



# Payroll Audit

## Fiscal Year 2013

*CITY OF KILLEEN*

A Report to the City  
of Killeen Audit  
Committee

Committee Members  
Scott Cospers  
Wayne Gilmore  
Juan Rivera

Internal Audit  
Department

City Auditor  
Amanda R. Wallace  
CPA

### Report Summary

This audit was conducted to determine whether there are proper controls in place to ensure that payroll is processed efficiently, effectively, and accurately. The audit revealed multiple control deficiencies and violations of policy to include the lack of proper authorization or approval in various aspects of the payroll process, as well as control deficiencies that significantly increase the risk of error and/or wrongdoing.

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**GOVERNMENT AUDITING STANDARDS COMPLIANCE**

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This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require that the audit be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. I believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

**AUDIT STAFF**

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2013



## AUDIT REPORT HIGHLIGHTS

### Why This Audit Was Conducted

This audit was conducted to determine whether there are proper controls in place to ensure that payroll is processed efficiently, effectively, and accurately.

### What Was Recommended

It was recommended that policies be reviewed, updated, and adhered to. Proper segregation of duties should be implemented, and there should be better supervisory review of all aspects of the payroll process. Additionally, documentation should be more thorough, especially with regard to personnel files.

# Payroll Audit

Mayor and Council,

I am pleased to present this audit of payroll, a function of City business that requires involvement of all departments.

### BACKGROUND

Payroll makes up approximately 30% of the City's annual budget, amounting to more than \$65 million each year. Each department of the City is involved in some aspect of the payroll process.

### OBJECTIVE AND SCOPE

The objective of the audit was to determine whether there are proper controls in place to ensure that payroll is processed efficiently, effectively, and accurately. The scope of the audit included payroll for the period October 1, 2012, through September 30, 2013.

### WHAT WAS FOUND

The audit revealed multiple control deficiencies, policy violations, and poor documentation, which significantly increase the risk for error and/or wrongdoing.

The control deficiencies are mostly attributable to the lack of proper segregation of duties and the lack of consistent supervisory review.

The policy violations refer to the on-call incentive pay policy for the most part; however, there are deficiencies in other policies as noted in the audit report, which should be addressed as well.

The poor documentation was noted in multiple areas, but mostly in the personnel files. The files were unorganized and lacked many of the documents which should be required to be included.

I appreciate the cooperation and assistance I received from staff during this audit.

A handwritten signature in black ink that reads "Amanda R. Wallace".

Amanda R. Wallace, City Auditor

## BACKGROUND

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Approximately 30% of the City of Killeen's annual budget is spent on salaries and benefits, amounting to more than \$65 million each year. As such, this is an area of business for the City that could be considered higher risk if proper controls are not in place. This audit serves as an assessment of controls and tests of those controls. The results of these tests are included in this audit report.

Payroll is a process that requires all departments of the City to play a significant role from adding employee information to issuing paychecks. Each department is involved in this process in some capacity. Human Resources (HR) is in charge of adding employees and inputting pay and benefit information. The departments are responsible for creating work schedules and managing time to include inputting time into the payroll processing system (AS400). The last step of processing payroll belongs to Finance in calculating and issuing paychecks.

The City currently uses a manual timekeeping system, which essentially means using timecards to keep track of employee time, and manually inputting the time for each pay period into AS400. As a check/balance, Finance then reviews the timecards to ensure that the departments inputted the time correctly and calculates each employee's paycheck in a spreadsheet. The spreadsheets are then compared to the calculations according to AS400.

Finance processes the paychecks and direct deposit receipts, and provides a file to the bank to ensure that direct deposits are completed by payday. Paychecks and direct deposit receipts are then delivered to City Hall for distribution to departments, and a representative from each department retrieves them from City Hall and is responsible for distributing them to the appropriate individuals.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

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The Payroll Audit was conducted in order to determine whether there are proper controls in place to ensure that payroll is processed efficiently, effectively, and accurately. This audit was also included in the FY2014 Audit Plan, as presented to the City Council and the Audit Committee.

### **Objective**

The objective of the audit was to determine whether the City has the necessary controls in place in processing payroll that are needed to ensure proper use of City funds, and to identify any potential fraud risks or abuse of City policy.

### **Scope**

The audit scope included payroll for the period October 1, 2012 through September 30, 2013.

### **Methodology**

To accomplish the audit objective, the following steps were performed:

- Conducted interviews with various departments and obtained information on policies and procedures as well as staff responsibilities.
- Obtained and tested payroll data from AS400.
- Analyzed supporting documentation to determine whether the policies and procedures were adhered to.
- Analyzed policies to determine effectiveness.
- Considered fraud, waste, and abuse as related to the audit objective.

## AUDIT RESULTS

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The audit focused on on-call and other incentive pays, overtime, terminations, workers' compensation codes, processes, and other general payroll areas. The various tests yielded a total of 152 personnel files and 350 paychecks reviewed for FY2013. There were also some observations noted that would be useful to management. These are included in this report following the findings.

On-call compensation was tested by selecting all exempt employees who received on-call pay during FY2013 and all employees who were paid more than \$1,000 in on-call pay during FY2013. The testing revealed that supervisors did not sign off on 40% of the sampled timecards. Additionally, 89% of the positions receiving on-call compensation regularly were not supported by approval from the City Manager. There were multiple findings associated with on-call compensation, which are detailed below in the findings section of this report.

Overtime was tested by choosing a random sample of each of the departments that were responsible for 3% or more of the total amount of overtime city-wide during FY2013. There were three departments that met these criteria - Police, Fire, and Solid Waste. This yielded a total sample size of 28 employees. For each of the 28 sampled employees, four pay periods during FY2013 were randomly chosen to test for approval as well as accuracy. It was revealed that overtime reported on timecards is not signed by supervisors signifying approval for 2 of the 3 departments tested. Additionally, there was an 11% discrepancy rate between the amounts of overtime or compensatory time the employees were paid or accrued and the amounts that were recorded on the timecards.

### **Finding 1: On-call compensation was paid without City Manager approval.**

According to the On-Call Incentive Pay KEEP policy, the City Manager must authorize, by approving requests from departments, which specific positions are eligible for on-call incentive pay. 89% of the sampled positions that received on-call pay during FY2013 are not supported by a memorandum or listing approved by the City Manager justifying on-call pay. Furthermore, per the policy, only nonexempt employees are eligible to receive on-call compensation, unless a reasonable exception exists, which would require City Manager approval. 35% of the sampled positions are exempt, with two of them being authorized by the City Manager as exceptions to the policy. The City Manager authorization for all on-call positions should be included in the employee personnel files; authorization was included in only 2 of the sampled personnel files regarding on-call pay.

It is imperative that departments obtain City Manager approval for each of the positions that require on-call duties. This allows for the proper check to be in place for Human Resources (HR) and Finance to verify approval prior to paying potentially unauthorized on-call pay. A master file should be maintained and updated regularly by HR. When Finance is processing

payroll, the on-call master file should be reviewed to ensure that all employees receiving on-call pay are approved to receive it.

**Finding 2: On-call pay was not consistently approved by a supervisor.**

According to the On-Call Incentive Pay KEEPRA policy, Department Heads (or designees) are required to approve the specific employees, who will be on an on-call schedule. 40% of the sampled on-call pay was not physically approved by signature by a supervisor. Additionally, there were 29 cases noted in the audit test where on-call compensation actually paid to employees did not agree to the timecards. On-call pay should be more actively supervised to ensure that the actual compensation is approved and appropriate.

**Finding 3: Scheduling was inconsistent and/or outside of policy.**

According to the On-Call Incentive Pay KEEPRA policy, only employees that are on a department approved on-call schedule are eligible for on-call compensation. Two of the departments tested do not maintain an on-call schedule. In one of these departments, for the division that was tested, there were only 2 employees who received on-call pay regularly, and they rotated weekly. With the other department noted here, each employee that received on-call pay remained on-call for 12 days out of each pay period for the entire year. Additionally, according to the on-call policy, employees cannot be scheduled for more than 7 consecutive days on-call. After 7 days, the employee must not be on-call for at least 2 days unless approved by the Department-Head. There were 2 instances in which an employee was on-call for 14 consecutive days without approval from the Department-Head.

**Finding 4: Policies need clarification and additional requirements.**

There was a conflicting statement in the On-Call Incentive Pay KEEPRA policy; reference IV.A.4 – the sentence uses the term “non-exempt” instead of “exempt”. In addition to this conflict, the policy is very lengthy and somewhat confusing with regard to responsibilities. Policies should be clear and concise.

Other than the On-Call Incentive Pay policy, the only other policy addressing incentive pays is the Bilingual Incentive Pay policy. There should be a policy in place that places requirements on all other offered incentive pays as well. Currently, there is no written requirement for individuals receiving incentives to provide proof on an annual basis that they are still in good standing with their certifications. There should be a tracking mechanism in place that will assist Human Resources in ensuring that employees that are receiving incentive pays are in good standing. Employees should be required to provide proof annually for each of his/her certifications, and this information should be included in the employees’ personnel files to ensure that the City is only compensating eligible employees for appropriate incentives.

Additionally, it was noted in the audit that one employee consistently received an incentive pay for a certification that was not necessary for his current duties. If there were a review process in place, this incentive pay would have been discovered and discontinued in a timely manner. There should be a review of all incentives for each employee to determine if all incentives being paid to each employee are valid and useful in the employees' current job status.

**Finding 5: Timecards are not consistently approved by supervisors and timekeeping is manual.**

According to the Hours of Work and Paydays KEEPR policy, employees are required to initial their timecards as verification of recorded hours. Currently, there is no requirement for supervisors to initial or sign employee timecards. It was noted in the audit that some departments perform this step despite lacking a requirement in the policy; however, several departments/divisions do not require supervisory approval. It is imperative that supervisors review employee time to ensure that employees do not claim and receive compensation for hours they did not work.

In testing overtime, there were 7 instances that revealed differences between actual compensatory time accrued or overtime paid and the timecards. All of these differences were for a single department. This same department was not able to provide the supporting documentation for the overtime paid to 2 individuals for one of the pay periods sampled. An automated timekeeping system would dramatically reduce the risk of employees falsely reporting hours worked, and it will also reduce the risk of human error.

**Finding 6: Police Department allows "special overtime".**

The City's current Overtime KEEPR policy requires employees to actually physically work 40 hours before premium pay is applied (150%); otherwise employees are paid straight time until the condition is met. According to the Special Overtime policy, specific to the Police Department, the Chief and Assistant Chiefs of Police can approve premium overtime regardless of the number of hours the employee physically worked in the workweek. This practice is not in compliance with the Overtime KEEPR policy, and it was noted while reviewing the Police Department overtime cards that during FY2013, the majority of overtime paid was paid as special overtime, incurring more cost to the City outside of policy. Furthermore, there was no evidence for the sampled overtime that the Chief or Assistant Chiefs specifically approved each of those special overtime instances. The Police Department should be required to present this special overtime process to the City Manager, who will then make the decision on whether it is necessary or reasonable to continue the process.

**Finding 7: Employees volunteered for a non-city activity, but were paid overtime or accrued compensatory time for their participation.**

An event that was sponsored by employees of the City, not the City itself, was considered a volunteer fundraising event to raise funds for a particular purpose. Many City employees participated, but only 2 of these employees claimed compensatory/overtime for the event. Since it was outside of the scope of these employees' regular duties as employees of the City, these hours were accrued against policy. This audit has raised questions about other events/fundraisers similar to this; therefore, a separate internal audit will be planned to learn about and address these issues.

**Finding 8: The payroll bank reconciliation is not completed timely.**

As of April 29, 2014, the last payroll bank reconciliation that was completed was for January 2014. The bank reconciliations for all bank accounts should be completed within 30 days of month-end. This ensures that any questionable activity will be caught in a timely manner. Additionally, there has been a reconciling item for \$189.28 listed on the payroll bank reconciliations since December 2003. This is not material, but should be cleared and corrected. The outstanding check listing that is attached to the monthly payroll bank reconciliation is manually generated. A system-generated report should be attached to the bank reconciliations along with all other supporting documentation to ensure that outstanding items are not manipulated on the bank reconciliation.

**Finding 9: Personnel files lacked the proper information.**

While reviewing personnel files for appropriate documentation, it was noted that 4 of the 152 sampled personnel files included misfiled information for other employees. In one of the 4 files, there were 2 instances of misfiled information, causing a discrepancy rate of about 4%. 2 of the 4 sampled direct deposit accounts did not have the proper direct deposit authorization forms in the employees' personnel files. The audit also revealed 18 out of 104 sampled pay periods in which there were discrepancies in deductions such as health insurance, dental insurance, life insurance, United Way, KPFFA, TMPA, and child support. In each of these instances, either the deduction form was not signed by the employee, was not included in the personnel file, rate changes were not communicated to the employee, the deduction continued beyond the time that was agreed to by the employee, or the deduction did not agree to supporting documentation. Additionally, in 2 of 52 sampled personnel files, the employee evaluations were not current in the file.

**Finding 10: A part-time employee is paid as full-time.**

One position was noted as a part-time employee per the job description and the employee works less than 20 hours per week, but is reported and paid in payroll as full-time, 40 hours per week. Because the employee is being paid as full-time and he is recorded in payroll as a full-time employee, he receives the full benefit package of the City, incurring an extra cost to the City of approximately \$6,000 per year in benefits and approximately \$10,000 per year more

in gross wages. There was no information in the employee's personnel file justifying this exception other than a memorandum instructing payroll to input the employee as full-time.

**Finding 11: Employee exit interview forms are not consistently included in personnel files.**

Upon an employee's exit/departure from employment, the City uses two exit interview forms: one for the supervisor to complete, and one for HR to complete. Each form has different information and both are necessary. In 3 of the 6 sampled personnel files, one or both of these forms were not in the file, which made it impossible to determine whether the employees returned their keys/accesses to buildings as this is one of the required items on the supervisor exit interview form. In one of the sampled personnel files, the employee had not signed the exit interview form. There could be a number of explanations for the lack of employee signature, and it is important to document the reason for the lack of signature. Additionally, the initial sample size for termination testing was 7 personnel files, and one of these files was not provided by HR; therefore, only 6 personnel files were reviewed for the purposes of the termination test.

**Finding 12: There are errors in workers' compensation codes.**

The workers' compensation code assigned to one of the 20 sampled employees was not reasonable in relation to the employee's job function. It was noted in conducting interviews with HR staff that new position paperwork is not required to be routed through the risk manager. This heightens the risk of inputting an inappropriate code into payroll. Additionally, the rates assigned to 3 of the 20 sampled employees did not agree to the rates as assigned by TML, the City's workers' compensation insurance carrier. In order to ensure that the City is paying the correct amounts for this insurance, it is essential that the risk manager be given the opportunity to review new position paperwork and to assign the appropriate code.

**Finding 13: HR forms do not require proper segregation of duties.**

In reviewing HR forms, it was noted that new hire forms (P-2s) were found to be "reviewed" and "entered" into payroll by the same employee. The forms should be reviewed by someone other than the enterer. Ideally, there should be a supervisory review step after the information is entered to ensure that it was entered correctly.

With regard to supervisor exit interview forms (P-8s), according to policy, the employee is responsible for delivering the form completed by the supervisor to HR. This allows for manipulation to occur between the time the form leaves the supervisor and the time that HR receives the form. It also allows for the form to be destroyed or lost, which could account for the number of missing supervisor exit interview forms as noted in Finding 11 of this report.

**Finding 14: Paychecks and employee information are easily accessible to unauthorized individuals.**

The current process regarding the distribution of paychecks involves Finance delivering the paychecks/direct deposit receipts to the receptionist at City Hall, who maintains a log by department of the checks received. The departments sign for their paychecks at the time of pick up. Any checks that are not claimed by the departments are retrieved by Finance; however, Finance does not verify and sign off on the log to ensure that they are retrieving all of the unclaimed checks.

Additionally, when payroll processing begins, the departments deliver their employee time cards to the receptionist at City Hall, who holds them for pick up by Finance. Then when Finance delivers the paychecks to City Hall, they also return the time cards. It was noted that many of the employee time cards have the employees' social security number on them. Social security numbers and other employee information should be better safeguarded to ensure that unauthorized use does not occur.

**Finding 15: There are control risks in the final pay run process.**

When pay checks are printed by Finance, there is not a supervisory level of approval prior to printing. This control risk could allow for an unauthorized check to get through the system. Similarly, with the direct deposit process, one employee verifies the totals of the direct deposit file and subsequently sends the file to the bank. This employee is the only employee that has the ability to send the direct deposit file to the bank, and is also involved in the processing of payroll. This lack of proper segregation of duties could allow this employee to either increase their own paycheck each pay period, and/or increase other employees' paychecks without detection. If this employee is to continue being involved in the actual processing of payroll, then they should not have the capability to handle the direct deposit file. Alternatively, the employee could be removed from the actual processing of payroll, and only perform supervisory-level responsibilities, such as verifying totals, approving the check run, etc. Additionally, there should be at least 2 others individuals outside of the payroll process who are capable of handling the direct deposit file.

## OBSERVATIONS

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The following observations were noted in the audit, but were not necessarily considered findings. However, they are important for management to be aware of.

### **Observation 1: \$5.4 million increase to base pay via incentive pays and overtime.**

A report was requested from the Finance Department for the purposes of analyzing employees' gross pay and the relationship between gross pay and base pay, with base pay being the approved pay rate for each employee, and gross pay being the total pay before taxes and benefit deductions. The analysis revealed that during FY2013, the total increase to base pay via incentive pays and overtime was approximately \$5.4 million. In further breaking down this increase, it was noted that 70 employees increased their base pay by more than 30% via overtime and incentives. 14 of the 70 increased it by more than 50%, and 5 of the 70 increased it by more than 70%. One employee in particular increased their base pay by \$44,462 during FY2013, causing them to be the 13<sup>th</sup> highest paid employee of the City for a total gross pay of \$111,720, and also causing them to be paid more than the assistant directors of the department and many other superiors. Three other employees of the same department increased their base pay to such an extent as to also be paid more than the assistant directors of the department and many department heads of the City.

Of the 1,478 total employees during FY2013, 47% represented employees of the Police Department and 42% represented employees of the Fire Department who increased their base pay by more than \$5,000 via incentives and overtime. The total increase for the Police Department was \$2.1 million, with \$1.6 million being attributable to overtime. The total increase for the Fire Department was \$1.4 million, with \$842 thousand being attributable to incentive pays.

### **Observation 2: Compensated absences liability was \$9.4 million at 2013 fiscal year end.**

Compensated absences represent the sick, vacation and compensatory time that employees of the City are entitled to upon their departure. This means that if all employees entitled to one or more of these payouts left the City at one time, the City would be responsible for paying \$9.4 million. Obviously, this is a scenario that would be extremely unlikely to occur. This \$9.4 million figure would be the amount the City would pay out over time as employees exit, and not all at once. This is not an alarming figure, and is in fact significantly less than several of Killeen's peer cities. It is helpful, however, to know and track this information for long-term planning purposes.

**Observation 3: Three positions were being paid out of the wrong department budget.**

It was noted in the audit that there were 3 positions being paid out of the wrong department budget. This issue came about when the City restructured current positions to better utilize staff. The change occurred at the beginning of FY2014, but as of the beginning of May 2014, a budget amendment had not been completed yet to move these positions to the correct departments. At the time this audit report was written, this issue had been corrected, and the budget amendment was approved by the City Council and posted to the general ledger.

## RECOMMENDATIONS

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The recommendations listed below are a result of the audit effort and are subject to the limitation of the scope of the audit. I believe that these recommendations provide reasonable approaches to help resolve the issues identified. I also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches, and I encourage them to do so when providing their responses to the recommendations. As such, I strongly recommend the following:

- 1. Each position that performs duties that justify on-call pay should be approved by the City Manager prior to the employee receiving on-call pay. A memo should be submitted to the City Manager for approval, and a copy of the approval should be maintained by Human Resources and at the department level as well. A master list of on-call positions should be maintained by Human Resources and should be available for review by the Finance department in processing payroll to ensure that only those positions that have been approved by the City Manager are receiving on-call pay.**
- 2. On-call pay should be approved by a supervisor via signature to ensure that on-call compensation is approved and appropriate.**
- 3. Each department that requires employees to be on-call should maintain an on-call schedule and should ensure that the schedule is in compliance with the On-Call policy at all times.**
- 4. Conflicting statements in policies should be addressed, and a policy should be implemented that addresses all incentive pays and the requirements for eligibility of receiving incentive pays. There should be a review process in which the certifications for which employees are requesting payment are reviewed for reasonableness to determine if the certifications are applicable to the employees' current job function.**
- 5. There should be language added to the Hours of Work and Paydays KEEPRA policy that requires supervisors to review and sign off on employee timecards, and this supervisory step should be enforced regularly. Alternatively, an automated time-keeping system would reduce the risk of payroll fraud as well as human error.**
- 6. The City KEEPRA policies should be applicable to all departments, and there should not be exceptions to those policies for any one department. If exceptions to the policies are necessary, then the proper approval should be obtained from the City Manager prior to implementing a department-level policy that is in opposition to the KEEPRA policies.**
- 7. It is not appropriate for employees to be compensated in events for which they volunteer outside of the scope of their regular duties as employees of the City, and for which the City does not sponsor. Supervisors and department heads must be mindful of these situations**

and ensure that the employees are not compensated for activities that are outside of the City's scope and outside of the scope of the employees' normal duties.

8. Bank reconciliations should be completed within 30 days of month-end, and reconciling items listed on the bank reconciliations should be limited to true reconciling situations.
9. Personnel files should be reviewed to ensure that each file has the necessary information included, and that each file includes only that information which pertains to that employee.
10. Employee statuses should be compared to employee job descriptions to ensure that employees are entered into payroll correctly.
11. Both exit interview forms should be included in the personnel file upon an employee's departure from the City.
12. Workers' compensation codes should be assigned by the Risk Manager to ensure that the appropriate code is used. The rates associated with each code should agree to the rates as assigned by TML.
13. A person other than the enterer should review forms to ensure that errors are avoided and to ensure that accountability is present. Supervisor exit interview forms should be delivered to HR by the department rather than the exiting employee.
14. Paychecks and employee information such as social security numbers should be better safeguarded.
15. The segregation of duties regarding the processing of payroll should be evaluated. There should be better segregation to ensure that no single employee has the level of access to allow for undetected manipulation of payroll information.

See Appendix A for Management's Response to each recommendation.

MANAGEMENT RESPONSE



## Interoffice Memorandum

To: Amanda Wallace, CPA, City Auditor  
From: Glenn Morrison, City Manager  
Date: June 20, 2014  
**Subject: FY 2013 Payroll Audit**

I want to acknowledge receipt of your report and also thank you for all the work you put into it. The report is very thorough and well-presented. It will provide a framework for improvement.

### Current Action on Recommendations

- Recommendations 1-3 will be corrected by July 11, 2014.
- Recommendations 4-6 are policy issues currently being addressed by Internal Services ACM. Corrective action will be taken by the end of July 2014.
- Recommendation 7 – will be addressed at the July 2 Department Head meeting with a follow up memo to be distributed to all Departments/Divisions.
- Recommendation 8 – Assigned to Finance – corrective action date pending
- Recommendation 9 – HR has an action plan in place and will make all necessary adjustments now and ensure controls are in place to maintain personnel files appropriately in the future.
- Recommendation 10-13 – Are currently being addressed by Internal services. Corrective action will be taken by end of July 2014.
- Recommendations 14-15 – Are currently being addressed by Internal Services with an expected correction date of end of fiscal year.

I will provide a follow up email with assigned tasks and updated timelines after my Department Head meeting on July 2, 2014.



Glenn Morrison  
City Manager  
City of Killeen