TORONTO STAFF REPORT

October 27, 2004

To: Audit Committee

From: Auditor General

Subject: Payroll Processing Review (Phase One)

Purpose:

The purpose of this review was to assess the adequacy of controls over payroll processing and to determine whether outstanding recommendations from previous audit reports issued by the Auditor General's Office in relation to payroll matters have been implemented and, where appropriate, to recommend further action to improve controls.

Financial Implications and Impact Statement:

There are no direct financial implications resulting from the adoption of this report. However, the implementation of certain recommendations contained in the report will improve internal controls and result in efficiencies and cost savings. The extent of future cost savings is not determinable at this time.

Recommendations:

It is recommended that:

(1)   City Council direct that this report be forwarded to the City's Agencies, Boards and Commissions in order to ensure that issues raised in this report are addressed by them, where appropriate. The City's Agencies, Boards and Commissions be required to report back to the Audit Committee at its meeting of July 11, 2005, in connection with the results of their review;

(2)   the Chief Administrative Officer establish Corporate standards and policies in relation to internal administrative controls for the processing of payroll information by Departments. Such controls include the requirement that:

      -      documentation supporting the initial recording of payroll information (such as time sheets) is reviewed and approved in writing by supervisory staff;

- payroll data input is reviewed and approved in writing or on-line by supervisory staff;

- payroll expenditures for all pay periods are reviewed, compared and approved in writing by supervisory staff;

- unusual payroll amounts are investigated, reviewed in detail and approved in writing by supervisory staff; and

- the Chief Administrative Officer be required to report to the Audit Committee at its meeting of July 11, 2005, on the action taken in regard to the above.

(3)   the Chief Financial Officer and Treasurer review those specific on-line system controls currently available through SAP and in addition implement those on-line system controls identified during the course of this review. Such implementation be completed by July 11, 2005, and reported to the Audit Committee at that time;

(4)   The Chief Administrative Officer require that departmental staff, independent of the payroll input process, review and verify the accuracy and completeness of payroll transactions.

(5)   the Chief Financial Officer and Treasurer review controls over SAP employee master file data to ensure that employee payroll information is accurate and in agreement with authorized payroll forms. All relevant payroll information such as authorized payroll forms should be properly maintained in employee personnel files;

(6)   the Chief Financial Officer and Treasurer review the extent and usefulness of payroll reports currently available. Those reports which serve no purpose and consequently are not being used should be discontinued. The Chief Financial Officer and Treasurer be required to advise all Departments of payroll reports available through the financial information system;

(7)   the Chief Financial Officer and Treasurer, in consultation with the Commissioners, review the accuracy of vacation, lieu time and sick leave bank balance information in the SAP Human Resources/Payroll system. Appropriate action should be taken to correct SAP bank balances as required and discontinue the use of manual records;

(8)   the Chief Financial Officer and Treasurer review the controls in the SAP Human Resources/Payroll system in regard to employee alternate rate assignments;

(9)   the Chief Administrative Officer direct that all City Commissioners review the use of temporary alternate rate assignments within their own operations to ensure compliance with Corporate policy. All long-term acting assignments should be recorded on the SAP Human Resources/Payroll system as continuous alternate rates with a one-year expiry date and monitored by Finance Department payroll staff;

(10) the Chief Financial Officer and Treasurer, investigate the reasons for all payroll overpayments and report to the Audit Committee at its meeting of July 11, 2005, on the results of this investigation and steps taken to prevent and/or minimize overpayments in the future;

(11) the Chief Financial Officer and Treasurer finalize the overpayment recovery process as soon as possible and report to the Audit Committee by July 11, 2005, on the results of action taken to recover payroll overpayments;

(12) the Commissioner of Economic Development, Culture and Tourism, in consultation with the Chief Financial Officer and Treasurer, review controls over payroll processing in the Parks and Recreation Division related to part-time recreation employees and make the necessary internal control and system improvements to reduce the risk of payroll overpayments and the number of manual cheques;

(13) the Chief Administrative Officer, review the possibility of implementing control self-assessment in all City departments. The objective of such an assessment is to ensure that the appropriate level of control exists, such controls are constantly monitored and evaluated and there is compliance with such controls;

(14) the Chief Financial Officer and Treasurer and the Commissioners review and assess the training needs of users of the SAP Human Resources/Payroll system and ensure additional training is provided. Such training should include information on payroll and human resource policies and collective agreements;

(15) the Commissioner, Economic Development, Culture and Tourism in consultation with the Commissioner of Corporate Services review the appropriateness of proceeding with the electronic time sheet (Pay.Net) pilot project at the same time as the Time Entry SAP system is being developed. Any development of a non-SAP system considers the costs and benefits of integrating such a system with SAP. The Commissioner, Economic Development, Culture and Tourism report to the Audit Committee at its meeting of July 11, 2005, on the steps taken to implement this recommendation;

(16) the Chief Financial Officer and Treasurer ensure that all reconciling items on payroll bank reconciliations are investigated and cleared on a timely basis;

(17) the Chief Administrative Officer direct that access to confidential personnel and employee payroll information be restricted to those employees who require access to perform their specific job functions. Employees should not be provided complete access to sensitive and confidential data unless specific written approval is obtained from management; and

(18) the Chief Financial Officer and Treasurer ensure that there is a process in place to determine that all employees currently in possession of temporary social insurance numbers are, after the required time frame, in possession of valid permanent social insurance numbers. Such a process ensure that individuals with temporary insurance numbers are eligible to work in Canada.

Background:

The Auditor General's 2004 Work Plan included a review of payroll processing and the management of employee benefits. This review was selected because salary and benefit costs represent the most significant expenditure in the City, amounting to $2.4 billion as of December 31, 2003, or 45 per cent of total City expenditures. These amounts exclude salary expenditures relating to the Toronto Police Service and other Agencies, Boards and Commissions. In total, City departments, excluding the Toronto Police Service and other Agencies, Boards and Commissions, have approximately 36,000 employees (including part-time, casual and temporary worker). In addition, benefit payments are made to 10,500 retirees.

The review was also selected because of a number of calls received on the City's Fraud and Waste Hotline, which related to payroll issues.

In order to ensure the timely reporting of issues identified during our audit, our review was divided into two phases. Phase One of our review relates to controls over payroll processing. Phase Two will address the management of employee benefits and will be completed in the first quarter of 2005.

In January 1999, the City was operating seven different financial information and human resource/payroll systems. By February 2001, the City had consolidated the individual systems through the implementation of SAP Canada Inc.'s (SAP) Financial Information System and Human Resources/Payroll system. The original implementation of SAP excluded the Time Entry System of the former Municipality of Metropolitan Toronto and City of Scarborough, mainly due to the risks involved in implementing this application in the short time frame available to meet Y2K deadlines. Consequently, the Time Entry System is currently being used to enter staff time for former Metro and Scarborough employees. The conversion of the Time Entry System to SAP, as well as system enhancements has begun with expected completion by 2006.

The Finance Department, Pension, Payroll and Employee Benefits Division has overall responsibility for payroll processing, as well as the administration of various City employee pension plans and benefit packages. Staff in City departments input payroll data for their employees into both SAP and the Time Entry System. The Corporate Services Department provides staffing, collective bargaining and other personnel functions through its Human Resources Division. Information technology support, including enhancements, upgrades and refinements to the SAP system are provided through the Information and Technology Division of the Corporate Services Department.

Since amalgamation, the Auditor General's Office has undertaken several payroll reviews that identified issues related to payroll input errors, controls over terminated employees and Workplace Safety and Insurance Board claims. Recommendations pertaining to the reviews and the status of the implementation of the recommendations are provided in Appendix A: Auditor General's Office – Audit Recommendation Status Report.

Objectives and Scope

Our review covered the period from January 1, 2003 to June 30, 2004. The conversion from the Time Entry System to SAP currently underway was not within the scope of this review.

The overall objective of this review was to determine whether proper controls are in place to ensure:

- salary payments are properly calculated, authorized and recorded;

- payroll cheques are not issued for fictitious or terminated employees;

- employees are only paid for hours worked; and

- changes to employee master files relating to new hires, terminations and long-term absences were accurate, complete and properly authorized.

In addition, we reviewed the status of recommendations made in previous payroll audit reports issued by the Auditor General's Office. We also reviewed employee payroll and benefit complaints received through the City's Fraud and Waste Hotline.

We reviewed payroll input and output controls at several locations in City departments including:

- Works and Emergency Services;
- Economic Development, Culture and Tourism; and
- Community and Neighbourhood Services.

In order to effectively coordinate audit activities, we consulted with the City's external auditor regarding payroll work conducted by them in 2003 and 2004. We also reviewed the Internal Audit Division's 2004 report entitled "Review of Employee Overtime".

Our work included:

- reviewing policies, procedures and Council and Committee reports;
- the analysis and extraction of data using computer assisted audit software;
- conducting interviews with appropriate payroll and departmental staff; and
- examining documents and records and analysing data as necessary.

Summary of Significant Audit Observations

Our overall conclusion is that controls over payroll processing require improvement. The following is a summary of the major issues identified during our review. Details supporting these observations, along with our recommendations, are provided in the body of the report.

- There are no procedures in place to evaluate or monitor the adequacy of internal controls over payroll processing in City departments. Payroll control procedures are not always documented and vary significantly among departments. Standard corporate policies and procedures are needed to ensure controls are in place and payroll records processed are accurate, timely, consistent, complete and properly authorized.

- Controls relating to payroll data entry to the SAP Human Resources/Payroll system require improvement. Reports providing payroll data entered by timekeepers are not available to detect data entry errors. A number of departments do not have adequate controls in place to ensure payroll transactions are accurate and complete. For example, in some departments employees independent of the data entry process do not verify payroll input.

- Our review of master file controls identified concerns with the accuracy of certain data. In addition, we were unable to locate certain employee payroll documents and authorized payroll forms in certain employee personnel files.

- Reasonableness reviews of payroll reports by departmental managers and supervisors are not being performed. Few departments distribute or use the many payroll reports available.

- Departments rely on manual processes to detect errors and monitor compliance with payroll policies and collective agreements. These activities are an inefficient use of staff time and are not effective in detecting invalid, inaccurate and incomplete information.

- The SAP Human Resources/Payroll system automatically tracks continuous or long term employee alternate rate assignments. However, there are no built-in SAP controls to specifically track and control employee temporary alternate rate assignments.

- Receivables resulting from payroll overpayments to employees amount to approximately $630,000 as of August 31, 2004. Investigation into the causes of overpayments is required to prevent future occurrences.

- Certain departmental management staff lack a clear understanding of the required controls to ensure the accuracy and completeness of payroll records.

- Current training for payroll users has focused on SAP use. Payroll training should be enhanced to include information relating to policies and collective agreements.

- The level of access to payroll information provided to certain employees is not necessary. This access should be discontinued.

- Evidence is not always on file that certain employees have a valid social insurance number and work permit (if required) to work in Canada.

- Eleven out of seventeen recommendations made in previous payroll audit reports have been implemented. Six have been partially implemented or are in progress. Those recommendations in progress should be addressed as soon as possible.

Comments:

Although certain monitoring and control procedures in relation to payroll processing have been implemented, our review indicated that certain system and departmental controls still require improvement. The major issues identified in the report relate to the following:

- The Need to Establish a Corporate Control Standard
- Reliability of Data
- Controls Required to Prevent Payroll Input Errors
- Salary Overpayments
- Control Self-Assessment
- Training
- Other Payroll Related Issues and Previous Audits

The recommendations contained in this report may apply to the City's Agencies, Boards and Commissions and, as such, this report be forwarded to them for their review, and consideration. The results of this review should be reported back to Audit Committee.

Recommendation:

1.   City Council direct that this report be forwarded to the City's Agencies, Boards and Commissions in order to ensure that issues raised in this report are addressed by them, where appropriate. The City's Agencies, Boards and Commissions be required to report back to the Audit Committee at its meeting of July 11, 2005, in connection with the results of their review.

The Need to Establish a Corporate Control Standard

Role of the City Finance Department in Departmental Operations

The Pension, Payroll and Employee Benefits Division in the Finance Department has the overall responsibility for timely and accurate payroll processing and administration of the SAP Human Resources/Payroll system. The Finance Department provides guidance to other Departments on payroll matters through training and the issue of payroll directives. Finance Department staff also make changes to employee master files, as well as perform certain monitoring activities to detect errors prior to the issue of payroll cheques. However, Finance Department staff does not receive departmental time sheets and cannot verify the accuracy or reasonableness of payroll input. Consequently, the Finance Department is not responsible for, nor are they aware of, payroll control procedures in other City departments.

Payroll Control Procedures in Operating Departments

The implementation of the SAP Human Resources/Payroll system focused "on base or critical functionality only" and did not consider departmental business processes. In addition, no Corporate standard has been established or implemented with regard to controls that should exist in operating departments. The responsibility for establishing proper control procedures and ensuring that payroll data is processed properly rests with departmental management.

Certain departments have not documented payroll control procedures describing the roles and responsibilities of payroll staff within their department.

We also observed inconsistencies in the role of departmental timekeepers. Some timekeepers perform data entry only and do not question the accuracy or reasonableness of authorized time sheets. In other areas, timekeepers actively question the reasonableness of data being entered and have prevented and detected errors.

Recommendation:

2.   The Chief Administrative Officer establish Corporate standards and policies in relation to internal administrative controls for the processing of payroll information by Departments. Such controls include the requirement that:

-       documentation supporting the initial recording of payroll information (such as time sheets) is reviewed and approved in writing by supervisory staff;

-       payroll data input is reviewed and approved in writing or on-line by supervisory staff;

-       payroll expenditures for all pay periods are reviewed, compared and approved in writing by supervisory staff;

-       unusual payroll amounts are investigated, reviewed in detail and approved in writing by supervisory staff; and

-       the Chief Administrative Officer be required to report to the Audit Committee at its meeting of July 11, 2005, on the action taken in regard to the above.

Reliability of Data

Certain key controls over payroll processing were not in place to ensure payroll transactions are accurate, complete and properly authorized. These key controls should be built into the SAP Human Resources/Payroll system, and include input and output controls administered by departments. These controls include:

-       effective on-line system controls;

-       review and verification of time entry;

- effective edit and exception reports; and

- a clear understanding by all management staff, departmental staff, and Finance payroll staff of their respective roles and responsibilities pertaining to payroll costs.

Controls Required to Prevent Payroll Input Errors

On-line System Controls

An effective way to prevent errors during payroll input is through on-line system controls or edits. On-line system controls are built into the computer software design to ensure payroll data is entered accurately and completely. For example, on-line system controls prevent timekeepers from entering erroneous payroll data by:

- requiring data in prescribed formats and fields;
- screening data through reasonability and limit checks;
- cross referencing to other data; and
- comparing to independent calculated amounts.

The SAP Human Resources/Payroll system has certain on-line system controls that prevent errors during payroll processing. For example, timekeepers cannot input employee pay rates or enter an absence on a day that the employee is not scheduled to work. However, our audit identified additional on-line system controls needed to prevent payroll input errors. These additional on-line system controls have been discussed with management and include, for example:

- the need to prevent the inputting of hours for employees who are on a long-term absence;

- the need to prevent the input of meal allowances when overtime is not worked; and

- the need to ensure that overtime is not paid to managers who are only entitled to lieu time.

Recommendation:

3. The Chief Financial Officer and Treasurer review those specific on-line system controls currently available through SAP and in addition implement those on-line system controls identified during the course of this review. Such implementation be completed by July 11, 2005, and reported to the Audit Committee at that time.

Review and Verification of Time Entry

In general, timekeepers enter employee payroll data based on authorized time sheets. Currently, data entered into the payroll system is not verified by an independent reviewer. In order to ensure the accuracy and completeness of payroll data entered, an employee independent of the payroll input process should verify and review the reasonableness of payroll transactions entered.

We found that independent review and verification of time entry is not performed in many departments. Consequently, there is a risk that payroll errors would not be detected.

The SAP Human Resources/Payroll system does not have the on-line approval capability included in the Time Entry System. The Time Entry System requires that prior to payroll processing, departmental supervisors approve payroll input on-line after verifying the accuracy and completeness of payroll data entered by timekeepers. We also found that the on-line approval capability included in the Time Entry System is not consistently applied. After each pay period, a report is produced listing the individuals failing to approve payroll. Our review of three pay periods noted that approximately 10 per cent were not approved.

Recommendation:

4.   The Chief Administrative Officer require that departmental staff, independent of the payroll input process, review and verify the accuracy and completeness of payroll transactions.

Employee Master File Controls

As part of our review, we reviewed whether changes to the employee master file such as new hires, terminations and long-term absences were accurate and complete. Our review did not identify any monetary errors or overpayments. However, certain SAP master file data did not agree with authorized payroll forms. In addition, we were unable to verify the accuracy of certain employee master file information in SAP because authorized payroll forms were not filed in the employee personnel files.

We did not identify any specific instances of incorrect payments made to terminated employees. We found that terminated employees were removed from the payroll master files on a timely basis and that separation payments were properly authorized and calculated correctly. However, based on our review of payroll overpayments, incorrect payments have been made to terminated employees when termination notices were submitted to the Finance Department after the termination date.

Recommendation:

5.   The Chief Financial Officer and Treasurer review controls over SAP employee master file data to ensure that employee payroll information is accurate and in agreement with authorized payroll forms. All relevant payroll information such as authorized payroll forms should be properly maintained in employee personnel files. In addition the Chief Financial Officer and Treasurer, in consultation with the Commissioner of Corporate Services, review the reasons for the delay in the preparation of termination notices and ensure that such notices are forwarded to the Finance Department on a timely basis.

Edit and Exception Reports

Payroll exception reports are important management tools, which assist the detection follow up payroll errors. A significant number of payroll exception reports have been developed by the Finance Department and are electronically available to all departments.

During our review, we found that some departments rarely use the exception reports available.

Recommendation:

6. The Chief Financial Officer and Treasurer review the extent and usefulness of payroll reports currently available. Those reports which serve no purpose and consequently are not being used should be discontinued. The Chief Financial Officer and Treasurer be required to advise all departments of payroll reports available through the financial information system.

Reliance on Manual Processes

Departments continue to rely on manual processes to detect payroll errors and monitor compliance with payroll policies and collective agreements. In some instances, we noted staff continue to maintain and update manual daily attendance records and vacation, lieu time and sick leave bank balance reports which are reconciled to the SAP Human Resources/Payroll system or Leave Balance amounts.

Recommendation:

7. The Chief Financial Officer and Treasurer, in consultation with the Commissioners, review the accuracy of vacation, lieu time and sick leave bank balance information in the SAP Human Resources/Payroll system. Appropriate action should be taken to correct SAP bank balances as required and discontinue the use of manual records.

Alternate Rates

In order to meet workload demand, management may assign and pay employees at a higher-rated job classification to fill a temporary vacancy. There are two kinds of alternate rates, temporary (short-term), and continuous (long-term). The SAP Human Resources/Payroll system automatically tracks continuous alternate rates. Temporary alternate rate assignments are not tracked.

For temporary alternate rates, timekeepers input employee absences (paid leave, sick pay, paid holidays and vacation) at the employee's base or normal rate until the employee has worked continuously in the alternate rate position for 60 days. The 60 day provision is a Labour Union requirement. SAP does not track when the employee reaches 60 days. Currently, timekeepers must track dates manually to ensure correct rates are paid during employee absences.

Recommendations:

8.   The Chief Financial Officer and Treasurer review the controls in the SAP Human Resources/Payroll system in regard to employee alternate rate assignments.

9.   The Chief Administrative Officer direct that all City Commissioners review the use of temporary alternate rate assignments within their own operations to ensure compliance with Corporate policy. All long-term acting assignments should be recorded on the SAP Human Resources/Payroll system as continuous alternate rates with a one-year expiry date and monitored by Finance Department payroll staff.

Salary Overpayments

While the scope of our work was to the period ended June 30, 2004, we reviewed the salary overpayment balances at August 31, 2004. As of August 31, 2004, receivables resulting from overpayments to employees, both current and past, amounted to approximately $630,000.

In June 2004, Finance Department payroll staff analysed receivables in the SAP Financial Information and Human Resources/Payroll systems to identify employee overpayments where recovery was still possible and determined which receivables were uncollectable. Finance Department payroll staff estimate that at least $300,000 of this total is uncollectable. We have not determined the validity of this amount.

Salary overpayments are generally the result of:

-    Employees being paid salary advances pending decisions being made on Workplace Safety and Insurance Board (WSIB) eligibility.

-    Employee termination documentation not being forwarded to the Finance Department on a timely basis.

In the case of the WSIB advances, these include a combination of current and terminated employees.

We understand that steps are currently being taken to recover salary overpayments.

Recommendations:

10.   The Chief Financial Officer and Treasurer, investigate the reasons for all payroll overpayments and report to the Audit Committee at its meeting of July 11, 2005, on the results of this investigation and steps taken to prevent and/or minimize overpayments in the future.

11.   The Chief Financial Officer and Treasurer finalize the overpayment recovery process as soon as possible and report to the Audit Committee by July 11, 2005, on the results of action taken to recover payroll overpayments.

Overpayments to Part-time Recreation Employees

The Parks and Recreation Division of the Economic Development, Culture and Tourism Department employ a significant number of part-time recreation employees, who are members of a separate collective agreement.

Part-time recreation employees are "positive reporting" employees, which require timekeepers to input all hours worked, as well as the wage type and cost centre. Recreation employees may also work in a number of recreational facilities throughout the City and in any or all of the four Parks and Recreation Districts. Consequently, different timekeepers may input hours worked for the same employee.

Many payroll overpayments relate to part-time recreation employees. Payroll overpayments and adjustments can occur because recreation staff prepare time sheets based on an employee's anticipated schedule, not on actual hours worked.

The SAP Human Resources/Payroll system is used to account for and recover payroll overpayments from recreation employees. For example, if a recreation employee is overpaid in a period, the overpayment will be automatically recovered in the subsequent pay periods. An overpayment results when the recreation employee is terminated and the amount cannot be recovered in the subsequent pay periods.

In addition, we noted that timekeepers sometimes do not input payroll for recreation employees by the required deadline because time sheets are not submitted on a timely basis. Therefore, to ensure an employee is paid, Finance payroll staff issue a manual cheque, which is both costly and time consuming. In fact, we were advised that approximately 85 per cent of manual cheques relate to recreation employees.

In order to detect errors prior to payroll processing, Finance Department payroll staff review variance reports reflecting standard hours and wages. Part-time recreation employees do not work standard hours, thus making this review process ineffective in detecting payroll errors.

Recommendation:

12.   The Commissioner of Economic Development, Culture and Tourism, in consultation with the Chief Financial Officer and Treasurer, review controls over payroll processing in the Parks and Recreation Division related to part-time recreation employees and make the necessary internal control and system improvements to reduce the risk of payroll overpayments and minimize the number of manual cheques issued.

Control Self-Assessment

Management is responsible for establishing and maintaining internal controls. Effective internal controls require that management identify the key controls that are needed to manage significant risks. Management also needs to monitor how well internal controls are functioning throughout their operations. Currently, there is no process in place to evaluate or monitor internal controls over payroll processing in City departments.

Control self-assessment is a generally accepted business practice that managers in many organizations have adopted to assess and improve internal controls. Control self-assessment is a methodology used to review key business objectives, risks involved in achieving objectives, and internal controls designed to manage those risks.

Control self-assessment requires active participation by departmental managers in assessing internal controls within their operations. Most organizations use a specialist to administer the control self-assessment process, coordinate with management and guide the process. As part of the process, departmental managers also develop action plans addressing control weaknesses identified.

Recommendation:

13.   The Chief Administrative Officer, review the possibility of implementing control self-assessment in all City departments. The objective of such an assessment is to ensure that the appropriate level of control exists, such controls are constantly monitored and evaluated and there is compliance with such controls.

Training

Payroll training should be improved to ensure that staff has a better understanding of policies and collective agreements. Current training for payroll users has focused on SAP use. Operating departmental managers and timekeepers do not always understand the terms of the collective agreements, payroll policies and payroll forms. In many instances, payroll information is not submitted timely and correct. Request for assistance and information are made on issues where managers and timekeepers should be knowledgeable. Although this information is available electronically, it is not part of payroll training.

Recommendation:

14.   The Chief Financial Officer and Treasurer and the Commissioners review and assess the training needs of users of the SAP Human Resources/Payroll system and ensure additional training is provided. Such training should include information on payroll and human resource policies and collective agreements.

Other Payroll Related Issues and Previous Audits

Integration with Other Business Systems

The Parks and Recreation Division of the Economic Development, Culture and Tourism Department, is currently piloting the use of an electronic time sheet (Pay.Net) to record time for all part-time recreation employees. The expected implementation date for this application is December 2004. This process is being done at the same time as a time entry SAP system is being implemented.

Parks and Recreation staff indicated that no work is currently planned to create an electronic interface with the SAP Human Resources/Payroll system. The lack of an electronic interface requires data input into both systems, resulting in duplication of effort and greater risk of error.

Recommendation:

15.   The Commissioner, Economic Development, Culture and Tourism in consultation with the Commissioner of Corporate Services review the appropriateness of proceeding with the electronic time sheet (Pay.Net) pilot project at the same time as the Time Entry SAP system is being developed. Any development of a non-SAP system consider the costs and benefits of integrating such a system with SAP. The Commissioner, Economic Development, Culture and Tourism report to the Audit Committee at its meeting of July 11, 2005, on the steps taken to address this recommendation.

Previous Payroll Audit Reports

As part of our audit, we reviewed the status of recommendations resulting from previous payroll audits by the Auditor General's Office. These audit reports were:

- Payroll Review (July 1999)
- Payroll Cheque Cashed Twice (May 2001)
- Review of Payroll and Benefits Year-end Processes (September 2001)
- Employee Separation Program Payment Review (November 2003)

The results of our current review indicate that progress has been made in implementing outstanding audit recommendations. Of the 17 outstanding recommendations, 11 are fully implemented, and 6 recommendations are partially implemented or in progress. The implementation status of recommendations made in previous reports and management responses is included in Appendix A: Auditor General's Office – Audit Recommendation Status Report.

The recommendation relating to payroll bank reconciliations from our July 8, 1999 report entitled "Payroll Review" is not fully implemented. The August 2004 payroll bank reconciliation includes reconciling items from 1999 to 2002.

Recommendation:

16.   The Chief Financial Officer and Treasurer ensure that all reconciling items on payroll bank reconciliations are investigated and cleared on a timely basis.

Access to Employee Personal Information

Controls are built into the SAP Human Resources/Payroll system to restrict timekeeper access to certain confidential employee payroll information. In two departments, Economic Development, Culture and Tourism and Works and Emergency Services, timekeepers have access to the payroll information for all employees in their department. This access is not required to perform their specific job duties.

Recommendation:

17. The Chief Administrative Officer direct that access to confidential personnel and employee payroll information be restricted to those employees who require access to perform their specific job functions. Employees should not be provided complete access to sensitive and confidential data unless specific written approval is obtained from management.

Social Insurance Numbers and Valid Work Permits

The Government of Canada has recently amended the social insurance number proof-of-identity requirements. Social insurance numbers beginning with "9" are issued to "individuals who are neither Canadian citizens nor permanent residents". Effective 2004, all social insurance numbers beginning with "9" must include an expiry date. According to the Immigration and Refugee Protection Act, employers are also required to ensure such employees have a valid work permit to work in Canada.

Currently, a process exists to identify such employees at the time of hire. In addition, payroll staff in the Finance Department also record the employee's assignment end date to coincide with the social insurance number/work permit expiry date.

We identified approximately 200 City employees assigned social insurance numbers beginning with "9". To ensure that the City is in compliance with federal legislation, Finance Department payroll staff should determine whether these employees have a valid social insurance number and valid permit to work in Canada.

Recommendation:

18. The Chief Financial Officer and Treasurer ensure that there is a process in place to determine that all employees currently in possession of temporary social insurance numbers are, after the required time frame, in possession of valid permanent social insurance numbers. Such a process ensure that individuals with temporary insurance numbers are eligible to work in Canada.

Conclusions:

The objective of this review was to assess the effectiveness of internal controls in processing payroll for City employees. Although certain monitoring and control procedures have been implemented, our review indicated that certain system and departmental controls still require improvement. Recommendations for improving internal controls over payroll included in this report will enable all City departments and managers to better manage and control payroll costs.

Contact:

Alan Ash, Director	Carolyn Baird, Senior Audit Manager
Auditor General's Office	Auditor General's Office
Tel: (416) 392-8476, Fax: (416) 392-3754	Tel: (416) 392-8463, Fax: (416) 392-3754
Email: AAsh@toronto.ca	Email: CBaird@toronto.ca

Jeffrey Griffiths
Auditor General

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List of Attachments:

Appendix A: Auditor General's Office – Audit Recommendation Status Report

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APPENDIX A

Auditor General's Office
Audit Recommendation Status Report
Payroll
as at June 30, 2004

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
1	Payroll Review – July 1999 All payroll bank reconciliations be brought up to date and from hereon be completed in a timely manner, that all reconciling items be promptly investigated and cleared, and that reconciliations be reviewed and approved by supervisory staff.	All bank reconciliations are prepared within Accounting Services' Funds Management unit, within 15 – 45 days after the period end. The completed reconciliations are reviewed by an AR & Funds Mgt Accounting Analyst and approved by the Supervisor. All reconciling items must be cleared with six (6) months. However, staff are expected to address and clear reconciling items within 30 days.	Requires improvement. Reconciling items are not investigated and cleared on a timely basis.
2	The upcoming conversions to the new SAP payroll system be adequately planned and properly managed, that all required testing be performed and documented, and that the necessary signoffs and approvals be obtained before implementation.	During 1998, the number of payroll systems in operation was reduced from seven to four. This was done mainly to retain financial control as management staff were exiting from the Corporation. In some of these payroll system conversions, technical resources were limited, therefore some of the conversion was handled manually. The implementation of the SAP HR/Payroll system was properly planned and managed. All required testing was performed and properly documented and necessary sign-offs and approvals obtained prior to implementation.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
3	Payroll Review – July 1999 Payroll management staff review the current procedures for employees on salary continuance and utilize electronic and other controls available, to further ensure employees are not paid beyond their termination date.	The end date of a salary continuation is entered in the Monitoring of Tasks infotype and a report is generated at the beginning of each month and distributed to the payroll clerks. In addition to this, each Sr. Payroll Clerk maintains a schedule listing the end dates of all employees on salary continuation to ensure payment is stopped and all other payments due the terminating employee is paid out.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
1	<u>Payroll Cheque Cashed Twice – May 2001</u> The Director, Pension, Payroll & Employee Benefits consider the need to review with appropriate Royal Bank officials the suitability of supplied blank cheque stock to appropriately display background void lettering that indicates it is a photocopy.	Security features currently used on City of Toronto cheque stock supplied by the Royal Bank Include: - Embedded chainlink watermark; - Visible red/blue fibers in the paper to confirm authenticity; - Non-visible fibers that can be identified using black light; - Paper that will react upon contact with most solvents, oxidants, and alkalis; and - Void screen pantograph to discourage photocopying/scanning. In 2003, the Royal Bank produced 7,907 Cheques and 795,957 Direct Deposit Stubs.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
2	Supervisory staff responsible for employee payroll review and adjustments be instructed not to accept or take photocopies of the payroll remittance advice without first ensuring the cheque portion is not attached and to exercise caution to ensure that they do not retain an employee's original cheque.	This was directed to departments so we are unable to comment.	Implemented Directive sent to departments.

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
3	Consideration be given to the implementation of a formal "request for adjustment document" signed by the employee to ensure that such requests are not overlooked for an extended period of time as was the case in this incident.	Replacement cheques are not issued until payroll staff receive a confirmation from the bank that the original cheque has not been cashed and a "stop payment" issued.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
1	<u>Review of Payroll and Benefits Year-end Processes – September 2001</u> The T4 reconciliation procedures include routine checks of both the amounts and number of records at each stage of the process to ensure the accuracy of any updates in the system.	Routine checks have been implemented at various stages of the process. Some of this checking occurs during the year end process, in addition routine checks are in place throughout the year, i.e.,: - cumulative tracking of taxable gross figures after each pay run; - a new weekly audit report - implemented November 2000; - reconcile T4s semi-annually In addition, a change has been made to the T4 program to ensure Box 14 – Taxable Income is not blank. Routine checks are in place and continue to be maintained.	Implemented
2	Staff complete the checklist designed to document the payroll processing and reconciliation procedures in order to ensure the timely and accurate processing of payroll and related transactions.	A checklist recording the FICO and Third Party posting to the GL was implemented during the early stages of the audit capturing the date, time and person responsible for the processing. The Supervisor is ensuring the checklist is being completed on a timely basis. Checklist continues to be maintained on a timely basis.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
3	<u>Review of Payroll and Benefits Year-end Processes – September 2001</u> Priority be given to reconciling the WSIB advances accounts to the general ledger, investigating and resolving any differences, and taking appropriate action to recover the outstanding amounts.	The WSIB Advance and Recoveries report is produced bi-weekly after each payrun and is reviewed by the payroll clerks. This report captures all advances, top-up and 102's entered and shows outstanding balance. Accuracy of information is checked against IDSM and Payroll's claim status working sheet. Where a WSIB claim is denied, an overpayment recovery process is in place. Note: WSIB advances are charged to department account.	Requires improvement in the recovery of WSIB overpayments.

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
4	Appropriate staff of Pension, Payroll & Employee Benefits and Accounting Services Divisions of Finance Department and Human Resources of Corporate Services Department and other operating departments review the current processing of WSIB claims with a view to establishing written procedures and guidelines, and assigning clear responsibility for each stage of the process including the recording of transactions, reconciliation and monitoring of related general accounts and the recovery of outstanding amounts.	We now have a document listing the agreed upon WSIB process between HR and Payroll. It lists the responsibilities of Payroll, the HR Business units and the HR Occupational Health, Safety & Workers Compensation unit. A directive was also circulated in January 2002 listing all wage types related to WSIB for departments' reference when reporting WSIB related absences. Payroll WSIB team members have up-to-date City of Toronto WSIB Process Document which outlines all appropriate steps from the start of a claim to completion.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
5	<u>Review of Payroll and Benefits Year-end Processes – September 2001</u> Immediately after the 2000 Financial Statement preparation stage, Pension, Payroll and Employee Benefits Division consult with Accounting Services Division regarding its reporting requirements for 2001 and make the necessary modifications to the current systems, if warranted, to provide the required information.	Financial information report requirements have been added to the year end checklist to ensure reports are generated on a timely basis. As of July 2001, the carried forward vacation balances have been updated in SAP for all City staff. This information will be available for the 2001 Financial Information reports. The Financial Information requirements are included on the year end checklist and reports are provided to Accounting Services on a timely basis.	Implemented

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
	<u>Employee Separation Program Payment Review – November 2003</u>		
1	The Chief Financial Officer and Treasurer review the adequacy and effectiveness of the controls in the City's payroll systems (SAP and TES), in facilitating the identification and correction of input errors at the point of entry.	Pension, Payroll & Employee Benefits and Information & Technology staff are currently replacing TES with SAP time entry Functionality. During the TES Replacement Project, internal controls will be reviewed. On completion of the TES replacement Project, time and attendance for all City employees will be reported in a consistent manner and on a daily basis. The number of employee groups will be reduced from 55 to eight (six union and two non-union groups). As part of the project, time and attendance controls are being enhanced. For example: - Timekeeper access to wage types will be restricted by Job Grouping (i.e., executive assistant, senior systems analyst). Timekeepers will not be able to enter overtime wage types for non-union staff in accordance with city policy. - Total hours entered on a daily basis will be restricted for exception wage type entered through the time and attendance module i.e., shift premium. Error or warning messages will be displayed when individual wage types or a combination of wage types exceed 16 or 24 hours. - Activity Report. This report will provide managers, supervisors and, or timekeepers with time and attendance transactions entered for a specified period of time by employee, organization structure. After the project, maximum daily hour controls will be reviewed to determine if additional changes are necessary.	In progress

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
2	Employee Separation Program Payment Review – November 2003 The Commissioner of Corporate Services ensure that, where a separation program payment is issued, all the necessary separation documents are completed, approved and forwarded to Pension, Payroll and Employee Benefits Division on a timely basis.	Direction was sent from Executive Director, HR to all appropriate HR staff to confirm the requirements as defined in the AG report.	Implemented
3	The Chief Financial Officer and Treasurer ensure that the appropriate approvals are received from Human Resources prior to processing any separation program payment.	Final separation payments are no longer processed until proper approval is received from Human Resources certifying that the settlement adheres to program and policy requirements or authorizing any exceptions to the corporate separation program.	Implemented
4	The Commissioner of Corporate Services periodically mail out notices to employees who receive a position termination package, inquiring as to their employment status. Separation payments be recovered where appropriate.	Implementation options developed in conjunction with the requirement for notarized declarations. Report to Employee & Labour Relations Committee for September meeting.	In progress
5	On any severance agreements, there be included a notarized declaration from the former employee to be submitted each year which would validate status of employment.	Implementation options developed in conjunction with the requirement for notarized declarations. Report to Employee & Labour Relations Committee for September meeting.	In progress

#	Recommendations	Response / Comments City Finance Department	Status Audit Comments
6	**Employee Separation Program Payment Review – November 2003** The Employee and Labour Relations Sub-Committee: (a) review the policies regarding severance packages and continuation pay to determine whether these policies are current, particularly with respect to continuation pay and a clawback provision regarding placement in a comparable job, so that the employee is not receiving salary in excess of City remuneration; and (b) develop a process which would ensure that all members of Council can be informed of the activities of the sub-committee.	Implementation options developed in conjunction with the requirement for notarized declarations. Report to Employee & Labour Relations Committee for September meeting.	In progress Requires improvement regarding definition of comparable employment.