



METRO

PAYROLL & BENEFIT CONTROLS AUDIT (21-07)

Terry Follmer, VP of Internal Audit

Distribution List:

Capital Metro Board of Directors

Randy Clarke, President and CEO

Kerri Butcher, EVP, Chief of Staff

Donna Simmons, EVP of Administration, Diversity and Inclusion Officer

Dottie Watkins, Chief Customer Officer, Chief Operating Officer

Sharmila Mukherjee, EVP, Planning and Development

Gardner Tabon, EVP, Chief Safety Officer

Brian Carter, EVP, Chief Experience and Engagement Officer

Catherine Walker, EVP, Chief Financial & Risk Officer

Ken Cartwright, VP, Facilities Management and Capital Construction

David Dech, VP, Rail Operations

Jane Schroter, VP, Chief Information Officer

Tangee Mobley, VP, Bus Operations & Maintenance

Chad Ballentine, VP, Demand Response and Innovative Mobility

Jeff Hiott, VP, Imagination, Research and Industry Benchmarking

Muhammad Abdullah, Senior Director/Chief of Procurement & Compliance Officer

Kevin Conlan, Deputy CFO, Finance

Susan Renshaw, Controller, Finance

Terry Thomas, Senior Director of People & Culture

Sherine Spence, Director of People & Culture

Alyce May, Manager of Payroll & Accounts Payable

Table of Contents

Executive Summary	1
Results.....	4
1. Automate & Strengthen Controls Over Personnel Changes.....	4
2. Improve Accuracy of Benefit Calculations.....	5
3. P&C Policies – Compliance & Approved Exceptions.....	6
4. Increase Oversight of Annual Merit Increases.....	7
5. Time and Attendance Reporting & Approvals.....	8
Appendix.....	9
A. Example of Personnel Change Notice (PCN) Form	9

EXECUTIVE SUMMARY

As part of our Fiscal Year 2021 Internal Audit Plan approved by the Capital Metro Board, we performed an audit of the payroll and benefit process to determine whether CMTA has sufficient internal controls to prevent and detect errors and/or irregularities. The scope included a review of internal controls and testing of payroll expenditure data for a selected time period in calendar year 2019 and 2020. The audit results including the objective, scope, and conclusion are as follows.

Background

The Finance Department's payroll section is charged with administering and overseeing payroll and consists of 2 employees (Manager and Coordinator of Payroll & Accounts Payable). Payroll operates on a biweekly pay schedule (26 pay periods per year) and each pay period's pay is paid the Friday after the ending of the two-week period. Outside of contracted labor, CapMetro employee labor and benefits is the largest operating expense. In Fiscal Year 2020, the operating budget included \$49.2 million for CapMetro labor and benefits and represented 17% of the total operating budget. CapMetro employs a mix of hourly, salaried, and part-time Austin Police Department (APD) officers (through a separate contract). Each CapMetro position is classified as either Exempt or Nonexempt and CapMetro follows the U.S. Department of Labor's Fair Labor Standards Act (FLSA) laws for Nonexempt employees concerning minimum wage and overtime. In Calendar Year 2019, CapMetro employed 276 (51%) salaried/FLSA Exempt employees and 266 (49%) hourly/FLSA Nonexempt employees, which included 109 APD officers. CapMetro's contracted labor (e.g. Bus drivers, dispatchers, maintenance, etc.) are paid separately by third-party service providers (i.e. MV Transportation, Herzog, MTM Transit) and were not included in this audit.

CapMetro uses a cloud-based human resources system, called UltiPro, to collect and manage human resources, payroll, talent, and time and attendance information for employees. It was purchased in 2007 and helped automate the payroll process. For example, exempt (i.e. salary) employees log into the Employee Self Service (ESS) portion of UltiPro, enter their time and attendance for the pay period, and then electronically submit to their supervisor for review and approval. Nonexempt (i.e. hourly) employees use UltiPro web clock to electronically punch in and out and the punches round up or down to the nearest 15-minute increment. Once all time has been entered for the bi-weekly pay period, the payroll group performs a series of quality checks and then the data is uploaded to AX, the banking systems for accounting, and direct deposit to employee's bank accounts.

The People and Culture (P&C) Department is the Administrator of the UltiPro system and is responsible for employee compensation and benefits. This includes ensuring all personnel changes (e.g. pay rates, new hires, promotions, terminations, reclassifications, etc.) and benefit information (e.g. long-term disability, health insurance, dental, 401(k) retirement plans, etc.) is updated in the UltiPro system. When an employee's job changes or ends, the P&C staff fill out a Personnel Change Notice (PCN) form (see Appendix A) with the new information (e.g. position

title, salary/payrate, effective date, etc.) The employee, supervisor, and P&C employee must all sign and date at the bottom of the form to evidence review and approval of the PCN. Next, P&C staff manually enter the changes into UltiPro and email the PCN form to Payroll so they can double-check the information in UltiPro and ensure the payroll change was approved as evidenced by the signatures on the PCN form. As an additional control, the P&C Department perform a weekly audit of PCN forms to ensure they are all correctly and completely updated in UltiPro. P&C's role is very important because the payroll section depends on the accuracy and completeness of P&C staff's data entry into UltiPro to help ensure employees are paid correctly each pay period.

Audit Objective & Scope

The primary objective of this audit was to determine whether internal controls over payroll were sufficient to prevent and detect errors and/or irregularities. The audit scope included a review of internal controls and testing of payroll expenditure data for a selected time period in calendar year 2019 and 2020.

Opinion

Overall, we determined that internal controls are generally in place and properly functioning, however, we found opportunities to enhance the payroll and benefit process by improving oversight/monitoring and strengthening internal controls. We made the following recommendations (see finding table below for full listing):

- Automate and strengthen controls over personnel changes.
- Improve accuracy of benefit calculations.
- Review and revise policies related to payroll and benefits to ensure they include deadlines, approval process for exceptions, and are owned by the department that oversees that process.
- Increase oversight of annual merit raises.
- Ensure time and attendance reports are submitted and approved.

The detailed audit report that follows provides more context and understanding on the audit opinion and recommendations above.

This audit was conducted in accordance with US Government Accountability Office's Generally Accepted Government Auditing Standards (GAGAS) and the Institute of Internal Auditor's International Standards for the Professional Practice of Internal Auditing. These 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was conducted by the following staff members in the Capital Metro Internal Audit Department:

- Sarah Daigle, Internal Auditor II (Project Lead)
- Terry Follmer, VP of Internal Audit

Recommendations to strengthen controls and improve accountability were provided to management. Management agrees with the internal audit recommendations and has provided target completion dates which are included in the detailed audit report below. A follow-up audit is performed semi-annually (i.e. May and November) to ensure management action plans for all issued audit reports are completed timely.

We appreciate the cooperation and assistance provided to us throughout this audit

<i>Issues & Risk</i>	<i>Recommendation</i>	<i>Management Action Plan</i>
<p><u>1. AUTOMATE & STRENGTHEN CONTROLS OVER PERSONNEL CHANGES</u></p> <p>The Personnel Change Notice (PCN) or HR16 form (see Appendix A) is a manual form with no automated workflow and is used to document and approve all personnel changes (e.g. pay rate, new hires, promotion, merit increase, termination¹, pay reduction, etc.). Policy HRC-200 (Compensation Plan & Administration) requires that compensation changes be documented and approved by the employee, supervisor and P&C Department using the PCN form. Once a PCN form is properly completed, the P&C Department enters in the approved changes into the UltiPro system.</p> <p>Because the PCN form and related workflow is manual, it is subject to human error and incomplete records and, as a result, there was \$22,351 in retro pay corrections to 26% (165 out of 625) of employees at some point during calendar years 2019 and 2020. In some instances, this was caused by supervisors not submitting required paperwork to P&C in a timely manner. During our review, we determined the PCN form process was vulnerable to the following risks:</p> <ul style="list-style-type: none"> • PCN form not being completed timely. • PCN form containing errors (e.g. pay rate, effective date, employment status, etc.) or data input errors when entering changes from the PCN form into UltiPro. • PCN form missing one of the required signatures. 	<p>The Controller and Senior Director of People & Culture should consider implementing the following improvements:</p> <ol style="list-style-type: none"> a) Look at automating the PCN form and related workflow into the new ERP system. If this is not possible, look at automating the workflow using workflow features in Outlook and SharePoint and/or within the UltiPro system. The workflow should be a closed loop with the parties receiving notice that the change has been made in UltiPro. b) The P&C Department should develop written procedures and tools to help guide P&C staff on their day-to-day tasks. The guide should cover various personnel changes (e.g. pay rate, terminations, promotions, new hires, etc.), payroll deadlines and holidays, and year end processing procedures including annual merit process. c) The Controller and Payroll Manager should track root causes for payroll errors and schedule quarterly meetings with P&C Department to review trends and opportunities to reduce rework. 	<p>Management agrees with the recommendations.</p> <p><u>Target Completion Date:</u></p> <ol style="list-style-type: none"> 1a) January 31, 2023 1b) December 31, 2021 1c) October 15, 2021

¹ Timely terminations are especially important because the Texas Labor Code § 61.014(a) legally requires an employer to pay a terminated employee within six days of the termination.

<i>Issues & Risk</i>	<i>Recommendation</i>	<i>Management Action Plan</i>
<p>2. IMPROVE ACCURACY OF BENEFIT CALCULATIONS Employee benefits (e.g. medical, dental, long-term disability, life insurance, 401(k) retirement plan, etc.) are managed by the P&C Department. We reviewed the internal controls related to benefit calculations and noted the following weaknesses:</p> <ul style="list-style-type: none"> • P&C Department has not developed written procedures for internal benefit calculations, including who within and outside of P&C must approve them. • Manual benefit calculations are not required to be approved by Finance Department or another independent consultant to validate accuracy. <p>We believe the weaknesses noted above together with UltiPro system limitations and a small timeframe for staff to complete the changes contributed to the following benefit errors during 2019:</p> <ul style="list-style-type: none"> • Error in manual entry of premium rates for long-term disability buy up insurance. • Error in manual entry of voluntary employee Group Term Life (GTL) insurance. • Duplicate life insurance premiums deducted from employee paychecks due to incorrect end date being entered into UltiPro. • Incorrect catch-up deducted from employee paychecks for 401(k), 401(k) Roth, and 457 retirement plans when the deductions should have been stopped. 	<p>The Controller and Senior Director of People & Culture should consider the following improvements:</p> <ol style="list-style-type: none"> a) Create an internal P&C Department Procedures Guide for staff to follow, which should include each benefit category offered by CapMetro, internal processes that staff should follow, deadlines, specific calculations, review and approval process, etc. (part of recommendation 1b above). b) Ensure that manual data entry for benefit calculations is double checked and reviewed to ensure accuracy by the Finance Department or other independent party. c) Obtain temporary resources in the last two months of the calendar year to assist with administration and quality assurance check. 	<p>Management agrees with the recommendations.</p> <p><u>Target Completion Date:</u> December 31, 2021</p>

<i>Issues & Risk</i>	<i>Recommendation</i>	<i>Management Action Plan</i>
<p>3. P&C POLICIES – COMPLIANCE & APPROVED EXCEPTIONS Leave Policy (HRC-440) defines and provides procedures for requesting and taking various types of leave including vacation, sick, bereavement, parental, military, and jury duty leave. After reviewing the policy, we identified the following control weaknesses and determined that the policy has:</p> <ul style="list-style-type: none"> • No defined timeframe that specifies how long after a birth or adoption event an employee must start using parental leave. We identified one instance in CY 2020 where an employee utilized parental leave 3 months after an adoption which does not appear to meet the intended purpose of the policy. • No defined process to approve special exceptions to the policy to help ensure fairness and transparency. Currently staff use informal emails to approve exceptions to the leave policy. • Doesn't require employees to submit a long-term (greater than two weeks) leave request to the P&C Department (listed as optional in the policy) so staff can ensure requests are properly approved and help track them. For example, if P&C staff do not know who is taking parental leave, it's harder for them to update employee's status in UltiPro in a timely manner and communicate this information to the payroll group. 	<p>The Controller and Senior Director of People & Culture should consider the following improvements to Leave Policy (HRC-440):</p> <ol style="list-style-type: none"> a) Ensure deadlines and the maximum elapsed time after an event are defined (birth, adoption, or placement of a child) in which the employee must start using the parental leave or other family related benefit. b) Define the process for approving special exceptions to the policy (e.g. who can approve them, how to document the approval). c) Require employees to submit a long-term (greater than two weeks) leave request to the P&C Department. d) Ensure parental and other types of leave are timely communicated to the payroll personnel so that time and attendance records can be properly updated. 	<p>Management agrees with the recommendations.</p> <p><u>Target Completion Date:</u> May 31, 2022</p>

<i>Issues & Risk</i>	<i>Recommendation</i>	<i>Management Action Plan</i>
<p>4. INCREASE OVERSIGHT OF ANNUAL MERIT INCREASES Annual merit increases occur each January which is based on individual performance and operating budget availability. The P&C staff calculate the amount of merit increase by downloading performance ratings from UltiPro creating a Merit Matrix in Excel and calculating the amount of pay increase for each employee (i.e. using VLOOKUP formula). Next, the results are given to management for approval. Policy HRC-200 requires senior management to review and approve the Merit Matrix. We reviewed the controls related to the annual merit increases and identified the following weaknesses:</p> <ul style="list-style-type: none"> • P&C Dept has not developed written procedures detailing the full life cycle of merit increases from individual performance ratings to payrate adjustments made in UltiPro and the double checks and approvals necessary to prevent/detect errors. • The Finance Department as well as individual department heads are not asked to formally review and approve final payroll adjustments based upon their purview and area of responsibility. 	<p>The Controller and the Senior Director of People & Culture should consider the following improvements:</p> <ol style="list-style-type: none"> a) Review and document the full cycle of annual merit increases from employee ratings to the Merit Matrix table and payroll adjustments made in UltiPro ensuring proper segregation of duties and required approvals at each stage of the process life cycle. b) The Finance Department should attest to the accuracy of the annual merit payroll adjustments and sign-off on the final file and related details that is sent to the bank for payroll distribution. c) The Finance Department should review the Merit Matrix spreadsheet and sign off (e.g. Controller and/or Deputy CFO) on it as evidence of review and approval of the merit increases. 	<p>Management agrees with the recommendations.</p> <p><u>Target Completion Date:</u> May 31, 2022</p>

<i>Issues & Risk</i>	<i>Recommendation</i>	<i>Management Action Plan</i>
<p>5. TIME AND ATTENDANCE REPORTING & APPROVALS Policy HRC-205 (Payroll Time & Attendance Administration) requires that employees enter their time and supervisors must review and approve. Payroll staff send an Unapproved Time Report to members of management after each bi-weekly payroll processing period to alert them of employee’s whose time and attendance has not been formally approved in UltiPro by the payroll processing deadline (i.e. Monday at 10am). While this is a good control to have in place, employees are paid even if their time and attendance has not been submitted and/or formally approved by their supervisor. We noted the following weaknesses in the current process:</p> <ul style="list-style-type: none"> • There is no follow-up and reconciliation to ensure that employees have submitted time sheets for all weeks employed. • There is no disciplinary action or consequences for either an employee not submitting their report and/or their supervisor not approving. • P&C Department owns policy HRC-205, however, the Finance Department enforces and oversees the content of the policy (policy owner not correctly aligned with who performs the work). <p>We believe the weaknesses noted above were contributing factors to the fact that in a two-week pay period in May 2020, there were 34 out of 401 (8%) of employees with unapproved time and attendance that included a total of 14 overtime hours, 40 sick hours, and 10.25 vacation hours that were not formally approved. Failure to maintain properly approved time and attendance records may result in overpayments to employees for vacation and sick time when they leave the organization.</p>	<p>The Controller, along with the Manager of Payroll/Accounts Payable, should consider the following improvements:</p> <ol style="list-style-type: none"> a) Create a cumulative report to track and report all unreported and unapproved time by week and by employee and manager until each week is properly reconciled and properly reported and approved. b) Have a formal process to communicate periodically (e.g. quarterly) to department heads regarding unapproved time for their department. c) During the employee exit process, require the manager to review unapproved time reports and certify prior to final paycheck. d) Setup an enterprise level calendar reminder to all CapMetro employees to remind them to submit and approve time before the payroll processing deadline. e) Ensure each supervisor has a back-up approver if they are on vacation or cannot approve time and attendance records. f) Review P&C policies to identify payroll and time and attendance policies that should be owned (e.g. HRC 205) by the Finance Department because their payroll group administers the area. 	<p>Management agrees with the recommendations.</p> <p>Target Completion Date: December 31, 2021</p>

