

# AUDITOR GENERAL

Halifax Regional Municipality



## Payroll Management Audit

May 2019

**May 9, 2019**

The following audit of **Payroll Management** completed under section 50(2) of the Halifax Regional Municipality Charter, is hereby submitted to the Audit and Finance Standing Committee of Regional Council.

Respectfully,

*Original signed by*

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## Summary

### Conclusion

Overall, some of HRM's payroll activities are effectively managed but many areas require improvement. There is limited formal monitoring to confirm payroll changes are correct which increases the risk of fraud and error.

While there are some practices to prevent unauthorized payroll payments, there was no monitoring of certain changes to payroll information, creating a risk of fraud or error not being detected. Payroll has many manual processes with limited management monitoring to detect errors. We also found who can approve payroll data changes is not clearly documented. Although Payroll staff accurately enter employee timesheets into the payroll system, these are often not approved by business unit management prior to payment.

### Key Take-aways

- Key payroll processes are manual. Management completes some checks on payroll data changes, but the process is informal and needs improvement.
  - Not clear which items were reviewed
  - We found an error which had been selected for review but the problem was not corrected.
  - No requirement to check changes to employee banking information
- Payroll staff check to identify errors such as unusually high pay, but process ineffective
  - Staff checking for errors also have access to change payroll amounts
- Not clear who should approve employee payroll data changes
  - Payroll staff have different interpretations of required approvals
  - Change form does not clearly state required approvals
- Employee time worked accurately entered in payroll system, but not always approved by appropriate HRM managers before payment issued
- Practices to prevent unauthorized payments exist; but there are gaps that should be addressed.
- Payroll performs regular backup procedures in case of payroll system failure.

## Audit Results

### Administration of Payroll

#### **Manual payroll processes; improved monitoring needed**

Payroll has many manual processes which increase the risk of errors. Appropriate monitoring is important to address this risk. However, we found certain areas had limited monitoring by management to make sure payroll changes are correct.

In a sample of 148 changes to employee payroll data, we found 15 errors (10%), eight of which impacted the employee's pay or leave balances (i.e.: vacation, emergency leave). One of these changes was selected for review as part of management's monitoring but the error was not corrected. Additionally, Payroll did not have the request forms to support three changes.

Changes to employee data are manually entered in the payroll system, making it important to have adequate monitoring to identify errors. While we saw some evidence that management completed quality assurance checks on payroll data changes, the process is informal. There were inconsistencies in how management documented the review and it was often not clear which change was selected for review, or if identified issues were followed up.

Payroll management and staff initially told us a second staff member should review new employee banking information to confirm it was entered correctly. This would be a good practice to identify errors. However, we tested 30 samples of new banking information and found half were not checked by a second staff member. Management subsequently told us this check was not a formal requirement. Processes which are informal and not required do not add benefit or help provide assurance changes were made correctly.

#### **Recommendation 1**

Payroll management should develop and document quality assurance procedures to detect errors in payroll employee data changes. This should include providing guidance on higher-risk items that should be checked and how many items to check. These quality assurance checks should be completed regularly and documented.

#### **Management Response**

*Agreed – We have put into place checklists for the standard operating procedures related to various master data changes and have added quality checks throughout the processes. Quota Corrections and cash outs are confirmed by a second Payroll Costing Coordinator. Audits are also completed on a bi-weekly basis on the higher risk items.*

**Future State**

*With future implementation of SuccessFactors, employees will be completing their personal information on-line in an electronic form which will load into SAP.*

Payroll has a good process to confirm the accuracy and completeness of annual salary increases it receives from Human Resources for non-union staff. These changes must be entered in the payroll system. While we found the increases were accurately captured in the payroll system, the process is manual and subject to error, with no formal checks by another staff member to verify the information was entered accurately.

Payroll management recalculates most salary changes provided by Human Resources before staff enter the changes in the payroll system. Management requires staff typing this information to check their own work. However, there is no evidence staff completed these checks. Additionally, reviewing one's own work is not a strong control to pick up errors. Management told us supervisors check that salaries and items affected by salary change (such as payroll deductions) were updated correctly but these processes are not documented. Management could not prove all of the checks occurred. Formal quality assurance checks would help ensure data entry errors are identified and addressed in a timely manner.

**Recommendation 2**

Payroll management should establish and perform documented quality assurance checks to identify errors in salary changes. This should include documenting who is responsible to complete checks and monitoring to ensure the quality assurance checks are done.

***Management Response***

*Agreed – Previously only exception reports were kept. As we move forward, we will more formally document who is performing the audits and keep files electronically for future reference. We are currently also performing bi-weekly audits on basic pay changes.*

***Timesheets not always approved before submitting to Payroll***

HRM employees complete timesheets showing time worked and leave taken. We found 27% of timesheets tested (58 of 214) were not approved before they were entered in the payroll system. Two-thirds of these timesheets were emailed by an administrative assistant for a supervisor, with the supervisor copied on the email. Management told us that they consider this an approval; however, being copied on an email does not represent approval. Supervisors approved time after it was entered into the payroll system.

### **Recommendation 3**

Payroll should obtain approvals directly from appropriate business unit supervisors before entering timesheets in the payroll system.

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

*Agreed – Payroll will implement changes to the process so that all payroll submitted must have the manager’s signature prior to processing.*

#### **Future State**

*All employee time will be processed through electronic time systems. All timesheets for the period will need to be electronically signed off by the manager in advance and all approvals will be electronically tracked.*

Payroll staff receive employee timesheets which they enter into the payroll system. We sampled 259 timesheets to test for accurate entry and found staff correctly entered time based on the timesheet.

The manual nature of timesheet entry creates a higher risk of error, therefore monitoring activities are important. For a sample of five pay periods, we found Payroll staff completed reasonability checks to identify potential errors for investigation, such as employees on leave receiving pay, or employees with unusually high pay. However, staff completing the checks also have payroll system access to make changes to time records. For this check to be effective, it should be completed by staff who cannot make changes to time in the payroll system. Management told us they are considering reassigning some tasks which would allow system access to be limited and resolve this issue.

### **Recommendation 4**

Payroll management should ensure time-entry monitoring activities are performed by staff members who do not have payroll system access to make changes to time records. Alternatively, if it is not practical to limit access, payroll management should monitor changes to time records to reduce this risk.

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

*Agree to the alternative in the recommendation and will monitor changes to time records to reduce this risk. We believe the checks we currently have in place are sufficient and we cannot limit all our payroll checks to staff that do not have payroll access. The level of monitoring performed by payroll management will be increased and documented.*

Future state

*All time will be loaded into SAP through Time Management/scheduling systems.*

Management told us they recently began new quality assurance checks on a sample of timesheets. The old process in place for our audit period required that supervisors approve employee time entered in the payroll system, but this was often completed after employees had been paid. The new process is an improvement, provided Payroll completes these quality assurance checks before the pay is deposited in employee bank accounts.

**Recommendation 5**

Payroll management should document the new quality assurance processes for timesheet entry, including a requirement to complete these checks before pay is deposited.

**Management Response**

*Agreed - The new process is documented, and the checks are required to be completed prior to pay being processed.*

Future state

*All time will be loaded through Time Management/scheduling systems*

***Not clear who must approve employee payroll data changes***

We found it is not clear which approvals are required before employee payroll data changes are entered. We interviewed five Payroll staff members and found there was no consistent understanding of the approvals required for each type of change. Business units complete and send employee data change forms to Payroll to request a change to employee information (i.e.: change in employment status, create a new employee). The form includes an approval signature field, but it does not clearly state required approvals for each type of change. Additionally, there were three versions of the form in use, each with different approval requirements.

Of the 148 employee data changes sampled, Payroll was missing one personnel file and two requests for employee payroll data changes. For an additional 14 samples, the change request was either in Payroll staff individual HRM email accounts (rather than personnel folders), or the file had been misplaced. Supporting documentation for Payroll files should not be maintained in Payroll employee email records.

For the remaining 145 changes we examined, more than half of the approval signatures were not clear and it was difficult to tell who the approver was. This creates a risk that the proper approval was not obtained. During the audit, the form was updated. It now includes a line for the approver



to print his or her name next to the signature. It also clarified certain required approvals but it still does not cover approvals for all types of changes.

**Recommendation 6**

Payroll management should establish and document approvals required for all employee data changes and communicate these to Payroll staff.

**Management Response**

*Agreed – The appendix attached to the Employee Data Change form is currently being updated to document the required approvals.*

Future state

*Manager Self-service and Success Factor Recruitment software will allow managers to submit the requests and the built-in workflow will send the forms to the appropriate approval level. Only after all the required approvals have been received will the forms be sent to Payroll to process.*

**Payroll processes – risks of error or fraud**

Management told us Payroll staff can make changes to their hours worked, salary and vacation balances in the system and this access cannot be limited for most Payroll staff. Management and staff told us there are informal processes to check for unauthorized changes to hours worked and salary. However, there are no checks for unauthorized changes to vacation balances.

**Recommendation 7**

Payroll management should establish a process to regularly monitor for unauthorized changes to vacation balances, salary amounts and hours worked.

**Management Response**

*Agreed – As part of our new audit processes, all salary changes and employee bank adjustments are verified by a second Payroll Costing Coordinator and audited on a bi-weekly basis and are independently reviewed.*

Future State

*We will examine if the system can be set to allow users to view their own information but eliminate the ability to update any information on their own records in SAP.*

We also found management does not monitor for unauthorized changes to employee banking information. This increases the risk that fraudulent payroll payments would not be identified.

Some casual HRM employees remain active in the payroll system if they are expected to return within the next several months. This creates an opportunity to change the employee's banking information and input unauthorized time worked to create false payroll payments.

We analyzed payroll data to identify payments made to inactive employees or employees on leave. We found one small error. The payment was made eight months after the employee finished work and could have been prevented had the employee's status been updated in a timely manner.

Management told us reports of employees who have not worked in months are sent to their supervisors to identify employees who should be removed from the system. However, there was limited evidence this occurs.

**Recommendation 8**

Payroll management should establish a process to regularly monitor for unauthorized changes to employee banking information.

**Management Response**

*Agreed – We have recently added various audit checklists and made changes to our audit processes. Banking changes are confirmed and audited by a second individual and selected items are audited bi-weekly. Audits will be filed in our bi-weekly payroll files and will be retained for seven years with Records Management.*

We tested files from the bank for five pay periods to confirm the payments processed agreed to the payroll system; no discrepancies were identified.

We found the online banking portal which Payroll staff use to create and approve payroll payments is set up to prevent unauthorized payments. Access to create and approve payroll payments was restricted to those who require it and there were no users who could both create and approve a payment. This limits the risk of fraud.

We also found the bank portal prevents administrators (those with greater system permissions) from changing their own access rights. Access changes must be approved by a second administrator. The bank told us these controls existed during our audit period, but we have no way to confirm this because we do not have a mandate to audit the bank. Organizations may require an independent report, often from an external auditor, to provide assurance that a third party's controls are effective. HRM has not requested the bank provide this type of report.

Payroll's processes allow bank file access to three users who approve the files in the banking portal. The files are in a format that can be changed which means approvers could make a change to the payroll file before the file is processed by the bank. When we brought this to management's attention, they addressed the issue by putting the bank payroll file in a location only one staff member can access until after processing. This prevents the possibility approvers could change the payroll bank file.

***Many payroll processes manual, however management considering improvements***

Management has begun to assess opportunities to reduce some of the manual payroll processes. For example, staff record and submit time worked to Payroll, and Payroll staff manually re-enter this information into the payroll system. Management recently picked a self-serve time entry system that should allow employees to enter their own time worked. Payroll management told us they intend to hire a project manager to lead planning and implementation.

***Process to secure physical payroll files***

Personnel files include employees' highly confidential, personal information, such as banking details and social insurance numbers. Most files are kept in unlocked filing cabinets in the Payroll work area, which is locked after hours by Payroll staff. Management told us cleaning and building management staff do not have keys to access this area after hours.

***Process to back up payroll files***

Payroll staff complete a bi-weekly checklist which includes steps to back up payroll data. Appropriate back up is a good practice and, for payroll, it helps ensure staff can be paid if there is an issue with the system. We looked at five payroll periods and found the backup procedures were performed in all instances.

Access to backup files should be further restricted to those who require it to prevent unintentional changes or deletions and to improve security and privacy of employees' banking information. We found four users had access to those files who did not require it.

- Two were previously in Payroll but moved to another position. Management submitted a request to have their access removed when we brought this to their attention.
- One staff member is in an acting role. We were told this individual will return to the Payroll Division.
- One staff member works in Payroll but does not need to access the backup files for his or her job duties.

**Recommendation 9**

Payroll management should limit access to pay period backup files to those who need it for their current job duties.

***Management Response***

*Agreed – Network drive access will be updated as employee changes occur to ensure that access to payroll backup files are limited to those who need it for their current job duties.*

## Background

The Payroll Operations Team works within Financial Services, under the Finance, Asset Management & ICT Business Unit. It is responsible for administering payroll for HRM except for Halifax Forum Community Association, Halifax Public Libraries, and Halifax Regional Police.

This includes keying time worked into the payroll system upon receipt of timesheets from supervisors, maintaining payroll master data (i.e.: creating new employee records, capturing changes such as position changes and terminations), and processing payroll and payment files.

HRM's payroll (excluding the Halifax Forum Community Association, Halifax Public Libraries, and Halifax Regional Police) for 2016-17 totalled \$208 million; 2017-18 totalled \$225 million.

The Payroll Operations Department has 22 employees.

- 13 Payroll Costing Coordinators (these staff perform most of the manual entry into the payroll system)
- 2 Payroll Administrators
- 1 Payroll Supervisor
- 1 Team Lead Payroll Processing
- 2 Position Management Coordinators
- 1 SAP Systems Trainer
- 1 Administrative Assistant
- 1 Payroll Manager

## About the Audit

We completed a performance audit of the management of payroll activities by the Finance, Asset Management & ICT Business Unit. The audit scope did not include an examination of payroll system user access. The following business groups were excluded from the audit scope: Halifax Forum Community Association; Halifax Public Libraries; and Halifax Regional Police, as they perform most of their own payroll processing tasks.

The purpose of the audit was to determine whether HRM effectively manages its payroll processes. Our role is to express an independent audit opinion of this area.

The objectives of the audit were to assess whether:

- HRM's payroll has processes to ensure amounts and employee leave balances are complete and accurate;
- HRM has adequate controls to ensure payroll risks are effectively managed; and
- HRM management evaluates the efficiency of its payroll activities.

We developed the criteria for this audit. These were discussed with, and accepted as appropriate by, management of Finance, Asset Management & ICT. The criteria used for this audit were as follows.

1. Policies and procedures should be implemented to prevent and detect payroll errors and fraud.
2. Confidential payroll information should be appropriately secured.
3. Processes and controls should ensure payroll data is appropriately backed up.
4. Management should work to identify payroll process inefficiencies and evaluate opportunities for improvement.

Our audit period was April 1, 2017 to September 30, 2018. Information from outside the audit period was considered as necessary.

Our audit approach included: reviewing internal policies, procedures and programs; interviewing management in Finance, Asset Management & ICT; and examining payroll records and other relevant documentation on a sample basis.

This audit was conducted in accordance with the Canadian Standard for Assurance Engagements CSAE 3001 – direct engagements published by the Chartered Professional Accountants of Canada.

We apply the Canadian Standard on Quality Control 1, and our staff comply with the independence and ethical requirements of the Chartered Professional Accountants of Nova Scotia Code of Conduct.

## Appendix 1 – Recommendations and Management Responses

### Recommendation 1

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### Management Response

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### Future State

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### Recommendation 2

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## Contact Information

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