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# Payroll Review

**November 13, 2013**

Report # 2013-04



**Date:** November 13, 2013

**To:** Kevin Carpenter, Finance & Property Services (Finance)  
Patience Ferguson, Human Resources (HR)

**Re:** Payroll Review

The Internal Audit Department (IA) contracted with PricewaterhouseCoopers (PwC), one of the big 4 audit firms, to collaboratively conduct a Payroll review for the City of Minneapolis (City). This review was included in the 2013 Internal Audit Plan.

**Background**

The process whereby the City makes payments owed to employees for salaries and wages, including payments of overtime, paid vacation, Worker’s Compensation, Family Medical Leave Act (FMLA), etc. and withholdings, deductions, and contributions is referred to as Payroll Processing. Data pertaining to the City’s Payroll Processing function for 2012 and 2013 (through September 30) is referred to in the table below:

| City of Minneapolis<br>Payroll Processing |                              |  |              |              |              |               |
|---|------------------------------|--|--------------|--------------|--------------|---------------|
| Year                                      | Average Number of Employees* | Amount of Payments Processed (for City Employees only) |              |              |              |               |
|   |                              | Q1   | Q2           | Q3           | Q4           | Total         |
| 2012                                      | 4,232                        | \$59,481,126   | \$68,596,701 | \$60,805,077 | \$70,233,166 | \$259,116,070 |
| 2013<br>(through September 30)            | 4,585                        | \$59,223,365   | \$68,410,985 | \$61,632,529 | -            | \$189,266,879 |

\*This includes all employees including temporary staff, part-time, short-term student employees in the summer, etc. This is not the average number of permanent budgeted FTE.

**Objectives**

The review was performed to:

- Identify key financial and operational risks within the Payroll process;
- Assess whether appropriate controls are designed to mitigate key risks;
- Assess whether key controls are operating effectively through sample testing;
- Provide control recommendations, as appropriate; and
- Document the end-to-end Payroll process with agreed upon key controls.

**Scope**

This review included identifying key internal controls, including current policies and procedures, through observation, inquiry, computer-assisted analysis of payroll data, and sample testing within the Payroll process. IA performed, on a sample basis, testing of current processes and transactions within the period of January 1, 2012 through September 30, 2013.

This review did not include expense reimbursement. Also, it did not include overtime reporting for the Minneapolis Police Department and IT security / system access, as those processes were covered under separate reviews within the last two audit cycles.

### **Approach**

To evaluate the Payroll process, meetings were held with key Finance personnel to map the end-to-end Payroll process and identify key risks. Once the risks were identified, IA assessed whether controls were in place to appropriately mitigate the key risks. This review focused on the following Payroll-related processes:

- Payroll Timekeeping;
- Payroll Calculations;
- Payroll Processing and Distribution;
- Employee Job Records;
- Benefits Management;
- Worker's Compensation; and
- General Ledger Recording.

### **Summary of Observations and Management Responses:**

IA noted that based on procedures performed, the Payroll process appears to be well-designed, well-controlled and functioning effectively overall. Opportunities for improvement to address risk areas observed during the review are included below and have been discussed with management.

#### **1. New Hire Approval Process**

A standard new hire process is in place at the City which provides the requirements for adding an approved new hire to the HR system. However, various City departments / functions follow non-standard processes when authorizing their new hires, creating inconsistency in the requirements needed to add a new hire to the HR system.

##### ***Management Response***

*The new HR Director is currently reviewing the HR processes and organization structure to make changes where needed to help strengthen HR's overall operations.*

#### **2. Employee Job Record Maintenance**

Employee job records are not always updated timely for employee job changes that impact Payroll and/or Benefits, creating potential risk of non-compliance with local, state and federal regulations.

It was noted that the Payroll Department currently audits queries as part of the bi-weekly payroll process to identify and track employees with job changes whose job records have not been appropriately updated; however, this process creates a lag between a change in an employee's status and the system recording of that change.

##### ***Management Response***

*The new HR Director is currently reviewing the HR processes and organization structure to make changes where needed to help strengthen HR's overall operations and recordkeeping practices.*

#### **3. Independent review of Payroll manual adjustments and overrides**

The Payroll team has the ability to record manual overrides during payroll processing. The Payroll Manager reviews the manual adjustments and overrides processed by the Payroll team; however, there is no independent review of manual adjustments and overrides processed by the Payroll Manager.

##### ***Management Response***

*The Controller's Office will look into options and implement a review process.*

#### **4. Reconciliation of physical checks printed during a payroll cycle**

As part of bi-weekly payroll processing, Treasury does not currently reconcile the total number of checks printed by the Data Center to the number of checks authorized within the payroll files.

Auditors noted that Treasury is currently reconciling the total dollar value of checks printed by the data center to the total dollar value provided by Payroll.

##### ***Management Response***

*Effective with the pay cycle dated 10/18/2013, Treasury has implemented a procedure to match the number of checks printed to the number of checks reported. Treasury is already reconciling the total dollar value of the checks.*

*The Treasury and Controller Divisions continue to explore options to increase the number of employees using direct deposit*

#### **5. Year-end reconciliation of payroll accrual**

The process used by Accounting to review and reconcile the year-end Payroll general ledger accounts is informal. This includes review of system-generated accruals and other payroll journal entries.

##### ***Management Response***

*We are in the process of developing additional reconciliation tools for the Payroll general ledger accounts. The payroll accruals are reconciled at year end and reviewed and tied out with the State Auditor during the regular financial audit process.*

#### **Conclusion**

Based on our review, the Payroll process appears to be well-designed, well-controlled and functioning effectively overall, with some opportunities for improvement to address risk areas identified in this report.

IA would like to extend our appreciation to the Payroll, HR, Information Technology and Finance personnel who assisted and cooperated with us during this review.

**Cc:** Paul Aasen, City Coordinator's Office  
Steve Anderson, HR  
Lisa Brown, Finance  
Sandra Christensen, Finance  
Connie Griffith, Finance  
Theresa Nistler, HR  
Larry Parker, Finance  
Barbara Payton, HR  
Bruce Plante, Finance

# Payroll Review

## Audit Findings and Management Responses

### 1. New Hire Approval Process

Auditors obtained a sample of 25 New Hire forms from HR personnel to verify that appropriate procedures are being followed and that new hires receive appropriate approval prior to being added to the employee master file. Of the 25 forms selected, Auditors noted two City full-time employees where the employee offer letter was attached in lieu of an approver's signature, not following the City's standard process. Auditors also noted 3 forms (2 election judges and 1 Convention Center Stagehand) that were not signed by an authorized approver. Auditors noted that hiring for these positions follows a separate process that currently does not require an approval signature, but the deviation in these requirements is not formally documented from the standard new hire approval process.

Additionally, the signatures on many of the forms were illegible and did not include title or position, which creates challenges in determining the appropriateness of historical approvers.

#### Recommendation

- IA recommends considering / formalizing which positions may be exceptions to the new hire approval process (e.g. election judges/certain convention center employees, etc.). Exceptions to the standard process should be minimized, but documented where necessary.
- It is recommended that training be provided and information communicated to departmental HR representatives to improve consistency in following the process for adding new hires. Also, a self-audit/quality assurance process should be considered to validate that protocols for new hires are being consistently followed.
- To make verification of approvers easier, consider updating the New Hire form to include fields for printed approver name and title in addition to the signature field.

#### Management Response

The HR Department has new leadership both in the position of overall HR Director and the position of Director, Human Resources Information System (HRIS), which supports the HR and Payroll functions. The new HR Director is currently reviewing the HR processes and organization structure to make changes where needed to help strengthen HR's overall operations and recordkeeping practices. HR has also recently hired a consultant to look at the City's current recordkeeping practices in such areas as the new hire approval process along with related compliance requirements to provide recommendations for business process improvement. The recommendations from this review report will be considered in that consultant review process. Finally, HRIS is in the process of being upgraded so that it can more effectively support the HR recordkeeping processes. Throughout the course of the next 15 to 18 months, as HR upgrades the current PeopleSoft HRIS and implements a new applicant tracking application system, we will be reviewing all current new hire approval processes to support consistent, best practice, efficient processes whenever possible.

#### Responsible Party

Patience Ferguson, HR Director  
Theresa Nistler, HRIS Director

#### Expected Completion Date

March 31, 2015 (to coincide with the update of the HRIS)

#### Projected Cost of Implementation

Cannot be determined.

## 2. Employee Job Record Maintenance

Based on interviews with HR and inspection of documents, Auditors noted that employee job records are not always updated timely by departmental HR representatives for employee job changes that impact Payroll and/or Benefits. The decentralized nature of the HR representatives poses challenges in the consistency and diligence with which employee job record changes are processed.

Additionally, it was noted that the Payroll Department currently audits queries as part of the bi-weekly payroll process to identify and track employees with job changes whose job records have not been appropriately updated; however, this process creates a lag between a change in an employee's status and the system recording of that change. During the period of lag, the City may be out of compliance with certain local, state and federal regulations depending on the type of job record change needing to be recorded.

### Recommendation

- Consider centralizing the employee files in order to consistently and diligently update employee job records timely.
- IA recommends training or otherwise communicating with departmental HR representatives to improve timeliness and consistency of employee job record updates.
- IA recommends formalizing the existing process in place in the Payroll Department to timely confirm with HR employees who are terminated, go on leave, or have other job changes impacting Payroll and/or Benefits. The formalized audit process will create consistency in the control in the event of employee turnover within the Payroll Department.

### Management Response

*The HR Department has new leadership both in the position of overall HR Director and the position of Director, HRIS, which supports the HR and Payroll functions. The new HR Director is currently reviewing the HR processes and organization structure to make changes where needed to help strengthen HR's overall operations and recordkeeping practices. HR has also recently hired a consultant to look at the City's current recordkeeping practices in such areas as the update of employee job records along with related compliance requirements to provide recommendations for business process improvements. The recommendations from this review report will be considered in that consultant review process. Finally, HRIS is in the process of being upgraded so that it can more effectively support the HR recordkeeping processes. Throughout the course of the next 15 to 18 months, as HR upgrades the current PeopleSoft HRIS and the related payroll processing and recordkeeping activities, and implements a new applicant tracking application system, HR will be partnering with the Finance and IT Departments to review ways to link the three systems as job changes occur to ensure timely processing is attained. Updates to HRIS functionality will strengthen the confirmation and reconciliation controls provided by Payroll related to employee job changes input into the HRIS by HR.*

#### Responsible Party

Patience Ferguson, HR Director  
Teresa Nistler, HRIS Director  
Connie Griffith, Controller, Finance

#### Expected Completion Date

March 31, 2015 (to coincide with the update of the HRIS)

#### Projected Cost of Implementation

Cannot be determined.

### 3. Independent review of Payroll manual adjustments and overrides

Auditors performed walk-throughs and interviews with Payroll and Finance personnel surrounding manual adjustments and overrides within the Payroll process. As required for accurate payroll processing, the Payroll team has the ability to record manual overrides to the payroll files during bi-weekly processing. The Payroll Manager verifies the manual adjustments and overrides performed by the Payroll team; however, auditors noted that there is no independent review in place of manual adjustments processed by the Payroll Manager.

#### Recommendation

We recommend that a report of manual overrides is reviewed by the Controller (or someone in a similar position) each pay cycle. The Controller, who does not have access to perform manual overrides in the system, reviews the report to identify any unusual adjustments / overrides that need further investigation. The Controller retains the report including evidence of review.

#### Management Response

*The Controller's Office will look into options and implement a process to review overrides which will include a report with evidence of review.*

#### Responsible Party

Connie Griffith, Controller, Finance

#### Expected Completion Date

June 30, 2014

#### Projected Cost of Implementation

Cannot be determined.

### 4. Reconciliation of physical checks printed during a payroll cycle

Auditors performed walk-throughs and interviews with Finance personnel surrounding the payroll disbursement reconciliations performed by Treasury during the bi-weekly Payroll process. Auditors noted that Treasury is currently reconciling the total dollar value of checks printed by the data center to the total dollar value provided in the payroll data files, but there is no reconciliation of the total number of checks printed by the data center to the number of checks provided by Payroll. This creates the opportunity that the physical checks may not accurately represent the intended payroll payments from the payroll register.

Additionally, City policy states that all employees should be enrolled in the "Direct Deposit" payroll process; however, this policy is not enforced and should be revisited by management.

#### Recommendation

IA recommends that the number of physical checks to be printed as well as the total dollar value of physical checks is included in the Positive Pay File provided to Treasury. The Treasury Account Clerk should reconcile both the number and the total dollar amount of physical checks printed by the data center in a payroll cycle to the number and total dollar amount of physical checks provided by Central Payroll to verify accurate processing. The reconciliation should be retained and any discrepancies should be investigated and resolved in a timely manner. Also, we recommend management to explore options to enforce the "Direct Deposit" policy.

#### Management Response

*Effective with the pay cycle dated 10/18/2013, Treasury has implemented a procedure to match the number of checks printed from the HRIS payroll file to the number of checks reported by the Payroll division. This number is then compared to the number of checks reported to the bank on the positive pay file. As noted above, Treasury is already reconciling the total dollar value of the checks.*

*The Finance Treasury and Controller Divisions continue to explore options to increase the number of employees using direct deposit. Currently more than 95% of regular City employees use the direct deposit function. New employees, short-term temporary employees, summer student employees, intermittent employees, etc. make up the majority of the less than 5% who are not currently using direct deposit. Addressing this issue is a continuous process. We will continue to make inroads towards improving utilization of the direct deposit function including a review of the policy.*

Responsible Party

Connie Griffith, Controller, FPS  
Larry Parker, Cash Manager, Treasury Division  
Bruce Plante, Treasury Division Director

Expected Completion Date

Completed implementation of change to reconciliation process.  
12/31/2014 for update on direct deposit policy issue.

Projected Cost of Implementation

Cannot be determined.

**5. Year-end reconciliation of payroll accrual**

Auditors inquired with Finance personnel regarding year-end reconciliations and reviews of payroll accounts and automatic payroll accruals within the general ledger. Auditors noted per inquiry that at year-end a reconciliation is performed for fringe benefit accruals, but a reconciliation of non-fringe automatic payroll accruals and accounts within the general ledger is informal.

**Recommendation**

- IA recommends that a review of all system-generated Payroll journal entries is performed by Accounting to verify accurate recording in the general ledger.
- A documented reconciliation of Payroll general ledger accounts is performed at year-end by the Accounting Clerk and reviewed by the Accounting Manager and/or Controller.

**Management Response**

*We are in the process of developing additional reconciliation tools for the Payroll general ledger accounts along with restructuring the coding of the payroll transactions so the reconciliation can be performed more timely and accurately. The Payroll accounts and monthly accruals will be reconciled monthly once the tools are developed and in place. The payroll accruals are reconciled at year end and reviewed and tied out with the State Auditor during the regular financial audit process.*

Responsible Party

Connie Griffith, Controller

Expected Completion Date

March 31, 2014

Projected Cost of Implementation

Cannot be determined.

| <b>Projected Cost of Implementation<br/>(contents provided by Finance)</b> |  |                             |
|--|--|-----------------------------|
| <b>Audit Finding</b>   |  | <b>Total Estimated Cost</b> |
| 1  | New Hire Approval Process                                      | Cannot be determined        |
| 2  | Employee Job Record Maintenance                                | Cannot be determined        |
| 3  | Independent Review of Payroll Manual Adjustments and Overrides | Cannot be determined        |
| 4  | Reconciliation of Physical Checks Printed During Payroll Cycle | Cannot be determined        |
| 5  | Year-End Reconciliation of Payroll Accrual                     | Cannot be determined        |
| <b>Totals</b>  |  | <b>\$</b>                   |

| <b>Abbreviations Used Throughout the Report</b> |   |
|---|---|
| <b>City</b>                                     | The City of Minneapolis                                       |
| <b>FMLA</b>                                     | Family Medical Leave Act                                      |
| <b>Finance</b>                                  | Finance and Property Services Department                      |
| <b>HR</b>                                       | Human Resources Department                                    |
| <b>HRIS</b>                                     | Human Resources Information System                            |
| <b>IA</b>                                       | Internal Audit Department                                     |
| <b>PwC</b>                                      | PricewaterhouseCoopers  |
| <b>Treasury</b>                                 | Treasury Division of Finance and Property Services Department |