

**PAYROLL VERIFICATION PROCEDURES FOR
FISCAL YEAR 2007**

NOVEMBER 2007



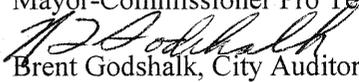
**CITY AUDITOR'S OFFICE
CITY OF GAINESVILLE, FLORIDA**

City of
Gainesville

Inter-Office Communication

November 29, 2007

TO: Audit, Finance and Legislative Committee
Mayor Pegeen Hanrahan, Chair
Mayor-Commissioner Pro Tem Rick Bryant, Member

FROM: 
Brent Godshalk, City Auditor

SUBJECT: Payroll Verification Procedures for Fiscal Year 2007

Recommendation

The Audit, Finance and Legislative Committee recommend that the City Commission:

- 1) Accept the City Auditor's report and the response from the City Manager, and
- 2) Instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit, Finance and Legislative Committee.

Explanation

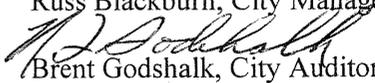
In accordance with our Annual Audit Plan, we conducted payroll verification procedures during fiscal year 2007. Our report, which includes a response from the City Manager, is attached for your review.

We request that the Committee recommend the City Commission accept our report and the City Manager's response. Also, in accordance with City Commission Resolution 970187, Section 10, Responsibilities for Follow-up on Audits, we request that the Committee recommend the City Commission instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit, Finance and Legislative Committee.

City of
Gainesville

Inter-Office Communication

October 23, 2007

TO: Russ Blackburn, City Manager
FROM:  Brent Godshalk, City Auditor
SUBJECT: Payroll Verification Procedures for Fiscal Year 2007

In accordance with our Annual Audit Plan, we have completed payroll verification procedures for fiscal year 2007. During our review, we verified the validity of active employees and retirees by comparing social security numbers against the U.S. Social Security Administration. In addition, we assessed internal controls over maintaining the active employee and retiree databases.

The attached draft report provides several recommendations we believe will assist you and your staff in strengthening management controls. Our recommendations have been reviewed with Administrative Services Director Becky Rountree, Human Resources Director Sandy Barnard, Finance Director Mark Benton and Risk Management Director Steve Varvel. We would like to acknowledge their professional courtesy and cooperation during our review and we look forward to continuing to work together with them to finalize this report and management's response.

In accordance with Commission Resolution 970187, Section 9, please submit your written response to the recommendations presented in the attached report within 30 days and indicate an actual or expected date of implementation for each recommendation. Our final report, which will include your written response, will then become public record and be submitted to the City Commission's Audit, Finance and Legislative Committee for review and approval. The next meeting is scheduled for December 3, 2007 but may be moved to late November.

As always, please feel free to contact me or my staff to discuss any questions or concerns regarding this draft report.

cc: Becky Rountree, Administrative Services Director
Sandy Barnard, Human Resources Director
Mark Benton, Finance Director
Steve Varvel, Risk Management Director

OBJECTIVES, SCOPE AND METHODOLOGY

In accordance with our Annual Audit Plan, the City Auditor's Office completed a review entitled Payroll Verification Procedures for Fiscal Year 2007. The primary focus of this review was to provide the City Commission with reasonable assurance on the adequacy of the system of management control in effect over employee and retiree identification information included in the respective system databases. Management controls include the processes for planning, organizing, directing and controlling program operations, including systems for measuring, reporting and monitoring program performance. Management is responsible for establishing and maintaining effective controls that, in general, include the plan of organization, methods and procedures to ensure that goals are met. Specific audit objectives included assessing the accuracy of data maintained for active employees and retirees and evaluating the policies, procedures and internal controls related to properly maintaining this data.

Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and accordingly included such tests of records and other auditing procedures as we considered necessary under the circumstances. Our procedures were designed to identify inaccurate social security numbers or fraudulent activity. Our procedures included electronically verifying City employee and retiree social security numbers against data maintained by the U.S. Social Security Administration, interviewing key staff, reviewing management controls and testing selected samples of transactions and supporting documentation. The scope of our review was generally for employee and retiree data maintained during fiscal year 2007. At the time of our review, the City had 2,211 active employees and 1,153 retired and vested future employees.

Based on the results of our review, we prepared specific issues and recommendations for improvement that were discussed with management. These recommendations, as well as management's written response, can be found in the following sections of this report.

BACKGROUND INFORMATION

The Human Resources Department maintains City employee personnel files including the job offer, application, copy of social security card, copy of driver's license/picture identification, Federal Forms W-4 and I-9, and other related documents. Upon hiring an applicant, an electronic employee record is created in the active payroll system using information from the employee personnel file. Subsequent changes in employee status are documented in the employee personnel file and recorded in the active payroll system.

When an employee retires or otherwise discontinues service with the City, the employee record in the active payroll system is updated. When an employee retires or ends their employment after becoming vested for future pension benefits, a new record is also created in the retiree system.

Effective June 2006, the Risk Management Department began overseeing and coordinating all aspects of the retiree process, from completing retiree maintenance forms, reviewing applications for pension, calculating pension benefit estimates, entering vested future employee records and forwarding retiree information to the Finance Department's Payroll Division for data entry.

The Payroll Division processes biweekly payroll checks and monthly pension checks and maintains information related to payroll deductions and taxes. Responsibilities also include entering retiree records into the retiree payroll system.

ISSUE #1

Improving the Accuracy of Employee and Retiree Identification Data

Discussion

During our review, we evaluated the validity of information included in the payroll and retiree systems and reviewed internal controls. We compiled and formatted approximately 3,600 records of active and retired City employees and submitted the data to the Social Security Administration (SSA) for name and Social Security Number (SSN) verification. Our comparison of the SSA information against City information identified 86 data mismatches consisting of SSN's, names, dates of birth and gender codes. We then made inquiries and reviewed employee and retiree personnel files to identify the causes of the mismatches. A brief summary of the errors detected is as follows:

- 6 records missing SSN's, dates of birth (DOB) and gender codes
- 15 mismatched SSN's
- 5 mismatched names
- 30 mismatched dates of birth
- 30 mismatched gender codes

Missing SSN, DOB and Gender Code

We found six records in the retiree system missing the SSN, DOB and gender codes. We reviewed personnel files and determined that all six records belonged to vested future employees entered by the Risk Management Department. We also noted during our review that records in the active employee payroll system and the retiree system are not linked, thereby requiring manual input.

Incomplete data hinders proper employee identification and can lead to confusion and errors. To illustrate, one incomplete record of a vested future employee shared the same first and last name as a retired employee and appeared to be a duplicate. Only after reviewing the personnel files was it determined that two individuals existed. In another example, a vested future record was found to be a duplicate. Risk Management has agreed to make necessary corrections and to include personal employee information for new vested future records in the retiree system.

In addition to the incomplete status of some future vested records, we identified a backlog of records in Risk Management pending correction or entry into the retiree system. This backlog hinders timely reconciliations and effective monitoring activities.

Mismatched SSN's and Names

All 15 records identified with mismatched SSN's were from the retiree system. Each record was off by one or two digits, indicating probable data input errors when manually entering data from the active employee payroll system into the retiree system.

The records for the five mismatched names were also all from the retiree system. We noted discrepant data in the retiree system to those found in both the payroll system and the employee personnel files. Mismatched records mainly consisted of data input errors within the retiree system, including SSN's incorrectly recorded or belonging to other individuals such as a spouse or another employee with the same last name, as well as one instance where a retiree's first and last names were switched.

The SSN is a unique and consistent identifier for individuals and an essential part of reporting income to the Internal Revenue Service (IRS). The IRS can impose penalties for incorrectly reported information. Payroll has been notified of these inaccuracies and has made or is making appropriate corrections to the retiree system, as well as to applicable 1099R forms previously submitted to the IRS.

Mismatched Dates of Birth (DOB)

Twenty-five of the 30 mismatched DOB codes were from the retiree system. We selected five of these records for additional testing, four from the retiree system and one from the employee payroll system. Again, we generally noted incorrect data in the retiree system compared to information found in both the employee payroll system and personnel files.

Although the DOB is not reported to the IRS on W-2 or 1099R forms, it does affect pension calculations. To illustrate, we found one record of a vested future employee with an actual DOB of 12/20/78 listed in the retiree system as 10/07/43. Pension calculations had been calculated and documented by the City's actuary based on the erroneous DOB of 10/07/43, indicating the employee was scheduled to receive pension benefits in November 2008, at approximately age 30. Payroll and Risk Management have been informed of these inaccuracies and have made or will make proper corrections.

Mismatched Gender Codes

Twenty-three of the 30 mismatched gender codes were from the retiree system. We selected five of these records for additional testing, four from the retiree system and one from the employee payroll system. Again, we generally noted incorrect data in the retiree system compared to information found in both the employee payroll system and personnel files. Although the gender code is not included in the W-2 or 1099R, it should be accurately reflected for proper identification. Payroll was informed of these inaccuracies and will make the corrections.

Conclusion

We believe that improved controls are needed over data input, review and reconciliation given that the employee and retiree systems are not integrated and multiple departments and divisions have record maintenance duties. Errors noted during our review were generally related to information within the retiree system found to be inconsistent with information in the active employee system and physical employee files. Many of the errors noted apparently resulted from a January 2006 software upgrade and conversion in the retiree system that required manual re-entry of all retiree and vested employee records. However, data entry errors are always possible when manually entering data.

Undetected inaccuracies could put the City at risk of erroneously paying pension benefits and receiving IRS fines. Test results have been communicated to management, who indicated that corrections have been or are in the process of being made.

Recommendation

We recommend management improve existing controls over data input, review and reconciliation in order to enhance data accuracy within the retiree system. Specific actions should include:

- A. Evaluating further whether relevant data within the employee payroll system can be electronically transferred into the retiree system when an employee's status changes in order to reduce data input errors and save input time;

- B. Preparing periodic reports to monitor the accuracy of information entered into the retiree system;
- C. Improving supervisory review of pension valuation reports and pension calculations provided by the City's actuary;
- D. Implementing periodic reconciliation processes, such as using the SSA's Employee Verification Service, to compare employee and retiree SSN's and associated data to source documents; and
- E. Taking action to reduce the backlog of pending items.

Management's Response

Management concurs with the City Auditor that the electronic transfer of data, when feasible, is preferable to manual input, from the perspective of both staff time and error reduction. As relates to the January 2006 conversion of retiree data, structural differences between the then-existing and upgraded software mitigated against our ability to transfer the data in such a manner. We agree that steps should be taken to improve controls over data input into the system. Staff will continue to explore the possibility of electronically transferring data from the active to the retiree payroll system, and in the interim we will develop a process to periodically review the accuracy of information entered into the retiree system.

Regarding pension valuation reports and pension annuity calculations, retiree data is "scrubbed" to verify accuracy through several control measures. At the beginning of the annual valuation process, all active and retiree demographic data is submitted to the actuary, who compares the data to a data file maintained by the actuary from the prior valuation, updated by changes that occurred between valuations. Differences between the files are noted by the actuary and submitted to the City for review and reconciliation. Corrections are forwarded to the actuary and if consensus on the data is reached, the actuary continues with the valuation process. Draft valuations are prepared by the actuary and reviewed by staff before the final document is approved. Management is confident with the material accuracy of the valuation data, the integrity of the actuarial valuation reports and the structure of the process that develops these reports.

Consolidated Police Officers' and Firefighters' Plan demographic data is also reviewed annually by the accounting staff of the Division of Retirement in Tallahassee in conjunction with the City's submittal of the state required annual report.

In the case of individual pension annuity calculations, upon receipt of the calculation from the City the actuary compares the demographic data utilized by the City against a data sheet they produce from their database. In reviewing the specific instance of the date-of-birth error cited by the City Auditor, management contacted the actuary and asked that they review their files for this calculation. The actuary stated that in fact their data summary sheet had the correct date of birth, but that they had failed to note that the date of birth City staff used for the pension calculation was incorrect. The proper control measure is in place, but in this particular instance it was simply poorly executed.

As an additional control, Risk Management has initiated a process that utilizes a "blank" estimate form. It appears that a previous estimate spreadsheet was used as the template for the estimate in question and the individual who performed the calculation did not change the date of birth. By using a "blank" template it will require the individual preparing the estimate to fill in all data requirements, thus eliminating the probability of previous data being included in an individual's estimate.

The backlog of items is largely due to the staffing vacancies that have occurred as a result of the hiring freeze. Risk Management is currently working on filling the vacant Management Analyst position. Once filled, it will allow for additional reviews and reduce the backlog in data entry.

Improving Retiree Data Records Administration

Discussion

In June 2006, coordination of retirement benefits was transferred to the Risk Management Department from Human Resources. This transfer of duties resulted in portions of employee files being maintained in two separate locations. Human Resources, as the central repository, maintains the most complete set of employee records including employment applications, personnel actions, performance evaluations, general correspondence or other information and pension benefit information. Risk Management maintains employee health benefit records and pension benefit information such as recertification and beneficiary information.

Although physical controls over the safety and security of employee records appear sufficient in both locations (sprinklers, fire resistant cabinets, electronic backup and offsite storage), we found pension-related records at Human Resources to be incomplete. Our review of retiree records identified pension recertification cards only up to 2001 and no other evidence that the annual recertification process was conducted, including the original mailing lists. The recertification cards for 2002 through 2005 were apparently filed in boxes and destroyed.

Although Risk Management indicates the 2006 recertification process was conducted, the results were not sent to Human Resource's central files. The cards remain stored in boxes separate from employee files. If someone were trying to conceal the death of a retiree, the card would have to be falsified. The cards are used as a preventative control by verifying the retiree is alive and actually receiving pension checks.

Conclusion

Employee records contain sensitive information and should be adequately safeguarded and secure. Human Resources is the designated guardian of employee records and must ensure full compliance with record security and file maintenance. Maintaining employee and retiree records in two locations could lead to inaccurate, duplicate and/or conflicting records. We believe that employee and retiree records should be centrally maintained to ensure record completeness, to prevent duplicate or conflicting information and to ensure compliance with Florida records retention laws.

Recommendation

We recommend management take action to improve the existing records management system and file maintenance practices over active employee and retiree records. Utilizing the SSA's Employee Verification Service discussed in Issue #1 may assist in verifying retiree eligibility on an annual basis.

Management's Response

Management concurs with the recommendation that there is a need for improvement over the system and file maintenance practices. All retirement paperwork is forwarded to Human Resources for inclusion in the employee/retiree's permanent file. In addition, an electronic copy of the paperwork is maintained by Risk Management as a backup.

In an effort to improve both the file management and system maintenance, management has initiated a team consisting of Risk Management, Finance and Human Resources to look at the retirement data entry process to ensure that all the necessary information is correctly transferred into the retiree system. The process will include instituting a workflow process with respect to data entry that will require supervisory review and approval of the system data entry process and a comparison to the information contained in the active system to make sure the data is consistent.