

January 17, 2014

The Honorable Mayor Kim McMillan
City Council Members
Audit Committee Members
Clarksville, Tennessee 37040

Executive Summary of Clarksville Gas, Water and Sewer Department's Payroll Audit

The following is an executive summary of the findings and management's comments in response to the findings related to the internal audit report on Clarksville Gas and Water Department's (CGW) Payroll. The full audit report is attached and contains additional details about the findings and recommendations as well as more background information.

Objectives of the Audit

- Report on CGW's payroll activity from January 2011 through March 2012.
- Determine compliance with Federal and State payroll-related law relevant to compensation and payroll records.
- Determine compliance with City Code and City Human Resource policy.
- Determine whether Fox Lawson & Associates pay study scales were properly implemented.
- Evaluate payroll-related local policy and procedures (City Code and City Human Resource Policy) for compliance with FLSA requirements.
- Evaluate the design and effectiveness of internal controls over the payroll process during the audit period.

Brief Background

CGW payroll expense increased from 13% to 18% of the total operating expenses for the Department from FY 2010 to FY 2013. The increase is explained by the adoption of the Fox Lawson Study, an increase in the number of employees and a decrease in total operating expenses during the period. The CGW payroll function is handled by CGW employees with support services provided by the City's Human Resources Department and the City's Finance Department.

Conclusions of the Report

Our audit revealed the following results related to our original objectives:

- Payroll expenses have increased in both dollar amount and percent of total operating expenses during the time period FY 2010 – FY 2013.
- Our testwork revealed the following in regard to compliance with Federal and State payroll-related laws:
 - Supporting documentation required by the Tennessee Lawful Employment Act is missing in 35 out of 167 (21%) files tested for compliance with the Act.

- Based on our testwork regarding compliance with City Code and City Human Resources policy, we are 95% confident that CGW personnel files are fully compliant with City Code and Human Resources policy.
- Based on our testwork regarding the implementation of the Fox Lawson & Associates study, we are 95% confident that CGW's employees were paid in accordance with the FLA study during the period tested.
- Based on our testwork regarding compliance in regard to City policy and procedures related to the requirements of the Fair Labor Standards Act, we are 95% confident that the CGW complies with all FLSA related City Code requirements and City policy and procedures.
- Our evaluation of the design and effectiveness of the internal controls surrounding the payroll process revealed the following:
 - In general, internal control procedures are operating effectively. However, we found four deficiencies in control procedures related to the following:
 - The employee setup process is not documented and does not require proper segregation of duties.
 - The payroll process is documented but does not require proper segregation of duties.
 - The payroll data entry is reviewed for accuracy by a person who can perform data entry (time and rates). Both the primary processor and the primary's backup have authority to both process payroll and set up new employees and/or change time and pay rates.
 - Payroll module system controls need to be established that support proper segregation of duties (e.g. require a separation of the employee setup/change role, the timekeeper role and the payroll processor role and the payroll reviewer role).
- Based on our randomly generated statistical sample of 259 payroll transactions out of a total population of 7,694 transactions during the period January 2011 through March 2012, we are 95% confident (3% tolerable error) that all transactions are accurately calculated and properly supported.

The audit identified two areas where efficiencies in payroll processing could be gained:

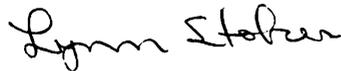
- A change from semi-monthly to bi-weekly payroll periods and the adoption of a five business day payroll lag would facilitate the payroll process by creating pay periods with a consistent number of days and it would reduce the number of reconciliations needed each month to adjust payroll to actual.
- A uniform timesheet for all divisions and subdivisions within CGW would facilitate the payroll review process.

The CGW management agrees with all of the findings and one of the recommendations set forth by the auditors. Management does not agree with the recommendation to change to a bi-weekly payroll cycle with a five business day payroll lag. Full details are contained in the report.

Internal Audit wants to thank CGW staff and management for their help and support throughout the performance of the audit.

If you have any questions about the audit, the findings, or the recommendations please contact me at 648-6106.

Respectfully,

A handwritten signature in black ink that reads "Lynn Stokes". The signature is written in a cursive style with a large initial "L".

**Lynn Stokes
Director of Internal Audit**

**cc: Bill Harpel, Chief of Administration
Laurie Matta, Director of Finance
Jennifer Rawls, Director of Communications
Pat Hickey, General Manager, CGW
Fred Klein, CFO, CGW**



INTERNAL AUDIT REPORT

AUDIT TITLE:	PAYROLL AUDIT
DEPARTMENT:	GAS, WATER AND SEWER DEPARTMENT
AUDIT PERIOD:	JANUARY 2011 THROUGH MARCH 2012

CITY OF CLARKSVILLE
GAS, WATER AND SEWER DEPARTMENT
PAYROLL AUDIT
AUDIT # 1309

Jim McNaughton

Auditor

Lynn Stokes

Audit Director

January 17, 2014

Date

**CITY OF CLARKSVILLE
INTERNAL AUDIT REPORT**

Gas, Water and Sewer Payroll Audit

Table of Contents

Origin of Audit.....	1
Audit Objectives.....	1
Scope and Methodology of Audit.....	1
Statement of Auditing Standards	1
Background	2-6
Internal Controls and Compliance with Laws and Policies.....	6-10
Results of the Audit	
Findings.....	11-12
Other Recommendations.....	12-16
Conclusion.....	16-17

Internal Audit Report

Origin of the Audit

The Internal Audit Department reviewed the Clarksville Gas, Water and Sewer Department's (CGW's) payroll to provide assurance and advisory services related to payroll. This audit was included in the FY 2013 Audit Plan approved by the Audit Committee.

Audit Objectives

Our objectives for this audit were to:

- Report on CGW payroll activity from January 2011 through March 2012.
- Determine compliance with Federal and State payroll-related law relevant to compensation and payroll records.
- Determine compliance with City Code and City Human Resource policy.
- Determine whether Fox Lawson & Associates pay study scales were properly implemented.
- Evaluate payroll-related local policy and procedures (City Code and City Human Resource Policy) for compliance with FLSA requirements.
- Evaluate the design and effectiveness of internal controls over the payroll process during the audit period.

Scope and Methodology of the Audit

Our audit scope included tests of payroll compliance related to compensation on the federal, state and local (City Code and City Human Resource policy) level.

The scope did not include an audit of benefits or payroll deductions.

Our audit scope included CGW's internal control structure and the payroll transaction activity during the selected audit period (January 2011 through March 2012). We assessed the effectiveness of the controls by assessing the accuracy of the existing payroll process and structural adequacy and the sustainability of the internal control structure.

The audit scope included an evaluation of Information Technology (IT) payroll permission controls, but did not include an evaluation of the financial systems or the adequacy or design of IT or financial systems.

Evidence to support our conclusions was gathered from direct inquiries of management and staff as well as observations of source documentation and tests of the controls surrounding the transaction approval, calculation, and record keeping requirements of the payroll process. From a population of 7,694 transactions, we randomly selected a sample of 259 transactions and 167 associated employee personnel files for review.

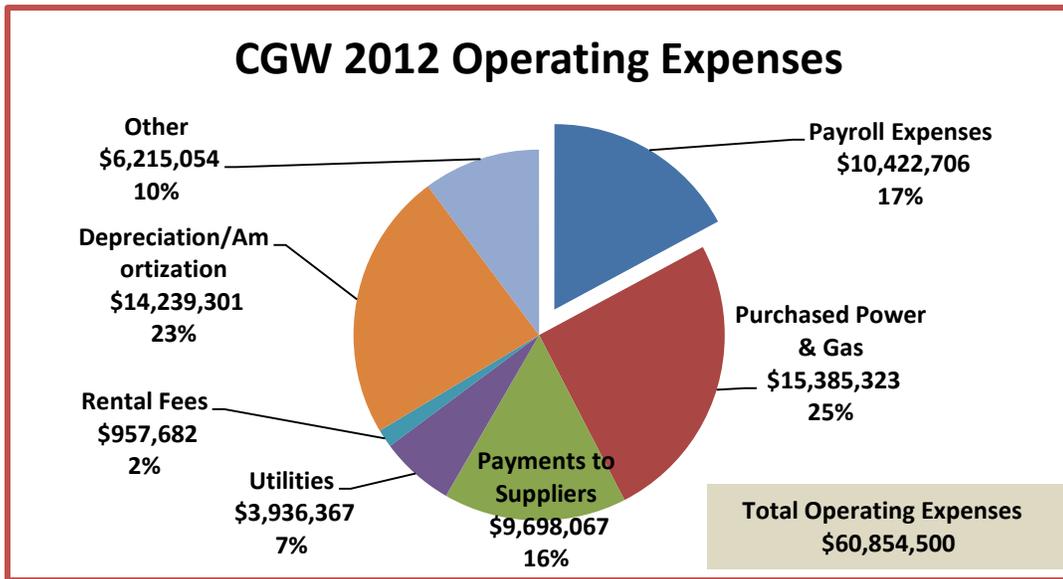
Statement of Auditing Standards

We conducted this performance audit in accordance with various auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our Internal Audit Department has not undergone a peer review which would independently verify that our Department conducts its audits in accordance with standards. However, a peer review is planned and budgeted for FY 2014.

Background

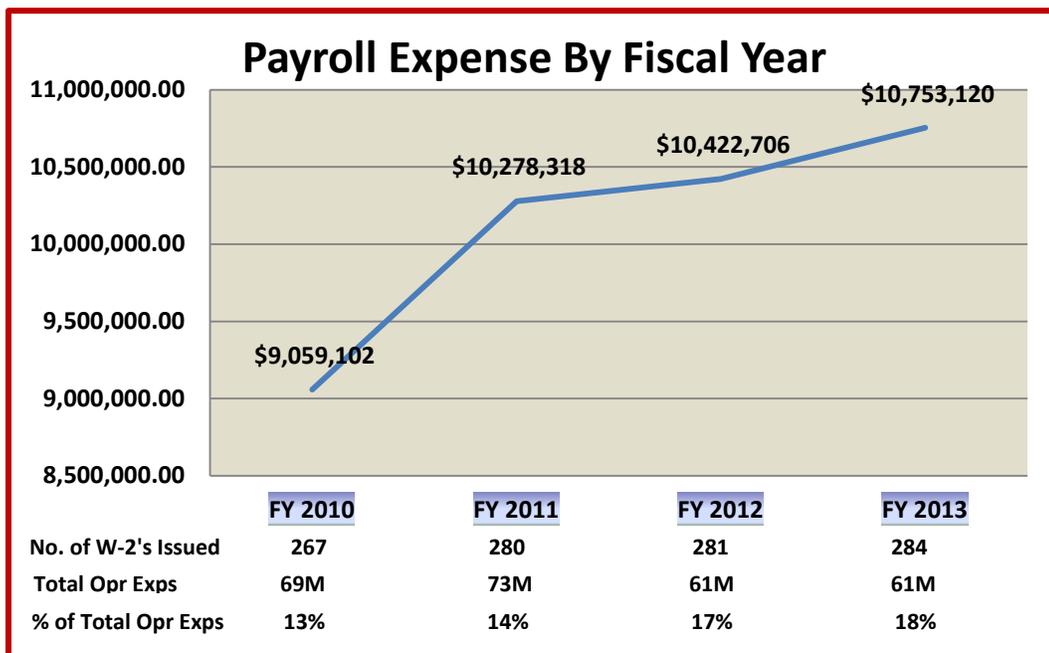
Reasons for Audit consideration:

In FY2012, payroll expense made up 17% of CGW's total expenditures.



Source: Munis accounting software.

Payroll expense trend:



The increase in wages between 2010 and 2011 is explained by the combination of the adoption of the Fox Lawson Study (FLA) findings (market adjustment), an extra payroll payment in 2011 (timing), and an increase in the number of employees. The findings of the FLA market adjustment study resulted in a one-time gross wage increase for most of the full time employees in April 2011.

The FLA study reviewed all full time positions to determine the appropriate classification and pay grade for each position and employee. The implementation of the study aligns the labor rates for City employees with other municipalities in the region.

The CGW payroll process:

Employee positions must be approved by Human Resources and supported by an approved CGW budget before they can be filled. When an employee fills a position, they are assigned an employee control number. After their employee number has been assigned, their rate of pay, work schedule, pay schedule, and personal information are entered into MUNIS.

Employees are paid on a semi-monthly schedule. There is no payroll time lag for CGW's full time employees so estimates are made for time worked each pay period. These estimates are reconciled to actual time worked in the follow-up pay period.

CGW payroll hours are reviewed and approved at the supervisor level and entered by the functional area time keepers.

Any rate changes are entered centrally by the accountant in charge of payroll processing. A list of changes and the backup that supports the changes is reviewed by the Accounting Manager each pay period.

Each CGW supervisor is responsible for:

- Accounting for the hours worked, overtime worked, and leave used by employees.
- Reviewing and approving/denying requests for overtime and leave submitted on leave slips.
- Ensuring that records of all time worked, overtime, and leave documentation are recorded on a timesheet with copies of leave forms attached.
- Tracking the leave time for all department employees (MUNIS report).
- Sending timesheet and leave slips to accounting for review and processing.
- Reconciling time worked against time paid in the previous period and sending adjustment information to central processing.
- Performing an annual performance evaluation for each employee in the department and sending a copy through CGW management to the City Human Resource department for filing.

Each functional timekeeper is responsible for:

- Checking that all timesheets are signed and approved.
- Entering all time (after checking for supervisor approval).
- Entering any out of period or correcting entries to time (requires support and approval).
- Compiling/forwarding support for all time entered (support for each payroll batch entered).
- Ensuring all required payroll information is entered by payroll cutoff date.

Central payroll processing is responsible for:

- Setting up new employees and making changes to any existing employees (only with approved backup).

- Entering rate adjustments for all employees (only with approved backup).
- Forwarding list of MUNIS changes and associated backup to Accounting Manager for review.
- Coordinating with timekeepers to correct time entered or making any previous period adjustments (errors discovered in central review).
- Checking that all batch support (timesheets and daily sheets) are signed and approved.
- Checking timesheets for accuracy (OT calculated correctly, leave taken available).
- Processing the payroll.
- Creating paychecks and vendor checks associated with payroll.
- Printing and maintaining payroll reports.
- Distributing all manual checks (notifications are electronically submitted to employee email accounts from MUNIS).
- Working with AP to ensure all payroll liabilities are paid and supported by backup.

Accounting Manager is responsible for:

- Reviewing all MUNIS changes (confirm supported).
- Reviewing GL and bank statement reconciliations.

CFO is responsible for:

- Performing final review of all Bank and GL reconciliations.

Human Resource department is responsible for (payroll specific):

- Maintaining personnel files that support employee setup, pay, and performance.
- Providing guidance through Human Resource policy and procedure.
- Assessing compliance with City Code requirements.
- Providing support for any benefits paid.

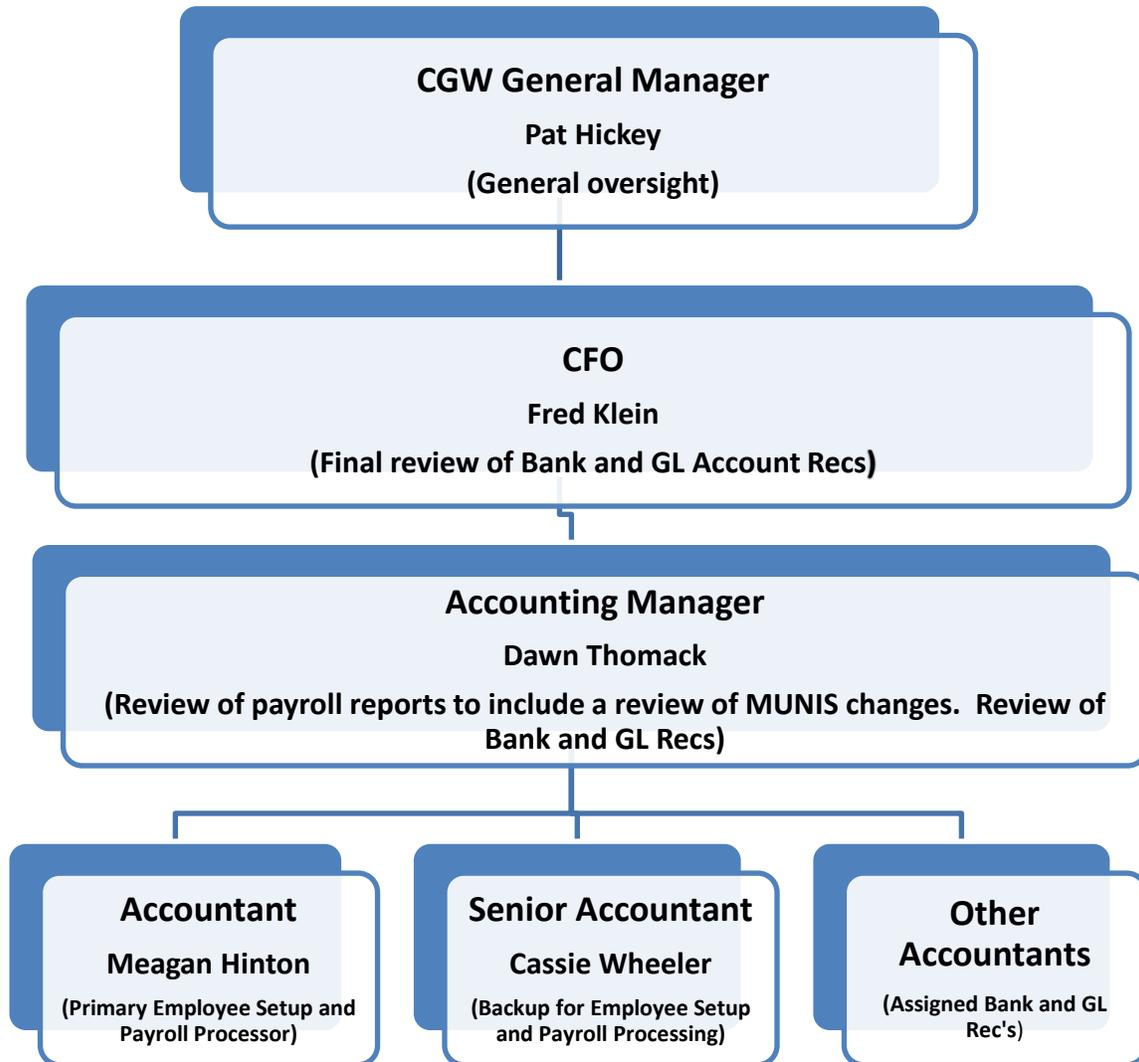
Finance department is responsible for (payroll specific):

- Coordinating indirect payments (collecting and submitting CGW's share of City benefits that need to be paid collectively).

In addition to payroll transactions that pay employees for their hours worked, payroll transactions include taxable benefits, retro pay adjustments, and longevity payments.

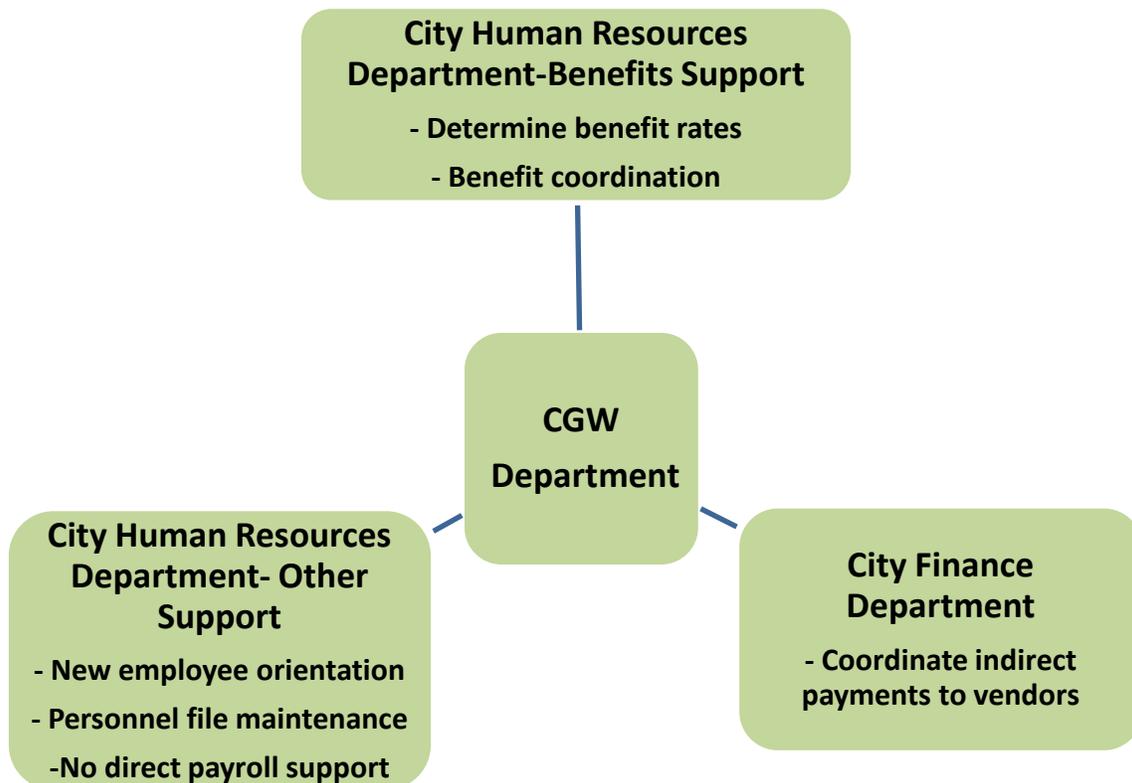
- Taxable benefits such as vehicle usage and cell phone stipend benefits are computed and added to the employee's wages.
- Retro pay adjustments pay the difference between what was supposed to be paid to an employee and what was actually paid. This occurs when an effective date of a payroll change happens before the start of the current pay period.
- Longevity payments are annual payments made to each employee that has more than 6 years of service with the city. The amount paid is easily calculated (service years at a specified measurement date x specified rate) and is paid in a separate payment to employees once per year.

Payroll Roles – CGW Department:



Source: Discussions with CGW CFO and CGW Accounting Department personnel.

Payroll Partners – Services Provided to CGW Department:



Source: Discussions with CGW management.

Internal Controls and Compliance with Federal and State Laws, City Code, and City Policies

Relevant Procedures and Controls	Yes	No	Other	Status
Internal Controls:				
Do payroll procedures exist?	X			Procedures are written. The described procedures were validated by observation, evidence in payroll backup, and evidence in personnel files.
Are the payroll process roles clearly defined and understood?	X			Roles are clearly defined and specific. The central role (primary payroll processor) directs the process and monitors compliance.
Do procedures provide that all authorizations (new hires, status changes, separations) include Human Resource approval and document immediate transmittal to the payroll	X			Employee changes have to be signed by HR, department management, and the Mayor. Documented on status change forms.

Relevant Procedures and Controls	Yes	No	Other	Status
<p>accountant?</p> <p>Segregation of Duties: Are key duties and responsibilities in authorizing, processing, recording, and reviewing transactions segregated?</p> <p>Does the software system access prevent any one employee from unilaterally changing payroll?</p>		<p>X</p> <p>X</p>		<p>Authorization of hours worked, OT and leave is agreed to by both the employees and the functional supervisors (documented on timesheets, OT and standby sheets, and leave forms). All timesheets are consolidated and reviewed for accuracy at a central point (accounting). Processing of the payroll is performed by central accounting. Check printing is performed by central accounting as part of the payroll processing. A clearing account for Payroll makes for easy reconciliation (accounting). Payroll-related GL accounts are reconciled monthly (accounting). Segregation of duties is clear and is defined by procedure. However, current practice allows/requires the same person to enter all new employees and employee changes, consolidate/check and then process payroll information that has been entered into the MUNIS payroll system.</p> <p>Although timekeepers have the time entry role, the central processing accountant and her backup are also able to enter/adjust hours. Central processing functions also include employee setup and adjustment and payroll processing. The primary payroll processor and the backup for the primary payroll processor have too</p>

Relevant Procedures and Controls	Yes	No	Other	Status
<p>Are controls in place to prevent the person who prepares the time sheets from changing the time after approval?</p>	X			<p>much access and functionality.</p> <p>Once time cards are approved they are never sent back to supervisors or employees. Any adjustments (after submission) are made after additional review and approval and all require support for the change.</p>
<p>Are overtime hours, standby time worked, detailed and approved prior to being paid (by someone other than who prepares payroll)?</p>	X			<p>All timesheets, overtime and leave approvals are approved by the department management. They are included as support for the payroll in which they were paid (held by department and forwarded as batch support and stored as payroll support after consolidation).</p>
<p>Are time sheets, overtime approvals, and leave form approvals documented and maintained?</p>	X			<p>All have approval documented. Held at the department. Approval is also documented on the timesheets, OT and Standby sheets and leave forms.</p>
<p>Is access to personnel files restricted?</p>	X			<p>Held in HR. Locked room except during business hours when access to the room is monitored and restricted. Access restricted to auditors, those with payroll roles, and management as needed.</p>
<p>Is access to payroll files restricted?</p>	X			<p>Held in CGW archive room. The room is locked except during business hours when access to the room is monitored and restricted. Access restricted to auditors, those with payroll roles, and management as needed.</p>
<p>Is payroll system access restricted appropriately for those with payroll roles?</p>		X		<p>Full access for primary payroll processor and backup. The person who</p>

Relevant Procedures and Controls	Yes	No	Other	Status
<p>Is payroll system access confined to those with a payroll role?</p> <p>Is check stock secured?</p> <p>Does the City maintain adequate bank account controls over payroll?</p> <p>Is the ability to transmit funds to the bank segregated from the ability to prepare payroll?</p>	<p>X</p> <p>X</p> <p>X</p> <p>X</p>			<p>enters employee data into system also processes payroll. Employee data changes are reviewed by Accounting Manager</p> <p>Payroll Processor controls check stock, prints all checks and coordinates with Accounts Payable to ensure all payments are supported. Payroll Processor distributes all checks by hand (pickup).</p> <p>CGW maintains a separate bank account for payroll clearing. The activity is nominal (bank transmittal, a handful of checks, and payments of liabilities). The balance of the accounts once all checks, the transmittal and payroll liabilities clear is \$0.</p> <p>The preparer of payroll releases the payroll once it is determined to be supported. The release of payroll acts as the funding authorization.</p>
<p>Procedures to ensure that payroll is properly calculated:</p> <p>Verify the time paid against supporting documents:</p> <p>a. Time sheets (hourly and salary NE)</p> <p>b. Default time</p>	<p>X</p> <p>X</p>			<p>All supervisors fill out timesheets, and OT and standby sheets. These sheets document approval on hours worked, OT, and leave.</p> <p>All employees (except Temps) start with the default and adjustments are made from there (OT, Leave, LWOP)</p>

Relevant Procedures and Controls	Yes	No	Other	Status
<p>c. Overtime (hourly and salary NE)</p> <p>d. Leave (vacation/sick/other)</p> <p>Verify rate paid is documented and validated in the personnel file</p> <p>Verify the overtime is calculated correctly</p> <p>Verify vacation /sick/holiday/other leave on the timesheet is supported by validated leave forms or holidays</p>	<p>X</p> <p>X</p> <p>X</p> <p>X</p> <p>X</p>			<p>if applicable).</p> <p>Personnel status changes are in the personnel file. Automatic pay adjustments (mass changes) are not, but can be verified through documented City Council actions.</p>
<p>Payroll policy and practice are in compliance with Federal and State of Tennessee laws and City Code and City Human Resource Policy:</p> <p>Payroll policy and practice is in compliance with the Federal (FLSA and ERISA), and State guidance (related to hours, compensation, and record keeping)?</p> <p>Payroll policy and practice is in compliance with City Code (related to hours, compensation, and record keeping)?</p> <p>Payroll policy and practice is in compliance with Human Resource policy (related to hours, compensation, and record keeping)?</p> <p>Is the compensation in accordance with the Fox Lawson & Associates pay study after the implementation?</p>	<p>X</p> <p>X</p> <p>X</p> <p>X</p>			

Results of Audit

Auditor testing and research revealed the following findings:

1. Some personnel files (21% of tested files) are lacking documentation required under the Tennessee Lawful Employment Act.

Criteria: Per TN Code Annotated § 50-1-703 (a) (3) [Tennessee Lawful Employment Act] employers must validate the lawful employment status of their employees. To prove lawful employment was validated, employers need to request and maintain eligibility verification documents as outlined in the Act.

Condition: Only 132 of 167 (79%) employee personnel files sampled had the required documentation.

Cause: The regulations surrounding documentation requirements relating to lawful employment have changed over time. The Tennessee Lawful Employment Act which went into effect on January 1, 2012, created the updated standard but efforts have not been made in the City to bring all employee files up to the new standard as of the audit report date.

Effect: CGW is not in compliance with the Tennessee Lawful Employment Act. The Department could be added to a published list of offenders and possibly subjected to fines if a complaint is filed and the Department is found to be in noncompliance with the validation requirements.

Recommendation: CGW and the Human Resources Department need to initiate steps to ensure the required Tennessee Lawful Employment Act actions are taken and that the resulting documents are obtained and maintained in each employee's personnel file.

Responsible Department: Human Resource Department

Management Comments: The lack of documentation is most likely missing in the older personnel files. We are in the final process of implementing the use of E-Verify as our employment validation tool. A copy of the E-Verify report will be placed in each employee file which will fulfill the employment validation requirement. In the meantime, we are ensuring that a copy of the I-9 is in all employee files.

Agree _____X_____ Disagree _____

Corrective Action Plan: For employees hired before July 1, 2013, Human Resources plans on re-certifying one department each month until all departments have been processed to ensure that proper employment validation documents exist in all personnel files.

Projected Completion Date: September 1, 2014

Responsible Manager: Will Wyatt

2. Segregation of payroll access needs to be documented in written procedure.

Criteria: Written procedures should demonstrate segregation of duties in the following areas:

- Employee setup

- Payroll processing
- Payroll review
- Payroll approval

Access to the MUNIS payroll system should be restricted to support the segregation.

Condition: Currently 2 employees have full user rights to MUNIS payroll and human resource functionality as it relates to payroll. These employees are only restricted by informal procedure. The individuals have the capability to set up new employees, enter time, change pay rates and also process payroll.

Cause: CGW has tasked the Payroll Processor function with providing the full scope of employee maintenance and payroll processing duties. The department has relied on trusted employees to fill these roles and to minimize the risk of not fully segregating the functions. The department performs its own MUNIS employee setup (normally an HR support role).

Effect: The current payroll procedure and access configurations increase the Department’s exposure to payroll fraud. The current method of control relies too heavily on trusting employees to restrict their system interaction.

Recommendation: Written procedures should be amended to establish proper segregation of duties and to allow for a smooth transition of responsibilities when duties shift from one employee to another. The procedures should document the duties of the Employee Setup/Changes role, the Timekeeper role, the Payroll Processor role, and the Payroll Reviewer role. The procedures should:

- Provide a way to segregate the employee setup and payroll processing functions.
- Provide for a detailed payroll reviewed by someone other than the processor for each payroll.
- Require a system identification of all employee changes and an associated review of all changes to source documents.
- Address the system controls needed in MUNIS with City IT.

Responsible Department: CGW

Management Comments:

Agree _____X_____ Disagree _____

Corrective Action Plan: We have begun training individuals in each of these roles and are reviewing roles/permissions in our software (Munis) in order to separate not only the job duties but the access to the system functions.

Projected Completion Date: February 1, 2014

Responsible Manager: Fred Klein

Other Recommendations

Although not considered findings, the auditors believe the following recommendations would improve the overall payroll process.

1. Improve the efficiency of payroll processing by creating a payroll lag and moving to a bi-weekly payroll.

The following efficiencies could be gained by such a move:

- No reconciliations of assumed work activity versus actual work activity are required (currently required each pay period).
- Standard deadlines create less confusion about payroll cutoff.
- End of the work week cutoff simplifies OT calculations.
- Possibility of overpayment to employees as they terminate is reduced or eliminated.
- More time is available to review payroll activity which reduces errors.

After reviewing case studies, the auditors believe implementation of a payroll lag and a bi-weekly payroll system can be accomplished with minimum impact to employees. Please contact the audit team for some specific examples.

Management Comments:

Agree _____

Disagree _____ X _____

I will address the perceived efficiencies listed above in order:

1. We would still need to estimate the hours worked at the end of each month because rarely would the bi-weekly payroll coincide with the actual month end date so this is just trading one "true-up" for another.

Just to be clear, assumed work versus actual work seems to imply that people are being paid for time they have not earned. A better description would be the reconciliation of time paid allocated between worked, sick or vacation. In the end, employees receive the correct pay but the classification between hour worked, sick time or vacation may need to be adjusted.

2. We do have standard deadlines, the 15th and the end of the month! Regardless of the pay date, the file needs to be at the bank 2 days prior to the pay date. We have NEVER been confused about payroll cut-off.

3. Overtime pay is already based on the work week because we only pay for hours worked over 40 in the work week (Mon-Sun). Overtime pay is never estimated. The calculation would not change; the only thing that would change is when the employee receives payment.

4. I admit this is a possibility however; it is highly improbable based on our experience. I looked at the past 5 years of data and it has never happened.

5. Time constraints have never been an issue when reviewing payroll. Additionally, since there would now be 26 payrolls to process in a year versus 24 there would actually be less time for review unless additional resources are added.

I also took the time to review the case studies listed as a basis for this recommendation.

The first was a 2008 survey by The Hackett Group. It starts by stating that most countries outside of the U.S. pay monthly, while most in the U.S. (69%) pay bi-weekly. It goes on to say "company culture and type of employees (i.e. hourly, salaried) are major considerations when determining the best pay cycle" and "The payroll cycle alone does not make the organization more effective or efficient"

The 1998 article in HR Magazine discusses how one company considered consolidating their pay process since they ran both bi-weekly and semi-monthly payrolls but in the end the company did not change either one. Paul Dorf, managing director of Compensation Resources

Inc. states “The emotional aspect of changing a pay cycle and having to communicate this to employees is very high”

Another HR Magazine article from 2012 discusses how there are advantages and disadvantages for different payroll cycles. It goes on to say bi-weekly saves money versus weekly payroll because of processing only 26 times instead of 52. Further, bi-monthly saves even more with 24 instead of 26 cycles.

The Harvard Gazette mainly focuses on their transition to a bi-weekly payroll and a pay advance equal to 9 days’ pay that would be paid back over the coming year. It’s interesting to note that under the semi-monthly pay cycle they were paid on the 12th for work through the 15th of the month and again on the 26th for work through the end of the month. They also had a number of faculty and hourly staff already on the bi-weekly cycle.

Boise Inc. has a Q & A to the employees of the recently purchased Hexacomb U.S. describing how they are moving them to a bi-weekly lag cycle from their current semi-monthly current cycle. They state they want everyone on the same payroll cycle. Although not stated, this would also improve the company’s cash flow.

Finally, Rogers v. City of Troy NY discusses the legalities and the method of moving from a weekly current cycle to a bi-weekly lag cycle.

In conclusion, I found little in these cases that provided any evidence that a move to bi-weekly pay would be beneficial over the way payroll is currently done at CGW. The recommendation is based on anecdotal evidence without any true analysis or consultation with the staff at CGW. Additionally, little consideration has been given to the impact on the employees all of whom will receive a smaller take home pay in all but 2 months of the year. The impact on an individual’s personal budget will create hardships for several of our employees.

Finally, the suggested implementation will cost CGW approximately \$190,000 in direct compensation, generate no benefit and will likely result in lower employee morale.

Corrective Action Plan: None

Projected Completion Date: None

Responsible Manager: Fred Klein

Auditor Comments in Response to Management Comments:

The auditors stand by their original recommendation. There are two separate changes addressed in the recommendation: 1) the move to bi-weekly payroll and 2) the creation of a payroll lag. The two changes were combined into a single recommendation in our report in order to make the report more concise. Each recommended change has its benefits.

Our research revealed that a bi-weekly pay cycle has the following advantages:

- 1. By federal regulation, overtime calculations are based on a 7-day workweek. Since bi-weekly payroll calculations more readily correspond to the regulatory requirement, they are easier than semi-monthly calculations for employees to understand and to calculate what to expect in regard to their overtime pay.*
- 2. With a bi-weekly pay cycle, two 7-day workweeks consistently match the pay period cycle of 14 days. In a semi-monthly payroll cycle the number of days in a pay period varies month to month, and the pay cycle doesn’t coincide with the workweek cycle.*

3. *In a bi-weekly payroll cycle, analysis of payroll data is enhanced because each pay period has an equal number of days.*
4. *A regular weekday deadline for timesheets is generally easier to remember than a date deadline which fluctuates month to month. A consistent weekday deadline also facilitates time management of other routinely scheduled activities that are performed on a weekly basis.*
5. *In a bi-weekly payroll cycle paydays never fall on the weekend. Paydays are always on the same day of the week, and since employees are paid more frequently a bi-weekly cycle often helps employees with money management.*
6. *Research shows that non-exempt employees generally prefer a bi-weekly pay cycle since it adds two additional pay periods per year. Exempt employees usually are less concerned about payroll cycles.*

Our research and inquiries revealed that a payroll lag has the following advantages:

1. *Monthly payroll reconciliations are generally fewer and easier with a payroll lag. Currently, there is a payroll "true up" after each payroll period (24 times a year) and it involves looking at what employees were actually paid compared to what they should have been paid, on an individual basis, as well as whether leave time needs to be adjusted. With a payroll lag there is no "true up" necessary. Accruals are made at the end of each month (12 times a year) for the purpose of monthly financial statements. The accrual can be calculated on a total payroll basis according to the number of days accrued.*
2. *With a lag there is, theoretically, less chance of payroll error since the payroll is calculated once and there is no need to look back and true up time worked.*
3. *With a payroll lag, the Munis timesheet module can be implemented which would provide an automatic interface between employee timesheets and the calculation of the payroll each pay period. The module has the capability to accurately track overtime and compensatory time automatically. Using this module could increase payroll efficiency across the City. According to the City's IT Department this module cannot be used unless there is a payroll lag. The module is unable to interface with payroll and produce a payroll run before the actual dates for time worked has passed.*

Payroll cycle changes can have a dramatic effect on employees. The importance of educating employees and providing easy-to-understand information to them upfront cannot be overstated. Once implemented, employees and the City will benefit from the changes resulting from increased efficiency, more consistent pay periods and more frequent paychecks.

The one-time cost of \$190,000 that is mentioned in Management's Comments refers to one suggested method for alleviating the financial burden on employees associated with implementing a payroll lag. In this method, employees receive a one-time pay stipend to cover the lag week on the front end of implementation so that they don't have to go without pay for an extra week. There are other methods of implementation which have little or no associated costs but are more of a financial burden on the employees.

2. Improve efficiency by developing a uniform timesheet that can be used by all divisions at CGW.

Currently, timesheets vary in form between divisions and within divisions. A uniform timesheet that displays all pertinent information in the same place for each employee would facilitate the payroll review process at all levels, particularly at the top level. Consistency of reporting would also help employees as they transfer positions within CGW.

Management Comments:

Agree _____X_____

Disagree _____

Corrective Action Plan: Develop and deploy a uniform timesheet.

Projected Completion Date: March 1, 2014

Responsible Manager: Pat Hickey

Conclusion

Our audit of the CGW's payroll process revealed the following results related to our original objectives:

- Payroll expenses have increased in both dollar amount and percent of total operating expenses during the time period FY 2010 – FY 2013. The implementation of the Fox Lawson & Associates study, other city-wide pay increases and a reduction in total operating expenses at CGW help account for the trend.
- Our testwork revealed the following in regard to compliance with Federal and State payroll-related laws:
 - Supporting documentation required by the Tennessee Lawful Employment Act is missing in 35 out of 167 (21%) files tested for compliance with the Act.
- Based on our testwork regarding compliance with City Code and City Human Resources policy, we are 95% confident that CGW personnel files are fully compliant with City Code and Human Resources policy.
- Based on our testwork regarding the implementation of the Fox Lawson & Associates study, we are 95% confident that CGW's employees were paid in accordance with the FLA study during the period tested.
- Based on our testwork regarding compliance in regard to City policy and procedures related to the requirements of the Fair Labor Standards Act, we are 95% confident that the CGW complies with all FLSA related City Code requirements and City policy and procedures.
- Our evaluation of the design and effectiveness of the internal controls surrounding the payroll process revealed the following:
 - In general, internal control procedures are operating effectively. However, we found four deficiencies in control procedures related to the following:
 - The employee setup process is not documented and does not require proper segregation of duties.
 - The payroll process is documented but does not require proper segregation of duties.
 - The payroll data entry is reviewed for accuracy by a person who can perform data entry (time and rates). Both the primary processor and the primary's backup have authority to both process payroll and set up new employees and/or change time and pay rates.

- Payroll module system controls need to be established that support proper segregation of duties (e.g. require a separation of the employee setup/change role, the timekeeper role and the payroll processor role and the payroll reviewer role).
- Based on our randomly generated statistical sample of 259 payroll transactions out of a total population of 7,694 transactions during the period January 2011 through March 2012, we are 95% confident with a 3% tolerable error rate that all transactions are accurately calculated and properly supported.

The audit identified two areas where efficiencies in payroll processing could be gained:

- A change from semi-monthly to bi-weekly payroll periods and the adoption of a five business day payroll lag would facilitate the payroll process by creating pay periods with a consistent number of days and it would reduce the number of reconciliations needed each month to adjust payroll to actual.
- A uniform timesheet for all divisions and subdivisions within CGW would facilitate the payroll review process.

The auditor would like to thank the CGW management and staff for their help and support during the performance of this audit. Their positive attitude facilitated the conduct of the audit and provides the necessary environment for process improvements to take place.

If further information about this audit is desired please contact Internal Audit at 931-648-6106.