



City of Ogdensburg Payroll Processing

Report of Examination

Period Covered:

January 1, 2013 — March 31, 2014

2014M-207



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

September 2014

Dear City Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and City Council governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the City of Ogdensburg, entitled Payroll Processing. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The City of Ogdensburg is located in St. Lawrence County and has a population of 11,128. The City provides various services to its residents, including general government, police and fire protection, water and sewer services, highway maintenance and development, recreation facilities and programs and a library and art museum. The City's budgeted appropriations for 2014 were approximately \$19.1 million. These appropriations are primarily funded with revenues from local property taxes, water and sewer rents, sales taxes and State aid.

The City is governed by an elected seven-member Common Council (Council) comprising a Mayor and six Councilors. The Council is the legislative body responsible for managing City operations, including establishing internal controls over financial operations. The City Manager serves as the chief executive officer, and the City's Comptroller (Comptroller) is the chief fiscal officer.

The City employs approximately 160 full- and part-time employees. Payroll is the City's most significant operating cost, totaling approximately \$7.4 million in 2013, which represents 38 percent of the total 2013 budgeted appropriations. The Comptroller is responsible for overseeing the City's finances, including the payroll function. The Comptroller's office has a payroll clerk who is responsible for payroll processing.

Objective

The objective of our audit was to review internal controls over payroll processing. Our audit addressed the following related question:

- Did City officials ensure that internal controls over payroll processing provide for adequate segregation of duties?

Scope and Methodology

We examined the City's payroll records and reports for the period January 1, 2013 through March 31, 2014. In addition, we tested internal controls over the City's information technology system during our audit period. Our audit identified areas in need of improvement concerning information technology controls. Because of the sensitivity of some of this information, certain vulnerabilities are not discussed in this report, but have been communicated confidentially to City officials so they could take corrective action.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

**Comments of
Local Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with City officials and their comments, which appear in Appendix A, have been considered in preparing this report.

The Council has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Council to make this plan available for public review in the City Clerk's office.

Payroll Processing

An effective system of internal controls over payroll processing helps ensure that employees are paid the wages and salaries and provided the benefits to which they are entitled. Internal controls include effective management oversight of those charged with processing payroll and adequate segregation of financial duties, so that no one individual can control all aspects of financial transactions. For example, the same employee should not enter new employees and pay rates into the computerized payroll program, process the payrolls, prepare and distribute paychecks and initiate direct deposits to the bank. Duties should be segregated so that the work of one employee is routinely verified in the course of another employee's regular duties. If it is not practical to adequately segregate financial duties, City management should establish compensating controls. Such compensating controls would consist of having someone who is independent of the payroll process review the payrolls for accuracy and sign (certify) the completed payrolls to indicate their review.¹

City officials did not ensure that internal controls over payroll processing provided for adequate segregation of duties. The payroll clerk performed all significant phases of the payroll process. She entered new employees, pay rates and employees' time worked from their time records into the computerized payroll system; calculated withholding adjustments; and finalized the payrolls. The payroll clerk also prepared, signed and distributed paychecks to employees and payroll withholding checks to outside agencies. The payroll clerk also had unrestricted access to a check-signing machine that she used to imprint the Comptroller's signature onto checks. She also prepared and transmitted the direct deposit file to the bank. When one person performs all the duties related to payroll processing, the City has an increased risk that funds could be misappropriated and remain undetected and uncorrected.

In addition, no one reviews the completed payrolls. The payroll clerk gives the Comptroller a report from the computerized payroll system that lists the gross pay for each individual employee separated by appropriation budget codes. The Comptroller uses the report to enter the payroll expenditure totals into the central accounting records, but does not review the individual employee names and respective pay amounts for accuracy.

¹ Completed payrolls are the City's payroll journals that include information such as employee name, gross pay, net pay, hours worked, detail of withholdings, direct deposit amount and check number.

The Comptroller provides some oversight of the payroll process by performing bank reconciliations and reviewing canceled payroll checks² for reasonableness. However, these oversight procedures would not identify errors or discrepancies on direct deposit payments. As a result, it would not prevent the payroll clerk from paying herself or other employees for time not worked or paying a fictitious employee.

We reviewed payroll payments totaling \$104,672 made to 30 City employees³ in September 2013 to ensure the amounts were authorized according to employee contracts and time worked by the 11 hourly employees was supported by time records. For the 19 salaried employees in our sample, we ensured that the total amount of regular pay totaling \$892,707 they received during 2013 also was authorized according to employee contracts. We found only minor discrepancies.

Although we found no significant exceptions, City officials' failure to segregate the payroll clerk's incompatible duties and provide adequate oversight of her work creates an environment that is susceptible to errors or irregularities occurring and going undetected. In addition, because City officials do not review and approve completed payrolls, the City has an increased risk that inappropriate transactions could occur and remain undetected.

Recommendations

1. City management should segregate the payroll clerk's duties so that one person does not control all significant aspects of the payroll process. Where it is not feasible to adequately segregate duties, City officials should routinely monitor and review the payroll clerk's work.
2. The Council should ensure that a City official who is independent of the payroll process reviews completed payrolls for accuracy and signs (certifies) the payrolls to indicate their review.

² Payroll checks provide information of the net pay per employee, but not gross pay, and the bank statement shows the total amount of the direct deposit payments, but not the amount paid to each individual employee.

³ 19 salaried employees and 11 hourly employees

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

The local officials' response to this audit can be found on the following page.

CITY OF OGDENSBURG, NEW YORK

City Manager's Office



September 9, 2014

New York State Office of the State Comptroller
Division of Local Government & School Accountability
110 State Street
Albany, NY 12236-0001


Re: City of Ogdensburg Draft Audit Report
January 1, 2013 through March 31, 2014

Dear Sir/Madam:

The City of Ogdensburg is in receipt of the draft audit report in connection with the period January 1, 2013 through March 31, 2014. After reviewing the draft, the City will be taking steps to try and implement the findings mentioned in the report. We will be filing a Corrective Action Plan in connection with the findings presented.

If you have any questions please feel free to contact us.

Sincerely


City Manager

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the City's internal controls. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. During the initial assessment, we interviewed City officials, performed limited tests of transactions and reviewed pertinent documents, such as City policies and procedures and financial records and reports.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed and evaluated those weaknesses for the risk of potential fraud, theft or professional misconduct. We then decided on the reported objective and scope by selecting for audit the area most at risk. We selected payroll processing for further testing for the period of January 1, 2013 through March 31, 2014.

To accomplish our audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed the payroll clerk, officials in the Comptroller's office and various department heads to gain an understanding of the payroll process and the current internal control system.
- We compared information from the City's computerized payroll system to bank statements, canceled checks, printed payroll journals and detailed direct deposit files to ensure the computerized payroll data were reliable.
- We randomly selected one month in the audit period (September 2013). We then randomly selected 25 employees and judgmentally selected five additional employees that were considered high risk from the September payrolls. These additional five employees were the payroll clerk, Comptroller, Assistant Comptroller, Mayor and City Manager. They were considered high risk due to their ability to change or authorize changes to payroll data without detection. We reviewed payroll payments made to these employees totaling \$104,672 to ensure the amount of pay received during the month was authorized according to employee contracts and that time records supported the time worked by hourly employees, as indicated on the payrolls. For the 19 salaried employees in our sample, we ensured that the total amount of regular pay they received during the 2013 calendar year totaling \$892,707 was authorized according to their employee contracts. We reviewed personnel files and leave records to ensure all employees selected were active employees.
- We reviewed all electronic direct deposit files that the payroll clerk transmitted to the bank during our audit period to determine whether the same bank account number was used for two or more employees to identify the possible existence of any fictitious employees.
- We scanned the City's payroll journals for high-risk transactions, including employees with excessive overtime hours, few or no deductions, or payroll amounts spread out among numerous department codes, and followed up on selected payments as necessary.

- We identified employees who had separated from City employment during our audit period to determine whether these employees correctly received pay subsequent to their separation.

We conducted this performance audit in accordance with GAGAS. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

Andrew A. SanFilippo, Executive Deputy Comptroller
Gabriel F. Deyo, Deputy Comptroller
Nathalie N. Carey, Assistant Comptroller

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