



CITY OF SAN ANTONIO

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June 9, 2014

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Mike Gallagher
Councilman, District 10

SUBJECT: Audit Report of Finance Department Payroll

Mayor and Council Members:

We are pleased to send you the final report of the Audit of the Finance Department Payroll. This audit began in October 2013 and concluded with an exit meeting with department management in March 2014. Management's verbatim response is included in Appendix B of the report. The Finance Department management and staff should be commended for their cooperation and assistance during this audit.

The Office of the City Auditor is available to discuss this report with you individually at your convenience.

Respectfully Submitted,

Kevin W. Barthold, CPA, CIA, CISA
City Auditor
City of San Antonio

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CITY OF SAN ANTONIO
OFFICE OF THE CITY AUDITOR



Audit of the Finance Department

Payroll

Project No. AU13-024

June 9, 2014

Kevin W. Barthold, CPA, CIA, CISA
City Auditor

Executive Summary

As part of our annual Audit Plan approved by City Council, we conducted an audit of the Finance Department's payroll process. The audit objective, conclusions, and recommendations follow:

Are controls over the City's payroll activities adequate?

Yes, controls over the City's payroll activities are in place and are working effectively. Payroll personnel ensure that employee pay and deductions are calculated accurately and paid properly in a prompt manner; however we observed areas that could be improved. We determined that:

- Payroll duties were not properly segregated and access rights were not properly restricted within the payroll software (SAP)
- Controls over physical check printing could be strengthened

We recommend that the Director of Finance:

- Create and implement rules within SAP for Payroll and HR user access roles so that a proper segregation of duties is established
- Strengthen internal controls over the payroll check printing process

Finance management's verbatim response is in Appendix B *on page 6*.

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Background

The City of San Antonio (CoSA) employs more than 11,000 employees in 36 departments who provide a wide range of municipal services. The Finance Department is organized into six areas: Accounting Services, Public Utilities, Purchasing & General Services, Compliance & Resolution, Financial Services, and Risk Management. Accounting Services supports and oversees payroll, account receivables, payables, grants, capital projects, time entry, and financial reporting.

The Payroll function administers 4 payroll types: Bi-weekly Civilian, Bi-weekly Uniform (Police and Fire Departments), Bi-weekly Temporary, and School Crossing Guards which are processed monthly. CoSA utilizes the SAP financial system to manage and process payroll for all City departments. A Time and Attendance Manager oversees 3 Time Coordinators and 35 Time Specialists who administer employee time for assigned departments and/or groups within departments. Their responsibility is to make sure employee time is entered accurately and promptly in order to process payroll. A Payroll Administrator oversees 3 Payroll Specialists whose responsibility is to identify errors related to employee time and master data, notify appropriate personnel for correction, and process payroll before established deadlines.

The total payroll for calendar year 2013 was approximately \$446 million, 97% of which was paid by direct deposit and 3% by physical check. See the table below for a breakdown by payroll types.

Calendar Year 2013 Payroll Totals					
Payroll Type	Direct Deposit Count	Direct Deposit Payroll Sum	Physical Check Count	Physical Check Payroll Sum	Total Payroll
Bi-weekly Civilian	198,556	\$ 197,425,630	8,555	\$ 8,172,716	\$205,598,346
Bi-weekly Uniform	126,117	\$ 232,201,256	620	\$ 4,202,739	\$236,403,995
Bi-weekly Temporary	6,667	\$ 1,742,118	5,659	\$ 1,920,518	\$ 3,662,636
Monthly School Crossing Guards	2,464	\$ 915,467	96	\$ 189,348	\$ 1,104,815
Totals	333,804	\$ 432,284,471	14,930	\$ 14,485,321	\$446,769,792

Audit Scope and Methodology

The audit scope was from January 2012 to September 2013. We performed testing from October 2013 through December 2013.

We interviewed Finance and Human Resources Department management and staff to gain an understanding of the payroll process including recruitment and hiring, activating new employees, approving time, processing payroll and the disbursement process. Additionally, we also examined Finance Department policies and procedures.

To establish testing criteria, we reviewed the following:

- Finance Department policies and procedures
- Human Resources policies and procedures
- Financial data obtained from SAP
- Fair Labor Standards Act (FLSA) and Texas Labor Laws
- Federal, State, Local Government Divisions of the IRS

During the course of the audit, we reviewed users and roles within SAP with the ability to maintain/update employee data, approve hours worked, process payroll, and edit tax tables.

We verified that monthly bank account reconciliations are performed, reviewed, and accurate based upon statements received from the City's banking institution. Additionally, we verified that the Finance Department is in compliance with IRS reporting requirements.

Furthermore, we reviewed the physical check printing and payroll disbursement processes. Finally, we verified that overtime calculations are in compliance with FLSA provisions and that tax rates are in alignment with IRS requirements.

We relied on computer-processed data in the SAP System, the City's financial and accounting system of record. Our reliance was based on performing direct tests on the data rather than evaluating the system's general and application controls. We do not believe that the absence of testing general and application controls had an effect on the results of our audit.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Results and Recommendations

A. Segregation of Duties / Access to SAP

SAP payroll duties were not properly segregated and access rights were not properly restricted.

The Finance Department's Compliance Office is responsible for establishing "rule books" within Approva. Approva is a tool used for the continuous monitoring of segregation of duties rules in SAP so that violations can be prevented or identified and remediated. Prior to this audit, the Compliance Office initiated the creation of a Payroll and Human Resources rule books project with an anticipated completion of October 2014. As of the end of fieldwork, this project had not been completed and consequently not all access conflicts in SAP had been identified and corrected.

Auditors found 7 active users who inappropriately have the ability to maintain employee data,¹ transfer and approve hours worked, and run payroll. Additionally, 23 active users have inappropriate access to edit employee data, and 5 active users have inappropriate access to process payroll.

A fundamental element of internal control is the segregation of certain key duties. Key duties in payroll processing including approving work hours, processing payroll, and updating personnel master data should be segregated.

In addition, Administrative Directive 7.8E, *User Account Management*, requires that staff only be given system access to the minimum resources necessary to perform the duties associated with their position.

When an inadequate segregation of duties exists, an employee has the ability to conceal errors and/or conduct fraudulent activities. During the audit, Finance Management became aware of these issues through their own internal control procedures and removed the inappropriate and/or excessive SAP payroll access rights.

Recommendation

The Director of Finance should complete the creation and implementation of rules within SAP for Payroll and HR user access roles so that a proper segregation of duties is established. Additionally, access to modify employee master data, approve hours worked, and run payroll should be restricted to only those users who require such access to perform their job duties.

¹Employee data includes but is not limited to organizational assignment, payroll data, address, and bank account information.

B. Physical Check Printing

Controls over physical check printing could be strengthened.

Auditors identified several internal control issues with the check printing process which the Information Technology Services Department (ITSD) oversees on behalf of the Finance Department. In 2013, physical checks represented 3.28%, or \$14 million of all payroll transactions.

- The check stock is not pre-numbered and is stored in a closet under the ITSD Service Monitoring Group's control. This closet also houses IT mobile communication equipment which must be accessible by telecommunications personnel. The closet is left unlocked during normal business hours and is accessible by 5 IT employees who have no responsibility for check printing.
- The check printing process may be assigned to only one employee within the ITSD Service Monitoring Group, depending on who is available. The employee uses a generic user ID and password to release the print job from the spooler to the printer. Furthermore, the printer does not require a user ID and password for printing checks.
- Due to frequent equipment malfunctions, the print job may have to be stopped and restarted which allows duplicate checks to be printed.
- The City's equipment used to fold and glue the checks does not work so the checks are couriered to a third party where they are folded, glued, and couriered to the Finance Department for disbursement.
- The ITSD print room does not have surveillance equipment so video of the check printing process does not exist.

Internal control weaknesses over the check printing process could result in fraudulent physical checks being produced.

Due to the magnitude of these payroll checks, the Finance Department has implemented controls over the check printing process including "Positive Pay." Positive Pay is an automated service that obligates the City's banking institution to match the account number, check number and dollar amount of checks presented for payment against a list of checks previously authorized and issued by the City. All three components² of the check must match exactly or the bank will not honor the check.

Recommendation

The Director of Finance should strengthen internal controls over the payroll check printing process.

² The Finance Department anticipates implementing an additional Positive Pay feature in 2014 whereby the payee name must also match.

Appendix A – Staff Acknowledgement

Mark Bigler, CPA-Utah, CISA, CFE, Audit Manager
Gabriel Trevino, CISA, Auditor in Charge
Michael Hurlbut, Auditor

Appendix B – Management Response



CITY OF SAN ANTONIO

P.O. Box 839966
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May 9, 2014

Kevin W. Barthold, CPA, CIA, CISA
City Auditor
San Antonio, Texas

RE: Management's Corrective Action Plan for Finance Department's Audit of Payroll

The Finance Department has reviewed the audit report and has developed the Corrective Action Plans below corresponding to report recommendations.

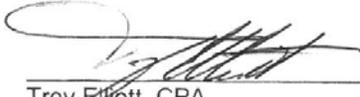
Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
A	<p>Segregation of Duties / Access to SAP</p> <p>Recommendation: The Director of Finance should complete the creation and implementation of rules within SAP for Payroll and HR user access roles so that a proper segregation of duties is established. Additionally, access to modify employee master data, approve hours worked, and run payroll should be restricted to only those users who require such access to perform their job duties.</p>	3	Accept	<p>Marion Gee / Asst Director</p> <p>&</p> <p>Melanie Seale / Asst Director</p>	October 2014

Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
	<p>Action plan:</p> <p>The Finance Department has made significant improvements in strengthening internal controls throughout the City organization over the past several years to include the implementation of shared services and special software to assist in monitoring system user roles and system access.</p> <p>The Implementation of the shared services program was recently completed and included the centralization and standardization of Human Resources and Time positions throughout the City. One of the goals of the Shared Services program was to create specialized positions such as Time Specialists and HR Business Partners. Through the implementation of Shared Services, position based controls were established by aligning system roles with positions therefore improving segregation of duties and limiting system access to functions needed by type of position. For example, prior to Shared Services, the City had over 140 employees across the City processing time for City personnel with duties in addition to time recording. Central Finance employees also possessed access to both time and payroll processing. The Shared Services Program standardized time positions and segregated duties between the time and payroll groups, while consolidating the number of individuals entering and changing employee time to 40 time and attendance employees.</p> <p>In addition to shared services, the Finance Department purchased software called Approva Infor to improve the provisioning of user systems roles and to assist in identifying instances where conflicts exist with users and access to the SAP system. The software was purchased in 2009 and has been steadily being expanded to monitor all functions and roles in SAP. Since that time, the Finance Department in cooperation with the Information Technology Services Department has analyzed and redesigned system roles, and implemented corrective action for the following SAP modules to include: Accounts Payable, Purchasing, Inventory, Fixed Assets, Projects, Sales & Distribution, Accounts Receivable, General Ledger and Finance. The modules remaining include HR/Payroll and Supplier Relationship Management. HR/Payroll was targeted for later implementation in order to allow time for the Shared Services implementation to be completed and for Human Resources to evaluate and complete a potential reorganization. Prior to this audit the Compliance & Resolution Division of the Finance Department had already initiated an analysis of the HR/Payroll roles and had begun the implementation of the rule books for the HR/Payroll functions. The expected completion date to have the revised rule books and HR/Payroll roles operational is September 30, 2014. In the interim, mitigating controls will continue to include the manual review of new roles being provisioned as well as review of user's roles to identify potential access and segregation of duties issues.</p>				
B	<p>Physical Check Printing</p> <p>Recommendation: The Director of Finance should strengthen internal controls over the payroll check printing process.</p>	4	Accept	Melanie Seale / Asst Director	March 2015

Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
	<p>Action plan:</p> <p>The City's Finance Department has made great strides in strengthen controls through reduction of the number of printed checks and utilization of fraud prevention services offered by the City's Depository.</p> <p>Since 2007, the Payroll Division of the Finance Department has been diligently working to reduce the number of physical checks printed through the implementation of Employee Self Service, revised employee on-boarding processes and educate employees on the advantages of direct deposit. Since that time, the City has been able to reduce the amount of paper checks printed from approximately 68,000 to 19,000 annually; representing a reduction of approximately 72% in the amount of paper checks being printed.</p> <p>In consultation with the City Attorney's Office, we have been advised that that the City cannot enforce a mandatory citywide direct deposit, as a result of (1) Texas Local Government Code, Section 144.002 that requires the employee's written request to participate in any type of electronic funds transfers; and (2) the Department of Labor's Field Operations Handbook, Section 30c00 Method of [Wages] Payment that requires that employees have the option of receiving payment by cash or check directly from the employer. The Finance Department continues to work with the City Attorney's Office and Human Resources to research additional ways to reduce and ideally eliminate paper checks. Currently, we are surveying individuals who continue to receive paper checks to identify what barriers exist to converting to direct deposit.</p> <p>The Finance Department has in place "Positive Pay" features with its Depository Bank as an additional fraud prevention measure. Positive Pay is an automated fraud detection service that matches the account number, check number and dollar amount of each check presented for payment against a list of checks previously authorized and issued by the City. All three components of the check must match exactly or it will not pay. Positive Pay requires the City to send (transmit) a file of issued checks to the Bank each time checks are written. When a check is presented that does not have a "match" in the file, it becomes an "exception item". The Bank provides an image of the exception item to the City and we instruct the Bank to pay or return the check. The Finance Department is currently working with its Bank to further enhance and strengthen the Positive Pay service to include the addition of the payee as a fourth criteria which must be matched before a check would be paid. It is anticipated this additional feature will have completed testing and be available by June 2014.</p> <p>The Payroll Audit also identified a concern regarding outsourcing of folding and gluing of payroll checks. The City's fold and glue machine utilized to seal employee checks broke November 2013, resulting in the Finance Department utilizing a third party vendor to "tab" close the checks. The Finance Department modified its procedures to require a City representative to stay with the checks while being tabbed by the third party. The Finance Department worked with ITSD to realign the employee name and address printed on the outside of the check to allow checks to be stuffed into windowed envelopes rather than having the checks tabbed and continues to work with ITSD on purchasing a replacement device to seal employee checks.</p> <p>The Finance Department and Information Technology Services Department are also evaluating the movement of check printing from ITSD's facility to the Finance Departments Print Shop to enhance controls and increase efficiency.</p>				

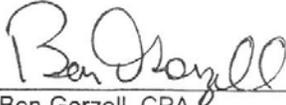
We are committed to addressing the recommendations in the audit report and the plan of actions presented above.

Sincerely,



Troy Elliott, CPA
Finance Director

5/14/2014
Date



Ben Gorzell, CPA
Chief Financial Officer
City Manager's Office

5/14/2014
Date