



19-02

INTERNAL AUDIT REPORT

Employee Payroll Deductions

March 2020

City of Sioux Falls Internal Audit Department
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Introduction

The Employee Payroll Deductions Audit was included on the 2019 Annual Audit Plan as a carryforward audit from 2018. The purpose of the audit was to review employee payroll deductions and the policies and procedures over employee payroll deductions to ensure internal controls are in place and functioning appropriately. Controls are intended to provide reasonable assurance, but cannot guarantee, that fraud & errors will not occur. The audit focuses on voluntary employee payroll deductions, payments made to after payroll vendors, and the reconciliation process.

Voluntary deductions are deductions that employees have the option to elect to participate in, such as health benefits, dental benefits, or charitable contributions. Mandatory deductions are deductions that are required, per law, to be deducted from employee checks, such as Medicare, Social Security, or Federal Income Tax. This audit will not include an in depth review or analysis of mandatory employee payroll deductions as this will be addressed in a separate audit. This audit will also not include a review of SDRS (South Dakota Retirement System) deductions, as these deductions were a focus of the 2018 Eide Bailly external audit that was performed.

Background

The City of Sioux Falls (City) offers its employees a wide range of benefits. In addition to health and dental benefits, employees have the option to participate in several voluntary deduction programs. Types of voluntary deductions include deferred compensation, union dues, vision insurance, charitable donations, third party insurance, and Flexible Spending Accounts (FSA). The City utilizes the Munis software system to manage its financials, which includes Payroll.

Employees are able to elect health, dental, vision, dependent care, flexible spending, and third party insurance through open enrollment period each year. Any changes to these deductions at any time other than open enrollment require a qualifying life event, such as marriage or birth of a child, for example. Supporting documentation proving the qualifying life event is required to be submitted when the employee elects the change through the Employee Self Service system. All supporting documentation is then reviewed and filed in the employee file. Employees may make changes to their deferred compensation contribution at any time through InSite, the City's Intranet portal. Records of the requested changes to deferred compensation are also saved in the employee's file.

Table 1 on the following page lists all voluntary employee deductions that are available to employees of the City as well as the percentage of employee participation in each voluntary deduction from calendar year 2015 through calendar year 2019.

Table 1. Voluntary Deduction Employee Participation

Voluntary Deductions	2015	2016	2017	2018	2019
Dental Pretax	94%	93%	95%	94%	96%
Health Insurance Pretax	93%	91%	93%	92%	93%
Deferred Comp Contr.	60%	56%	57%	56%	59%
United Way	30%	51%	43%	42%	35%
VSP Pretax	0%	0%	0%	0%	32%
Medical Flex Contr.	26%	26%	27%	26%	26%
Deferred Comp Match	22%	22%	22%	22%	23%
FOP Lodge Dues	22%	20%	22%	22%	22%
FOP Legal Defense Fund	19%	19%	21%	20%	22%
Aflac Pretax	14%	14%	15%	15%	18%
Group Accident Aflac	19%	21%	21%	21%	17%
IAFF Dues	16%	16%	16%	15%	16%
Sun Life Long Term Disability	0%	14%	13%	13%	13%
Voluntary Life	6%	13%	13%	12%	12%
Roth IRA	3%	5%	8%	9%	12%
AFSCME Dues	10%	11%	11%	10%	10%
Aflac Group Critical Illness	12%	11%	11%	10%	9%
Dependent Care Contr.	6%	7%	7%	7%	7%
Dental Post Tax	6%	4%	4%	4%	4%
Health Insurance	4%	3%	3%	3%	4%
Sun Life Long Term Disability	0%	3%	3%	2%	2%
Aflac Cancer	1%	1%	1%	1%	1%
Universal Life ReliaStar	1%	<1%	<1%	<1%	<1%
Aflac Group Accident	<1%	<1%	<1%	<1%	<1%
VSP Post Tax	0%	0%	0%	0%	<1%
Fire PAC Dues	4%	3%	3%	<1%	0%

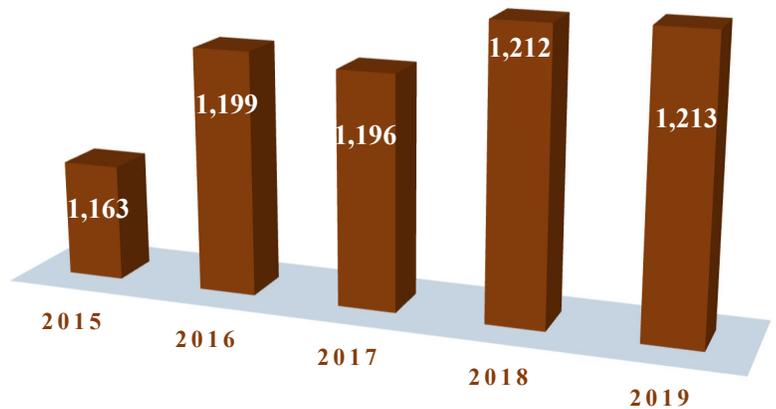
The Human Resources, Information Technology (IT), and Finance departments have primary responsibility for payroll processing functions. The Human Resources Department responsibilities include maintaining employee data, verifying deductions are properly authorized, and updating Munis. The payroll analyst reviews payroll data to ensure deductions are appropriate each time payroll is run. IT is responsible for sending the electronic payroll file to the bank, which includes electronic payments made to after payroll vendors. Finance is responsible for managing and monitoring the bank account, posting payroll to the general ledger, making payroll tax, health, and dental payments, and bank account reconciliation.

In calendar year 2019, the payroll voluntary employee deductions totaled \$10.8 million. Of the 1,213 total City employees in 2019, over 1,100 employees participated in at least one of the voluntary deductions that were included in the scope of this audit.

Financial information and staffing levels for calendar years 2015 through 2019 is pictured below in Figure 1 and Figure 2.

Figure 1: Total Number of City Employees

TOTAL NUMBER OF CITY EMPLOYEES



In 2019, over 1,100 employees participated in at least one voluntary deduction.

Figure 2: Employee Voluntary Deductions

Employee Voluntary Deductions



Objectives

- 1 Determine if payroll deductions are properly authorized and calculations are accurate.
- 2 Determine if proper internal controls are in place to ensure payroll deductions are submitted timely and accurately to the appropriate third party.
- 3 Determine if an accurate and timely reconciliation is prepared between the payroll account and the general ledger.

Scope

The audit scope included a review of voluntary payroll deductions, current system access, and policies and procedures as they are currently in place. The detailed testing of transactions covered the twelve-month period of October 1, 2018 through September 30, 2019.

Methodology

To complete this audit, we performed the following steps:

- Review of written policies and procedures over the payroll process.
- Interviews with management and staff.
- Review of a sample of employee checks and employee files to determine if deductions have proper authorization, accurate calculations, and if there is indication of proper review and supporting documentation on any changes to deductions or deduction amounts.
- Review of a judgmental sample of twenty corrections to payroll corrections to verify changes are properly authorized and supported.
- Analysis of a judgmental sample of five payroll reports to verify payroll checks have the required deductions taken out.
- Review of the Master Vendor File.
- Review of a sample of five payroll reports to compare to the general ledger to ensure accuracy.
- Review of Munis system access to verify access is limited to only those employees who require it to complete their job duties.
- Review of a judgmental sample of five payroll vendor payment reports to determine if payments are submitted to the appropriate vendor and are submitted timely and accurately.
- Review of payroll tax report submissions for the years of 2018 and 2019.
- Review of a sample of two bank reconciliations.

Results

Authorization and Calculations of Payroll Deductions

We selected, obtained, and reviewed a sample of forty-two employee payroll checks. We reviewed employee files for evidence of proper employee authorization and supporting documentation for voluntary deductions appearing on the checks and verified that the amounts deducted on the checks matched what was authorized in the system. We verified that the deductions appearing on employee checks were legitimate by comparing to the master vendor file. We also verified that appropriate payroll correction paperwork was on file for any deduction or deduction amount other than what was originally authorized by the employee.

We looked at employee payroll corrections for the testing period and verified the following: 1) the amount on the payroll correction form matched what was deducted on the check; 2) appropriate supporting documentation was on file for changes to deductions; and 3) proper authorization was received. We reviewed the employee elections in Munis and confirmed that they were consistent with what was deducted on the check. We also verified that appropriate controls are in place for corrections to payroll deductions and found nothing inconsistent in our sample selection. All elections are made by the employee and records of elections are stored electronically. All payroll correction paperwork is scanned and saved in Munis and is also reviewed by the Compensation and Benefits Manager.

We also reviewed a judgmental sample of payroll reports and determined that payroll checks do have the required deductions taken out of their checks, per regulations. These required deductions are also reviewed by the Payroll Analyst prior to running biweekly payroll, to ensure accuracy.

Internal Controls Over Payments to After Payroll Vendors

We interviewed management and staff from Human Resources, Information Technology, and Finance and found that after payroll vendors are paid in one of three ways: Electronic Fund Transfer (EFT), Automated Clearing House (ACH), or physical check. The frequency of payments to vendors varies, depending on the vendor, as some are paid once a month, some twice a month, and some three times a month. Through our testing of payments made to vendors, we determined that payments made to vendors are made timely, are issued to the correct vendor, and are mathematically accurate. Additionally, regular reconciliations are performed to ensure accuracy.

We also reviewed system access rights in Munis. We determined that system access is appropriate and is limited to only those employees who require it to complete their job duties. In addition, segregation of duties are in place so that no one person has complete and total control of the entire employee administration process, payroll process, and vendor process. Proper review takes place and supporting documentation is validated and saved accordingly.

Human Resources sends a payroll tax report quarterly to the government for reconciliation of payroll taxes being deducted from employee checks. These reports calculate the expected amount of withholding based on the taxable wages of employees. We determined that these reports are being sent quarterly, as stated.

The following audit finding was noted during our review of the Master Vendor File.

Finding 1

We reviewed the after payroll vendors in the master vendor file and determined ACH and W-9 forms are on file for all but seven vendors. The after payroll vendors were set up in the Munis system based on information from the previous financial system. The City did not require previous vendors to reregister with the migration to the Munis system. One new vendor did not fill out an ACH form upon agreement to conduct business with the City, which should have been required by the Finance Department. **See Recommendation 1 below.**

Seven of the fifteen payroll vendors did not have complete documentation in the master vendor file.

Reconciliation

We obtained a sample of five Detail Proof Final payroll reports from Munis and compared to the general ledger to ensure accuracy. We found that all five payroll reports matched the entry in the general ledger. We also found that segregation of duties are in place as the employee who posts the entries in the general ledger is not the same employee who runs payroll.

We also judgmentally selected a sample of two monthly bank reconciliations from October 1, 2018 through September 30, 2019. We determined that the reconciliations are accurate and properly completed monthly by an employee independent of the payroll function. In addition, management completes a review of the reconciliations and signs off on them after they have been completed. We determined that an accurate reconciliation is completed between the bank account and the general ledger on a monthly basis.

Recommendation and Management Response

1 We recommend that management ensure that ACH forms are completed, signed, and kept on file for all vendors that the City of Sioux Falls issues payment to electronically.

Management's Response: There are currently 7 after payroll vendors that are setup in our vendor file. We were able to locate the ACH paperwork for 4 of these vendors that was filed and stored in the vault from our previous financial system. We did not electronically attach this paperwork to the new vendors setup in Munis. 2 of the after payroll vendors we did not receive ACH paperwork from, rather the information was just emailed to us from Human Resources to setup the vendor. 1 after payroll vendor is no longer active.

We will reach out immediately to the remaining 6 active payroll vendors and obtain their updated W-9 and ACH paperwork and electronically attach it to their current vendor file.

Management Representative Responding: Janelle Zerr, Finance Manager

Date of expected implementation: May 1, 2020

Opportunity

1 OPPORTUNITY: During our planning and testing of this audit, it was determined that the health and dental deductions and the process relating to health and dental deductions would be best suited for a detailed audit of its own. This would allow for intentional focus specifically on the details involving all aspects surrounding the health and dental deductions, contracts, and accounts. We would suggest that this audit be included in future annual audit plan development.

Conclusion

In conclusion, we determined that adequate controls exist over the employee payroll deduction process that is overseen by the City's Human Resources Department. Appropriate authorization and documentation is being obtained and filed adequately. Based upon our testing, we did not identify any fraudulent or erroneous deductions or unauthorized transactions. The recommendation above will provide additional assurance to mitigate the risk of potential fraud in regard to ACH transactions. We would like to thank the Human Resources, Finance, and Information Technology Departments for their assistance provided during this audit.

Authorization

The Sioux Falls City Council approved this audit by resolution in December 2019 as a carryforward audit from the 2019 Annual Audit Plan. The Internal Audit Division operates under the authority of Sections 32.010 through 32.025 of the Sioux Falls Code of Ordinances.

Audit Standards

This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

Statement of Independence

Internal Audit administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per Section 32.022 of the Code of Ordinances of Sioux Falls, SD.

Distribution of Reports

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record and its distribution is not limited.

Performed By

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