to 2007. We found these employees did not have Medicare tax withheld for one of the following reasons:

1) **Payroll system conversion.** Twelve employee records were erroneously removed or changed as not being required to pay Medicare tax when the City converted to a new payroll system during 2002.

2) **Processing errors**. Fifteen employee records were not properly established to require Medicare withholding. Of these, the Office of Financial Services Payroll Section inadvertently made errors when ten employees were rehired between June 1986 and August 1999 and Human Resources personnel inadvertently made errors when five employees were rehired between October 2004 and September 2005. Payroll or Human Resources personnel must

make manual adjustments to ensure rehired employees are properly having withholding for Medicare.

3) **Unknown cause of error.** One employee did not have Medicare tax withheld in 2005 and for some pay periods in 2004 and 2006. Human Resources and Payroll Section have not yet identified the cause of the error.

Employers who fail to withhold Medicare tax may be liable for federal back taxes, penalties, and interest. We estimate the 28 City employees owe $138,811 in Medicare taxes and the City owes the employer's Medicare portion of $138,811. Further, the failure to deduct Medicare tax for the covered employees will impact the employees' eligibility for Medicare.

## B. Medicare tax incorrectly withheld on six employees.

We identified six employees who should be exempt from Medicare tax because they were hired before March 31, 1986 and have been continuously employed by the City. The City improperly withheld $158 in Medicare tax during one or two pay periods in 2005. This was caused by the Human Resources staff incorrectly setting up the Medicare exemption status for these employees when manually processing personnel change action documents.

## C. Medicare wages and tax were incorrectly calculated and withheld.

Medicare wages equals total wages less Plan 125 health insurance and life insurance, Employee Medical Spending Plan (EMSP), and Dependent Care Assistance Plan (DCAP) contributions. Based on the above criteria, we recalculated the Medicare wages and tax for 10,938 City employees (civilians and uniforms) and found:

- Sixty-six employees with reported Medicare wages of $2 million have errors greater than $10 each and 29 employees have minor discrepancies. Most of these errors were caused by Human Resources employees not checking Medicare tax withholding settings while making other manual changes when an employee was promoted or transferred. The errors were not identified or corrected effectively before the processing of Form W-2.

- Two employees' 2005 Form W-2 showed discrepancies on Medicare wages and tax. The Medicare tax deducted does not equal 1.45% of Medicare wages.

o Employee A: Medicare tax withheld was 2.9% of the Medicare wages because of erroneous overstatement in a payroll adjustment.

o Employee B: Medicare tax withheld was 1.467% of the Medicare wages. The discrepancy was because the Medicare tax was paid on $2,123 which the City contributed to the employee's 401(k) Plan as a special benefit. The Medicare wages were not adjusted to include this amount because the benefit was not paid directly to the employee.

## D. Federal income tax wages were inaccurately reported on form W-2.

We analyzed the 2005 Form W-2s and identified 42 employees with unexplained errors of $21,495; wages were either understated by $15,969 or overstated by $5,526 on reported wages of $1.5 million. Payroll personnel have not yet determined the cause of these errors.

## E. One employee's form W-2 was not submitted to SSA.

One employee had actually received gross wages of $89,802 in 2005, but there was no record of the Form W-2 in the file sent to SSA. As a result, the City did not report this employee's earnings and tax information to the SSA and, consequently, the IRS would not receive the same information. This occurred because the City did not validate the data completeness or consistency when processing Form W-2 records for the file sent to SSA.

The City has a risk of issuing erroneous documents. The IRS and other agencies impose stiff penalties on employers for a variety of errors, failures, and omissions related to withholding, depositing, and reporting taxes. Form W-2 errors will also directly impact employees' federal income tax returns filed with the IRS.

## Recommendation 9:

We recommend the Director of Office of Financial Services and Human Resources:

- Correct the amount of federal income tax wages, Medicare wages, and Medicare tax for the employees with errors and discrepancies, file accurate payroll reports and Form W-2 with the IRS, SSA, and employees, and obtain advice from the City Attorney on how or whether to collect the tax owed from employees.

- Implement an effective quality review and control system over the manual payroll process, train the staff on Medicare issues, implement an effective reconciliation process, identify and fix

system anomalies that cause payroll calculation processing errors and deficiencies, and implement basic information technology controls to ensure data completeness.

## Management's Response

Agree. The CCO Payroll (CCO) Office will correct the federal income tax wages, Medicare wages, and Medicare tax for the employees identified in the Audit. Upon consultation with the City Attorney's Office, we will determine the appropriate mechanism to pay the Medicare taxes owed to the Federal government.

Existing procedures regarding the payroll process have been or will be modified as necessary. For example:

- Year end procedures for 2007 now include reconciliation between the payroll reports used to print 2007 W2's in January 2008 and the same reports used to submit payroll information to the Social Security Administration in March 2008.

- All employees hired before April 1, 1986 and who are not subject to paying Medicare have had their files updated to remove deduction cycles as well as to disable Medicare deductions. This action will make it more difficult for the system to "turn on" Medicare for these employees whenever a personnel action is made.

- A Medicare Report is being designed to help minimize Medicare errors. This report will allow staff to test for Medicare anomalies on a quarterly basis by recalculating Medicare and Medicare wages and comparing to actual deductions. This new report will supplement an existing report which checks for Medicare deductions taken from employees who should be *exempt from* Medicare deductions, so that refunds can be made and the erroneous deductions turned off.

- A Taxable Wages report is also being designed to test wages subject to Federal income taxes. This new report will allow staff to ensure the system generated taxable wages are accurate. This report will also identify cases where taxes are not being deducted or where said deductions have stopped.

As provided previously, the American Payroll Association's 2003 and 2004 benchmarking studies indicate that companies participating in the studies generate payroll on a bi-weekly basis. This practice provides these organizations at least a week to reconcile payroll entries and ensure

accuracy prior to processing payroll and issuing paychecks and vouchers. Management, therefore, is also evaluating the ability to change the City's payroll processing schedule in order to enhance audit and review time during payroll processing.  Printing payroll checks on Thursday night for distribution on Friday is an option under consideration.  As stated in response to Recommendation 1, payroll is currently processed so that checks are printed on Wednesday night for distribution on Thursday.  This one day change will allow time for staff to perform additional review and audit of the payroll information being processed and to make corrections **before** checks are printed rather than afterwards.  This change will also reduce the incidence of inadvertent overpayments, thereby saving the City money.

In the event management decides the one day change being evaluated above is not feasible or will be inadequate for the level of audit and review required, management would then evaluate the possibility of moving the official pay day to the Tuesday following the payroll close.  This will allow even more time for processing payroll as well as provide additional time for supervisors to approve employee time entries.

## Background, Objectives, Scope and Methodology

### Background

The City's Fiscal Year (FY) 2004-2005 gross salary payroll cost was $668,112,777. Many of the inherent characteristics of the payroll process — frequency, regularity and volume of transactions, amount of expenditures, and autonomy of payroll administrators and departments' managers — expose the payroll function to fraud; however, the payroll activity is also highly susceptible to processing errors due to complex federal tax regulations, several time and attendance systems, and various pay schedules. The City's internal control evaluation in FY 2004 and FY 2005 indicates the payroll system is:

- Very complex – requires input knowledge for over 100 computer screens as well as knowledge of payroll and personnel rules; and,
- Under extreme time constraints – a great deal of payroll work to be processed, including payroll processing every week.

The Office of Financial Services (OFS) provides financial management and accounting services support to the City Manager's Office. The Accounting Services Division within OFS develops administrative and accounting policies and procedures for City-wide use, processes all vendor payments for the City, produces the City's financial statements, maintains the City's fixed asset records, and the Payroll Section processes all personnel actions involving the City's payroll. In addition, the Division ensures the integrity of the City's accounting and payroll systems.

The Human Resources Payroll Division's primary role is to assist employees concerning their payroll, personnel records, and time entries. This unit has a critical role in ensuring the accuracy and timeliness of the civilian and uniform employees' payrolls, which are processed on alternating weeks. The Payroll unit enters and maintains the information contained in the Human Resources Information System (HRIS). The significance of this responsibility is indicated by the fact this data is used to generate the City's weekly payroll and issuance of checks, pay stubs, and other payroll related services. The staff interacts with employees from all levels of the City organization and also works closely with Human Resources assistants to research and resolve departmental payroll issues.

City payroll related activities involve:

- 13,200 active employees (civilian 8,560 and uniform 4,640);
- 4,700 retirees serviced in HRIS;
- 50,000 personnel actions performed each year;

- 1,700 new hires processed each year;
- 700 employee terminations each year;
- 300 retirements each year;
- 351,000 paychecks generated each year;
- 15,200 Form W-2, Wage and Tax Statement, issued each year (including reprints);
- 9,000 employees using Self-Evident Application (SEA) for time-entry; and,
- 2,700 employees using Kronos time clocks for time-entry.

## Objectives, Scope and Methodology

Our audit objectives were to ensure that:

- Employees receiving salary payments are valid and authorized and required data in the payroll system is complete and accurate; and,

- Employees' salary and other payments to employees, and employee deductions are properly calculated, authorized, and timely processed.

The audit was conducted in accordance with generally accepted government auditing standards and covered January 1, 2005 through December 31, 2006. We also examined certain events, records, and transactions occurring before and after this period. We primarily limited our review to payroll issues affecting civilian employees.

To achieve these objectives, we:

- Interviewed City department managers and staff to develop an understanding of relevant internal controls and evaluated administrative directives and other relevant policies and procedures.

- Evaluated the adequacy of internal controls and conducted various audit tests to provide reasonable assurance of detecting any risk of fraud or illegal acts to include the following data anomalies:

  o Identified duplicate names, addresses, or SSNs;

  o Identified personnel records listing only a Post Office Box and no physical address; and,

  o Cross-referenced payroll records, personnel records and identification badge records.

- Used computer-assisted audit techniques to determine whether sampled payrolls were appropriately approved by managers on the time and attendance systems.

- Selected a random sample of 60 employees from the 2005 W-2 / payroll file and:

  o Compared information in the payroll system to key personnel data in Human Resources files to ensure all payroll information is supported by source documents that are properly approved and are valid; and,

  o Verified the employees actually exist by ensuring the sampled employees have a building badge or an e-mail account.

- Verified that the salary, wages, and deductions of a random sample of 30 employees were properly authorized and calculated. We reviewed the personnel files for pay rate change authorizations, recalculated the gross salary, taxable gross wages, Medicare taxable wages, Medicare tax withholding, deduction, and the net pay amounts.

- Selected a judgmental sample of eight personnel from Human Resources and Payroll to ensure their pay rate changes were supported by source documents that were properly approved and were valid.

- Identified all employees hired between January 1 and July 19, 2006 and randomly selected a sample of 30 new hires and verified new hire information was timely and accurately reported to the Texas Office of Attorney General.

- Evaluated how the City ensures all non-US citizens working for the City have valid worker permits. Compared information in the payroll system to key personnel data in Human Resources files to ensure all payroll information is supported by source documents that are properly approved and are valid (i.e., Form I-9, Form W-4).

- Used computer-assisted audit techniques to identify "ghost employees" and checked all 2006 active employee SSNs against the SSA Death Master File.

- Used computer-assisted audit techniques to analyze Form W-2 files and other payroll reports in calendar year 2005 for all City employees.

  o Recomputed the federal income taxable wages to ensure the amount equals the salary less any contributions to the 401(K),

457(B), employee retirement fund, certain health insurance deductions, and other non-taxable items;

o Ensured that only those employees who were hired prior to April 1, 1986 without a break in service are exempt from the Medicare tax; and,

o Recomputed the Medicare tax wages to ensure the amount equals to the salary less certain health insurance deductions and other non-taxable items.

## Hours Not Approved by Management in the SEA Timekeeping System

| Three Sample Pay Periods in 2007 | | |
|---|---|---|
| **Department** | **Unapproved Hours** | **Total Hours** |
| **Dallas Water Utilities** | 14,326 | 54,920 |
| **Dallas Police Dept - Civilian** | 13,353 | 49,703 |
| **Parks & Recreation** | 11,579 | 53,678 |
| **Public Works & Transportation** | 8,281 | 53,333 |
| **Environmental & Health Services** | 6,599 | 40,755 |
| **Communication & Info Services** | 5,471 | 10,046 |
| **Development Services** | 4,638 | 12,546 |
| **City Attorney's Office** | 4,151 | 6,388 |
| **Dallas Public Library** | 3,831 | 65,380 |
| **Street Services** | 3,177 | 5,095 |
| **Sub Total** | **75,406** | **351,844** |
| **All Other 20 Departments** | 24,367 | 96,500 |
| **TOTAL** | **99,773** | **448,344** |

| Three Sample Pay Periods in 2005 | | |
|---|---|---|
| **Department** | **Unapproved Hours** | **Total Hours** |
| **Dallas Water Utilities** | 12,373 | 48,483 |
| **Parks & Recreation** | 11,909 | 45,285 |
| **Dallas Police Dept - Civilian** | 11,089 | 46,059 |
| **Public Works & Transportation** | 8,408 | 51,276 |
| **Development Services** | 5,638 | 12,800 |
| **Environmental & Health Services** | 4,816 | 29,977 |
| **Dallas Public Library** | 4,486 | 66,398 |
| **Housing** | 3,311 | 15,073 |
| **Code Compliance Services** | 2,691 | 11,642 |
| **City Attorney's Office** | 2,455 | 5,985 |
| **Sub Total** | **67,176** | **332,978** |
| **All Other 21 Departments** | 19,459 | 75,198 |
| **TOTAL** | **86,635** | **408,176** |

**Source: City Auditor's analyses of SEA timekeeping system.**

## Major Contributors to This Report

Gary Lewis, CIA, CFE, Audit Manager
Rowena Zhang, CIA, Project Manager
Anatoli Douditski, CIA, Auditor
Mark Bolten, CIA, CISA, CISM, Auditor
Jing Xiao, Auditor
Reisha Taylor, Auditor
Eva Chen, Auditor
Harry Krewson, Auditor
Theresa Hampden, Quality Control Manager

<div align="right">**Appendix IV**</div>

<div align="center">**Management's Response to the Draft Report**</div>

## Memorandum

RECEIVED

JUL 3 0 2007

CITY AUDITOR'S OFFICE

CITY OF DALLAS

Date:    July 26, 2007

To:    Craig D. Kinton, CPA

Subject:    Management Response – Audit of Payroll and Payroll Related Activities

The Department of Human Resources (H.R.) was requested to provide a response to the audit report of the Purchasing Program. Our response to the audit recommendations are as follows:

**Recommendation 1:**
We recommend the Directors of Human Resources and Office of Financial Services establish City policies and procedures that require managements' approval of employees' time and attendance on the automated system before the payroll is processed and periodically provide reports of departmental non-compliance to both Department Directors and Assistant City Managers.

Agree____ ☒ ____         Disagree_____         Partially Agree_____

**Management Response**
As indicated in the Executive summary, the City's payroll system is very complex and is under extreme time constraints with an extensive amount of payroll processing required every week. Payroll related activities involve 13,200 active employees. The American Payroll Association's 2003 and 2004 benchmarking studies indicate that companies participating in the studies generate payroll on a bi-weekly basis. This practice provides these organizations at least a week to reconcile payroll entries and ensure accuracy prior to processing payroll and issuing paychecks and vouchers. The City, however, processes payroll every week alternatively for civilian and uniformed employees and paychecks/vouchers are issued the next day immediately following payroll processing. The City's practice does not allow adequate time to analyze and review time entries and other payroll related information. Adjustments and corrections, therefore, are made after the payroll cycle.

Administrative Directive 3-8, regarding Human Resources Records Processing, is being revised to include the following changes for enhanced internal controls of current payroll procedures and processes

1. In the absence of a supervisor's signature for payroll approval, the Human Resources Department shall require the department director's or other executive designee's signature for final authorization.

2. To further assist departments in the accountability and management of their payroll processes and time card approvals, Human Resources will begin distributing Payroll Accountability Reports to Department Directors. These reports will provide directors the names of managers and supervisors in their department who have not approved employee time cards within each pay period. Reports will be issued to directors on a bi-weekly basis; Assistant City Managers will be provided quarterly reports.

3. Human Resources will recommend to Lawson Incorporated that they enhance their human resources/payroll software to enable supervisors to approve time cards both with and *without* time entry pay code exceptions.

The City is also evaluating the feasibility of the following options:
- Change the day that paychecks and vouchers are distributed from Thursday to Friday, the City's official payday. This will allow additional time for staff to analyze data and time entries and make adjustments prior to the distribution of payroll funds.

- Change the City's payroll closing day for departments from Tuesdays to Mondays, allowing additional time for staff to analyze data and time entries and make adjustments prior to processing payroll.

<u>Implementation Date</u>
January, 2008

<u>Responsible Manager</u>
David K. Etheridge

**Recommendation 2:**
We recommend the Directors of Human Resources and Office of Financial Services update the process and procedures to ensure the pay authorizations are properly processed, received, and filed in the official personnel file.

Agree \_\_\_\_X\_\_\_\_        Disagree_____        Partially Agree_____

**Management Response**
The payroll change authorizations for the two Human Resources payroll employees have been placed in the file. Pay change authorizations for the other identified employees will also be filed appropriately.

Administrative Directive 3-8, Human Resources Records Processing, is being revised for citywide review and eventual publication. Other measures taken to improve controls and integrity of records management and processing include the following Human Resources internal procedures:

- Human Resources will date-stamp documents upon receipt.

Management Response – Audit of Payroll and Payroll Related Activities 07/26/2007        2

- Human Resources payroll staff will submit required personnel documents to the File Room within sixty (60) days of final action.

- File Room Staff will check files for completeness before filing them.

In addition, internal controls will be implemented to prevent Human Resources Payroll staff from making entries or changes to their personal pay rate or that of any other Human Resources Payroll employee within the Human Resources Information System (HRIS). The Payroll Supervisor shall enter all pay rate changes for Human Resources Payroll staff.

Implementation Date
January, 2008

Responsible Manager
David K. Etheridge

**Recommendation 3:**
We recommend the Director of Human Resources verify that all current employees hired after January 1, 2006 have been properly reported to the Office of the Attorney General.

Agree____ | X | ____        Disagree_____        Partially Agree_____

**Management Response**
As required by law, Human Resources submitted, via U.S. mail, the New Hire Reporting form for the referenced employees in this report; however, copies of these forms were not retained and the State does not have the evidence of the documentation. Human Resources is in the process of automating this process to ensure both timeliness and documentation. Pending automation, staff will continue to send new hire reporting forms to the State via U.S. mail; however, staff now retains copies of the New Hire Reporting forms (for employees' files) and sends the originals, via certified mail, to the State.

We have generated a report of all current employees who were hired after January 1, 2006 and will review each employee's file to ensure that it contains a copy of the New Hire Reporting form. Periodic internal reviews will be performed and documented to ensure integrity of the new hire reporting process.

Implementation Date
February, 2008

Responsible Manager
David K. Etheridge

**Recommendation 4:**
We recommend the Director of Human Resources establish written policies and procedures to ensure information is timely submitted to the State, an audit trail is maintained to show compliance with the new hire reporting requirement, and an annual report on compliance with this law is provided to the Assistant City Managers.

Agree____ | X | ____        Disagree_____        Partially Agree_____

Management Response – Audit of Payroll and Payroll Related Activities 07/26/2007        3

**Management Response**
Human Resources submits new hire and rehire reports to the Attorney General Office (OAG) on a weekly basis thru the traditional U.S. postal mail system. This manual and paper intensive process does not allow efficient tracking or indication that the OAG received the information. To that end, the Human Resources Department has implemented several enhancements to assure better tracking to include the following:

1. File Room procedures have been revised to include steps for completion and submission of the new hire reporting information to the State.

2. In an effort to automate and ensure timely compliance, the Human Resources has submitted an application to the State of Texas' for approval to transmit new hire information in an electronic format. Upon approval, the City will begin sending new hire information to the Office of Attorney General, electronically, every fourteen (14) days. Automated e-mail responses will confirm the success or failure to each report sent to the state. These reports will be archived along with the state's confirmation of receipt for ready retrieval.

3. Pending the State's approval of the City's request, staff will continue to send new hire reporting forms to the State by certified mail and maintain copies in employees personnel files.

Implementation Date
October, 2007

Responsible Manager
David K. Etheridge

**Recommendation 5:**
We recommend the Director of Human Resources complete the required employment eligibility verifications on the four employees still working for the City.

Agree____| X |____            Disagree_____        Partially Agree_____

**Management Response**
The employment eligibility verifications for these four employees have been completed and copies of the required documents have been placed in the employees' files. The Department of Homeland Security's instructions regarding Employment Eligibility Verification state that employers "…must re-verify employment eligibility of their employees on or before the expiration date..." recorded in the employee's I9 form. To ensure compliance, Human Resources staff will maintain a separate file of work permits provided by non citizen employees and will verify currency of the work permits. Both the employee and department director will be notified prior to the expiration date of the employee's work permit.

In July 2004, the City began participating in the Basic Employment Verification Pilot program, under the authority and direction of the Social Security Administration (SSA) and the Department of Homeland Security. This is a pilot program in which the employment eligibility of all newly hired employees are confirmed after the Employment Eligibility Verification Form (Form I-9) has been completed. Authority for this program is found in Title IV, Subtitle A, of

the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA), Pub. L. 104-208,110 Stat. 3009.

The internal controls inherent in revised hiring process checklist, the new on-boarding process and continued participation in Basic Employment Verification Pilot program will help ensure timely verification and documentation of all employment eligibility.

<u>Implementation Date</u>
August, 2007

<u>Responsible Manager</u>
David K. Etheridge

**Recommendation 6:**
We recommend the Director of Human Resources establish written policies and procedures to ensure all employment eligibility documents are timely and properly completed for all employees, all non-citizen employees have valid working authorizations, an audit trail is maintained to show compliance with the law, and an annual report on compliance with this law is provided to the Assistant City Managers.

Agree_____ | X |_____          Disagree_____          Partially Agree_____

**Management Response**
Policies and procedures shall be reviewed to enhance internal controls to ensure accuracy and timeliness of employment eligibility documentation. The review will include revisions to Administrative Directive3-4, regarding Employment Procedures the Hiring Process Checklist and the Personnel Change Action Checklist. Newly hired employees will be asked to sign an agreement informing them that all required employment eligibility documentation shall be submitted to Human Resources within seven (7) days their first day at work to avoid the risk of termination. Periodic internal audits will be conducted and documented to ensure compliance with Administrative 3-4.

The new on-boarding process will enhance our ability to obtain required employee information by streamlining information flow and establishing process continuity. In this process, new hire packets are sent to new employees two weeks prior to their first day of work. The packets include all the forms employees are obligated to complete and provide the City. Employees will be instructed to bring the competed forms along with required picture identifications to the New Employee Orientation (NEO) Registration, which serves as the first day of City employment. Capturing all required documentation at NEO eliminates follow-up inquiries and additional steps required to locate employees. The need to provide completed information will be further emphasized during the two-day NEO program.

We will review with the City Attorney's Office legalities of not allowing employees to report to their assigned work stations if information is not provided at NEO.

<u>Implementation Date</u>
January, 2008

<u>Responsible Manager</u>
David K. Etheridge

Management Response – Audit of Payroll and Payroll Related Activities 07/26/2007          5

**Recommendation 7:**
We recommend the Director of Human Resources establish written policies and procedures to ensure the effective and timely resolution of SSN mismatches and include a requirement that all City employees must timely resolve any SSN issues as a condition of continued employment.

Agree___ X ___          Disagree_____          Partially Agree_____

**Management Response**
Each year the City Controller's Office submits an electronic batch payroll file to the Social Security Administration (SSA) payroll file that includes the name and social security number for each City employee. The City Controllers' Office now has the capability to review Social Security Numbers (SSN) of current employees and match those numbers against the SSNs of deceased individuals. As a result of any records that are rejected by the SSA, the City Controller's Office will now require the employee in question to respond to the discrepancy. The City Controller's Office will notify the Department Director, Human Resources Department and City Attorney's Office of any discrepancies for appropriate action.

The Human Resources Department shall revise Administrative Directive 3-4, regarding Citywide Employment Procedures which will include a mandate that employees shall comply with directives to correct and/or update personnel files. New employees will be required to acknowledge receipt of this mandate via signature/initial sign-off on information provided in their new hire employees' packets.

Employees who commit fraudulent acts such as using SSNs of deceased persons will be investigated by the appropriate authority.

<u>Implementation Date</u>
January, 2008

<u>Responsible Manager</u>
David K. Etheridge

**Recommendation 8:**
We recommend the Director of Human Resources establish a new process to check SSNs of all new hires and any SSN mismatches against the SSA Death Master File.

Agree___ X ___          Disagree_____          Partially Agree_____

**Management Response**
To prepare for the end of year W2 process, the City Controller's Office generates a city wide Social Security Numbers (SSN) report and submits it to the Social Security Administration (SSA) in the fourth quarter of each year. Effective December 2007, the SSA will automatically match the City's (and other organizations) SSN reports against the SSA's Death Master File and will include any death related information in their report to the City.

Additionally, Human Resources will continue to participate in the Basic Employment Verification Pilot program which enables the City to confirm the accuracy of SSN information of all new hires. The program allows the City to confirm the accuracy of Social Security

Numbers provided by all newly hired employees and the employment authorization of some newly hired employees. As a program participant, the City has direct access to the SSA's website for automated verification and confirmation of employee's employment eligibility within three (3) "Federal Government" work days of the initial inquiry. New employees will be informed that SSN issue must be resolved (with the exception of individuals who changed there names and are in the process of reconciling with the Social Security Administration) in order to complete the hiring process and for continuation of employment.

<u>Implementation Date</u>
January, 2008

<u>Responsible Manager</u>
David K. Etheridge / Edward Scott

**Recommendation 9:**
We recommend the Director of Office of Financial Services and Human Resources:

- Correct the amount of federal income tax wages, Medicare wages, and Medicare tax for the employees with errors and discrepancies, file accurate payroll reports and Form W-2 with the IRS, SSA, and employees, and obtain advice from the City Attorney on how or whether to collect the tax owed from employees.

- Implement an effective quality system review and control over the manual payroll process, train the staff on Medicare issues, implement an effective reconciliation process, identify and fix system anomalies that cause payroll calculation processing errors and deficiencies, and implement basic information technology controls to ensure data completeness.

Agree___ X ___          Disagree_____          Partially Agree_____

**Management Response**

The CCO Payroll (CCO) Office will correct the federal income tax wages, Medicare wages, and Medicare tax for the employees identified in the Audit. Upon consultation with the City Attorney's Office, we will determine the appropriate mechanism to pay the Medicare taxes owed to the Federal government.

Existing procedures regarding the payroll process have been or will be modified as necessary. For example:

- Year end procedures for 2007 now include reconciliation between the payroll reports used to print 2007 W2's in January 2008 and the same reports used to submit payroll information to the Social Security Administration in March 2008.

- All employees hired before April 1, 1986 and who are not subject to paying Medicare have had their files updated to remove deduction cycles as well as to disable Medicare deductions. This action will make it more difficult for the system to "turn on" Medicare for these employees whenever a personnel action is made.

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- A Medicare Report is being designed to help minimize Medicare errors. This report will allow staff to test for Medicare anomalies on a quarterly basis by recalculating Medicare and Medicare wages and comparing to actual deductions. This new report will supplement an existing report which checks for Medicare deductions taken from employees who should be *exempt from* Medicare deductions, so that refunds can be made and the erroneous deduction turned off.

- A Taxable Wages report is also being designed to test wages subject to Federal income taxes. This new report will allow staff to ensure the system generated taxable wages are accurate. This report will also identify cases where taxes are not being deducted or where said deductions have stopped.

As provided previously, the American Payroll Association's 2003 and 2004 benchmarking studies indicate that companies participating in the studies generate payroll on a bi-weekly basis. This practice provides these organizations at least a week to reconcile payroll entries and ensure accuracy prior to processing payroll and issuing paychecks and vouchers. Management, therefore, is also evaluating the ability to change the City's payroll processing schedule in order to enhance audit and review time during payroll processing. Printing payroll checks on Thursday night for distribution on Friday is an option under consideration. As stated in response to Recommendation 1, payroll is currently processed so that checks are printed on Wednesday night for distribution on Thursday. This one day change will allow some time for staff to perform additional review and audit of the payroll information being processed and to make corrections **before** checks are printed rather than afterwards. This change will also reduce the incidence of inadvertent overpayments, thereby saving the City money.

In the event management decides the one day change being evaluated above is not feasible or will be inadequate for the level of audit and review required, management would then evaluate the possibility of moving the official pay day to the Tuesday following the payroll close. This will allow even more time for processing payroll as well as provide additional time for supervisors to approve employee time entries.

Implementation Date
January, 2008

Responsible Manager
Edward Scott

Jill A. Jordan, P.E.
Assistant City Manager

Cc:   Mary K. Suhm, City Manager
      David K. Cook, Chief Financial Officer
      David K. Etheridge, Director of Human Resources
      Maria Alicia Garcia, Director of Office of Financial Services

Management Response – Audit of Payroll and Payroll Related Activities 07/26/2007      8