



**A Report to the
Audit Committee**

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Office of
Internal Audit

Audit of Metro Water Services Payroll Process

December 28, 2017

EXECUTIVE SUMMARY
December 28, 2017



Why We Did This Audit

Salaries and benefits are a significant expense for Metro Water Services, \$56.3 million or 44 percent of the operating budget for fiscal year 2017.

What We Recommend

- Develop standard procedure to facilitate consistent practices over the payroll process life cycle.
- Explore more efficient and effective ways to leverage the use of technology.

Audit of Metro Water Services – Payroll Process

BACKGROUND

This audit engagement covered the payroll process for Metro Water Services. Metro Water Services uses the PeopleSoft system to manage benefit leave accruals, track earned compensatory time, document payroll exceptions, and maintain employee leave balances.

Between May 1, 2015, and April 30, 2017, 40,386 paychecks for 907 employees were processed by Metro Water Services. Metro Water Services currently has an average of 755 employees per pay period. The major pay types during the audited period totaling \$86.3 million are shown in Exhibit A below.

Exhibit A - Metro Water Services Major Pay Type Amounts between May 1, 2015, and April 30, 2017

Major Pay Type	Amount
Regular	\$65,259,388
Sick, Vacation, and Holiday	10,891,393
Overtime and First Response	7,746,581
Longevity Bonus	836,904
Compensatory Time	596,491
Leave Paid Out at Termination	255,672
Shift Differential Pay	235,733
Bereavement Leave	228,857
Out-of-Class	149,376
Retro Pay and Adjustments	82,356
Injury on Duty Pay	63,699
Other Pay and Adjustments	-9,006
Total Payroll	\$86,337,444

Source: Metro EnterpriseOne Payroll Detail by Department Report

OBJECTIVE AND SCOPE

The objective of this audit is to determine if controls pertaining to the payroll process are in place and working effectively.

This audit reviewed payroll transactions from May 1, 2015, to April 30, 2017.

WHAT WE FOUND

Metro Water Services has controls in place over the payroll process. However, payroll practices are not consistent across sections within Metropolitan Water Services, and use of the PeopleSoft system is not cost-efficient.

GOVERNANCE

Metro Water Services Payroll is governed by the Civil Service Rules and Civil Service Policies promulgated by the Metropolitan Nashville Government Civil Service Commission.

PAYROLL PROCESS

Metro Water Services processes payroll by exception using Leave Request forms submitted by employees to their supervisor for approval. Overtime, first response, and out-of-class events are communicated from supervisors by emails and notes to timekeepers for processing. Also, some supervisors may prepare attendance sheets to document employee work efforts for the pay period. Using this information, the timekeeper will enter time exceptions into a spreadsheet and leave time into the PeopleSoft system for the pay period. These timesheets are approved by the section supervisor and sent to the Finance/Accounting Division for additional processing.

The Finance/Accounting Division payroll processors export payroll exceptions from the PeopleSoft system, review the timesheets and consolidate the information into a combined master sheet for their supervisor's review and approval. The master sheet is then uploaded into EnterpriseOne, the Metropolitan Nashville Government accounting and payroll system. Metro Water Services Finance Administrator will sign and approve all EnterpriseOne payroll related reports for the pay period. Then the Metropolitan Nashville Government Finance Department Payroll Division will process payments to employees.

Metro Water Services Human Resources Division is responsible for processing employee target upgrades, leave accrual rate changes, and compensatory time elections.

The PeopleSoft system is the official record for employee leave balances. Leave accruals are updated monthly within the PeopleSoft system when a Customer Services Division timekeeper manually triggers the accruals being added to balances.

OBJECTIVES AND CONCLUSIONS

1. *Are controls pertaining to the payroll processes in place and effective?*

Generally, yes. Overall, controls are in place and working. However, control activities are not performed in a consistent manner, and calculations for accruals and retroactive payments contained errors (see Observation A). Also, the department is not leveraging technology efficiently and effectively (see Observations B and C).

Supporting Objectives and Conclusions

a. *Are controls in place to ensure that the overtime, compensatory time, first response, and shift differential pay type hours paid are actually worked to benefit Metro Water Services?*

Generally, yes. Overtime, compensatory time earned, first response pay, and shift differential time are approved and documented. However, the specific documentation is not consistent between sections. (See Observation A.)

b. *Are controls in place to ensure that vacation, sick, personal, and compensatory time leave hours are approved, and employees agree with leave balances?*

Generally, yes. Controls are in place to ensure that vacation, sick, personal, and compensatory time leave hours are approved. However, the retention of documentation is not consistent between sections and the procedure to ensure employees agree with their leave balances is not consistently applied. (See Observation A.)

c. *Are controls in place to ensure that retroactive pay is justified?*

Generally, yes. Controls are in place to ensure that retroactive pay is justified. However, retroactive pay adjustments are not always approved timely, resulting in additional complexity and errors in some retroactive pay calculations. (See Observation A.)

d. *Are controls in place to ensure that leave accruals are processed accurately?*

Generally, yes. Controls to ensure leave accruals processed accurately are in place, but not working effectively. Differences in leave time accrual balances existed for 25 (49 percent) out of 51 employee balances reviewed. (See Observation A.)

e. *Are controls in place to ensure that amounts paid for terminated employees are accurate?*

Yes. Controls are in place to ensure that amounts paid to terminated employees are accurate.

f. *Are controls in place to ensure that pay relating to bereavement leave is in accordance with Metropolitan Nashville Government Civil Service Rule 4.9 Bereavement?*

Generally, yes. Controls are in place to ensure bereavement leave is awarded in accordance with *Metropolitan Nashville Government Civil Service Rule 4.9 Bereavement*. However, the retention of documentation among the sections is not consistent and the number of hours allowed is not always in accordance with Metropolitan Nashville Government Civil Service Rule 4.9 Bereavement requirements. (See Observation A.)

g. *Are controls in place to limit PeopleSoft account privileges based on business and information security requirements?*

Generally, yes. Controls are in place, but segregation of duties and best practices are not always followed. (See Observations B.)

AUDIT OBSERVATIONS

Internal control helps entities achieve important objectives and sustain and improve performance. The Committee of Sponsoring Organizations of the Treadway Commission (*COSO*), *Internal Control – Integrated Framework*, enables organizations to effectively and efficiently develop systems of internal control that adapt to changing business and operating environment, mitigate risks to acceptable levels, and support sound decision making and governance of the organization. The audit observations listed are offered to assist management in fulfilling their internal control responsibilities.

Observation A –Inconsistent Payroll Practices Across Sections

The application of payroll business rules is applied inconsistently within Metro Water Services sections. A review of payroll activities for 21 Metro Water Services sections showed the following inconsistent practices.

Leave Accrual

Differences in leave time accrual balances existed for 25 (49 percent) out of 51 employee balances reviewed. The differences ranged from 46.35 hours of missing benefit time to 26 hours of unearned benefit time.

Confirmation of Employee Annual Leave Balances

Annual leave balance confirmations are not maintained in all sections or in the Metro Water Services Human Resources Division. Out of 52 employees leave balances reviewed, yearly leave balance audit reports were not available for 42 (81 percent) employees to show they agreed with the balances.

Leave Action Forms - Vacation, Sick, and Compensatory Leave

Leave Action forms documenting employees request and management's approval for leave time could not be located for 28 forms, and 4 forms were not signed by a supervisor, resulting in 32 (53 percent) out of 60 leave pay occurrences missing documented supervisor approval. Leave Action forms were not available for 5 (83 percent) out of 6 compensatory time occurrences reviewed.

Also, compensatory time earned was recorded on the Leave Action form, which may cause unnecessary confusion.

Overtime Pay or Compensatory Time Election Forms

Compensatory Time Election forms are not consistently maintained in all sections or in the Metro Water Services Human Resources Division.

Overtime Pay or Compensatory Time Election forms are not always verified when payroll is processed. Pay types for three transactions did not match the employees' election, although no duplicated payments were noted.

Earned overtime is reported and approved in different formats, such as spreadsheets, printed-paper forms, emails, or handwriting on papers, making it difficult for tracking and documentation.

Bereavement Leave

Leave Action forms documenting the bereavement leave category for the employee's family relationship were not available for 17 (59 percent) out of 29 bereavement leave occurrences

reviewed. In addition, one Leave Action form for employee bereavement leave was missing the supervisor approval.

Two employees were allowed bereavement leave in excess of the one work shift allowed for extended family relationships (one employee for one additional work shift and the other employee was allowed four additional work shifts).

Retroactive Pay

Some Metro Water Services employees are eligible for target pay upgrades when certain criteria are met. Employees submit documents to Metro Water Services Human Resources Division for pay upgrade approval. If management approval or the Metro Water Services Finance/Accounting Division is not informed of the pay increase prior to the pay period end for the pay upgrade effective date, retroactive pay adjustments have to be calculated.

Out of five retroactive payment occurrences reviewed, one payment was made 23 pay periods after the effective date, and another payment was made 6 pay periods after the effective date. Metro-wide adjustments applied before the pay rate increase caused additional complexity in the retroactive pay calculation. This resulted in these employees receiving retroactive payments of \$243.66 and \$62.87 more than the authorized pay amount.

Metro Water Services Payroll Operating Procedures

A review of 21 Metro Water Services payroll sections showed supervisors and timekeepers did not follow the same practice for work time approval and recording. Metro Water Services Human Resources Division and Metro Water Services Finance/Accounting Division did not always have the same understanding of the Civil Service Rules for approving Leave Action forms. Standard operating procedures for processing payroll exceptions were not available. At the time of this report, Metro Water Services is developing standard operating procedures to address this issue.

Criteria:

- *Metropolitan Civil Service Rules*—4.3 Scheduling and Approving Leave, 4.6 Vacation, and 4.9 Bereavement
- *Metropolitan Civil Service Policy*—5.7 B-II Election of Compensatory Time in Lieu of Overtime Pay by Non-Exempt Employees
- *COSO—Control Activities—Principle 12*—The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.
- *COSO—Control Activities—Principle 10*—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

Recommendations for management of the Office of Metro Water Services to:

1. Finalize its payroll process standard operating procedures and ensure procedures are followed throughout Metro Water Services.
2. Determine the cause of differences in leave time accrual balances and update controls as needed.
3. Review retroactive pay calculations for the past two years and determine if overpayments should be recovered or any underpayments should be paid to employees.

Observation B – PeopleSoft Access Controls

One timekeeper has update privileges to all Metro Water Services employees' leave balances in the PeopleSoft system through the multiple roles and IDs assigned to the employee, effectively all the permissions in the system. When the system was initially implemented, approximately ten years ago, this employee worked in the Metro Water Services Human Resources Division. The employee's current section timekeeper function is not compatible with update privileges for all Metro Water Services employees' leave balances.

Moreover, two vendors had accounts created based on profiles of employees, and one of them had a second account based on the profile of the aforementioned active employee. In PeopleSoft, ID type is configurable based on business needs to separate vendors from employees. Additionally, it was the practice at the department to provide multiple IDs to one user to implement row security, while the system allows the creation of roles based on row security.

Circumventing controls in the system would increase the risk of potential fraud and abuse, and ultimately Metropolitan Nashville Government's liability for leave benefits.

Criteria:

- *COSO—Control Activities—Principle 11—The organization selects and develops general control activities over technology to support the achievement of objectives.*
- *Metropolitan Nashville Government Information Security Policy Number 9—Access Control and User Account Management Policy*

Recommendation for management of the Office of Metro Water Services to:

1. Ensure processes in the payroll lifecycle are implemented in appropriate functions so that duties for approval, implementation, and execution are separated.
2. Ensure employee or contractor application privileges in the PeopleSoft system only grant access based on business and information security requirements.

Observation C - Inefficient Use of PeopleSoft

The use of PeopleSoft is no longer cost-efficient. Approximately \$185,000 annually can be saved by replacing PeopleSoft functionality with the Metropolitan Nashville Government's EnterpriseOne and Kronos systems. Other advantages include eliminating the need for staff to support the PeopleSoft system and strengthen controls by adding audit trails and eliminating the manual transfer of exception records from one system to the other.

Exhibit B – Estimated Annual Expense using PeopleSoft versus Kronos Software for Payroll

	PeopleSoft	Kronos
PeopleSoft License Fee and Maintenance	\$236,108 ¹	
Kronos Internal Service Fee Estimate		\$51,000 ²
EnterpriseOne Internal Service Fee	40,962 ³	40,962
Estimated Technology Annual Expense	\$277,070	\$91,962

Source: EBS payment records for PeopleSoft vendors, ITS internal service charge fee structure, and Office of Internal Audit Calculation

Criteria:

COSO-- Control Activities—Principle 11—The organization selects and develops general control activities over technology to support the achievement of objectives.

Recommendation for management of the Office of Metro Water Services to:

Convert functions in the PeopleSoft system into the Metropolitan Nashville Government's enterprise resource management system and timekeeping system.

¹ PeopleSoft license fees and maintenance support annual expense average since 2010.

² Metro Water Services number of paychecks times Metropolitan Nashville Government Information Technology Services fiscal year 2018 internal service fee schedule adjusted for additional Metro Water Services transactions.

³ Metro Water Services internal service fee for fiscal year 2018 for use of the Human Resources and Payroll modules.

GOVERNMENT AUDITING STANDARDS COMPLIANCE

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 observations and conclusions based on our audit objectives.

METHODOLOGY

To accomplish our audit objectives, we performed the following steps:

- Interviewed key personnel within Metro Water Services including:
 - Section Timekeepers
 - Finance/Accounting Division
 - Human Resources Division
 - Operations staff
- Reviewed and analyzed documentation for compliance with the Metropolitan Nashville Code of Laws, Metropolitan Government of Nashville and Davidson County Civil Service Rules, and other applicable laws, regulations, and policies.
- Evaluated internal controls currently in place.
- Performed test work on samples to determine the effectiveness of internal controls.
- Considered risk of fraud, waste, and abuse
- Considered risks and controls in the information system

AUDIT TEAM

Mary Cole, Senior Auditor, CPA, CFE, CISA CGFM, In-Charge Auditor

Laura Henry, CFE, Staff Auditor

Qian Yuan, CIA, CISA, ACDA, CMFO, Quality Assurance

Mark Swann, CPA, CISA, CIA, ACDA, CMFO, Metropolitan Auditor

APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

MEGAN BARRY
MAYOR



METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

DEPARTMENT OF WATER AND SEWERAGE SERVICES
Office of the Director
1600 Second Avenue, North
Nashville Tennessee 37208-2206

December 21, 2017
Mark Swann
Metropolitan Auditor
Office of Internal Audit
404 James Robertson Pkwy, Ste 190
Nashville, TN 37219

Dear Mr. Swann,

This letter acknowledges that Metro Water Services received the Payroll Process audit report and has reviewed the audit comments and recommendations. Metro Water Services implemented improvements prior to the completion of the report and will continue to implement the agreed upon recommended process improvements as appropriate.

It was a pleasure working with you and your team on this project and we appreciate the opportunity to make improvements to our internal control environment.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott Potter".

Scott Potter, PE
Director, Metro Water Services



If you need assistance or an accommodation, please contact Metro Water Services,
at 615-862-4862, 1600 Second Avenue North, Nashville, Tennessee 37208.

APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

We believe that operational management is in a unique position to best understand their operations and may be able to identify more innovative and effective approaches, and we encourage them to do so when providing their response to our recommendations.

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<i>Recommendation for management of Metro Water Services to:</i>		
A.1 Finalize its payroll process standard operating procedures and ensure procedures are followed throughout Metro Water Services.	Accept. Metro Water Services has implemented a Leave Action Policy and associated form that creates consistency across the department and includes checks and balances to ensure accuracy. This will also address inconsistency with bereavement, overtime and comp time.	June 1, 2018
A.2 Determine the cause of differences in leave time accrual balances and update controls as needed.	Accept. Metro Water Services believes the causes for the accrual balances have been identified. Each differentiation will be reviewed and adjusted appropriately. Additionally, the new policy includes an annual leave balance audit to check for discrepancies. A policy for leave accrual exceptions will be created. Leave accrual duties will be created and segregated in PeopleSoft.	April 15, 2018
A.3 Review retroactive pay calculations for the past two years and determine if overpayments should be recovered, or any underpayments should be paid to employees.	Accept. Retroactive payments are reviewed on a regular basis. Human Resources and Payroll personnel have adopted a doubled certification model that verifies retroactive pay. Payroll personnel have compiled a listing of all retroactive pay over the last two years. Reviewing two years of previous payments that did not go through the current process will be helpful, but time-consuming.	June 30, 2018
B.1 Ensure processes in the payroll lifecycle are implemented in appropriate functions so that duties for approval, implementation, and execution are separated.	Accept. Metro Water Services agrees that the accrual function should be moved to the appropriate area (Human Resources from Customer Service) and duties segregated. All other functions already reside in Finance and Human Resources where the responsibility ultimately lies.	September 1, 2018

APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<p>B.2 Ensure employee or contractor application privileges in the PeopleSoft system only grant access based on business and information security requirements.</p>	<p>Accept. Metro Water Services use of PeopleSoft is limited to division time-keepers and a few administrators. It has worked for the department, but we recognize that the software may have options for more efficient execution and workflows. We will explore those workflows and appropriate access for those using the software.</p>	<p>June 1, 2018</p>
<p>C.1 Convert functions in the PeopleSoft system into the Metropolitan Nashville Government’s enterprise resource management system and timekeeping system.</p>	<p>Accept. Metro Water Services understands that because the General Government is going through an upgrade to the EBS (ERM) system (R12), that ability to adopt Kronos near may be inhibited. Metro Water Services would like to explore how other departments with like shift work and size use the Kronos. Additionally, Metro Water Services would like to understand the relationship of Kronos to EBS and the expected relationship when R12 goes live.</p>	<p>Based on R12 Implementation but exploration can start. December 31, 2018 – Understand how other departments use.</p>