



# REPORT TO THE CITY COUNCIL BY THE CITY INTERNAL AUDITOR

## LIMITED SCOPE PERFORMANCE AUDIT OF PAYROLL AND PAYROLL TAX REPORTING PROCESS

### INTERNAL AUDIT REPORT (IAR) 050319-09

December 31, 2019

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City Internal Auditor

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#### Report Highlights

#### Page(s)

- The payroll system is unreliable when generating IRS reports 7
- The City's net penalties cost less abatements and refunds was \$29,442 10



The Council  
City of Shreveport

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December 31, 2019

Councilman Jerry Bowman  
Chairman, Shreveport City Council

Dear Councilman Bowman:

Subject: IAR 050319-09– Limited Scope Performance Audit of Payroll and Payroll Tax Reporting Process

Attached please find the report mentioned above. Management comments are included in the report.

Sincerely,

Leanis L. Steward, CPA, CIA  
City Internal Auditor

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**EXECUTIVE SUMMARY**  
**LIMITED SCOPE PERFORMANCE AUDIT OF PAYROLL AND**  
**PAYROLL TAX REPORTING PROCESS**  
**INTERNAL AUDIT REPORT (IAR) 050319-09**

**Why We Did This Audit**

We conducted a limited scope performance audit of the City's Payroll and Payroll Tax Reporting Processes. This audit was conducted as a result of a City Council Resolution authorizing its Audit and Finance Committee to investigate payroll issues in the Finance Department that were reported by the external auditors. Our objectives were to determine the root causes of breakdowns in the payroll process, particularly payroll tax reporting and payment accuracy and timeliness.

**What We Recommended**

To improve controls over the payroll process, we recommended:

- Set a deadline for employees to submit requests for checks outside regular payroll (known as manual checks).
- Require all new-hire information to be complete and updated in the payroll system before employees begin work.
- Require supervisors to review and approve employee time sheets before posting to timekeeping system
- Restrict payroll division from editing employee hours/pay in the payroll system

To improve controls over reporting and comply with the Internal Revenue Service (IRS) and the Louisiana Department of Revenue (LDR), we recommend:

- Maintain a permanent record of each payroll with correct calculation of payroll liabilities and ensure tax deposits are made on the correct due dates.
- Develop and implement a written set of policies and procedures for the payroll process.

**Limited Scope Performance Audit:  
Payroll and Payroll Tax Reporting  
Process**

**What We Found**

We found the payroll system can be unreliable for reporting tax liabilities to be submitted to the IRS. Tax liabilities associated with voided checks are removed from the tax liability report; and payroll cannot go back and recreate a complete and accurate report. The Controller was not reviewing these reports for accuracy; and was not timely filing quarterly reports.

The City's net penalties after total abatements/refunds were \$29,442. This includes initial penalties of \$457,336 less total abatement/refunds of \$427,894.

We believe the following caused the penalty assessments:

- City Department supervisors allowing employees to begin work prior to completion of new hire paper work.
- Unreliable payroll system liability reports.
- Controller's failure to review payroll liability submissions to taxing authorities.
- Misclassification of government entity status with the Louisiana Department of Revenue.
- Director of Finance filed three state returns late.

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## Introduction

While updating the Council's Audit & Finance Committee on the progress of the external audit, the external auditors disclosed a number of deficiencies, including penalty payments to the Louisiana Department of Revenue for filing three quarterly payroll tax reports late. Because of this and other accounting deficiencies, the Council passed a resolution authorizing an investigation of the Finance Department. The City Internal Auditor was tasked to perform some of this investigation. During the course of our work, we found that penalties had also been assessed by Internal Revenue Service; and our investigation was converted to a limited scope performance audit.

This report provides the results of our limited scope performance audit of the payroll and payroll tax reporting processes.

The objectives of this limited scope performance audit are to:

- Determine what controls are in place to ensure employees' salaries and hours worked are accurate in the system each time payroll is processed.
- Identify payroll tax penalties assessed and review the associated transactions for accuracy and proper authorization.





**Recommendation Evaluation Risk Criteria**

This report contains two findings with five recommendations. The chart below summarizes our evaluation of risk for the recommendations outlined in the report. Each recommendation was assessed a high, medium, or low risk level based on a qualitative assessment of exposure and/or corrective action priority.

<i><b>Risk Levels</b></i>	<i><b>Recommendations</b></i>
<p style="text-align: center;"><b>High Risk</b></p> <p>Represents a <b>significant</b> level of risk exposure to city assets, public safety, or achievement of objectives or mission. Corrective action should have the highest priority.</p>	<ul style="list-style-type: none"> <li>➤ Maintain a permanent record of each payroll with correct tax liability amounts and ensure tax reporting deadlines are met. <b>(Finding: Lack of Controls and Supervisory Review)</b></li> </ul>
<p style="text-align: center;"><b>Medium Risk</b></p> <p>Represents a <b>moderate</b> level of risk exposure to the city from extensive operating inefficiencies or high-level non-compliance issues. Corrective action should occur expeditiously.</p>	<ul style="list-style-type: none"> <li>➤ Set a deadline for submitting check requests outside regular payroll (known as manual checks) each pay period. <b>(Finding: System Unreliable for IRS Reporting)</b></li> <li>➤ Require all new-hire information to be complete and updated in the payroll system before employees begin work. <b>(Finding: System Unreliable for IRS Reporting)</b></li> <li>➤ Require supervisors to review and approve employee time sheets prior to posting to timekeeping system and restrict editing in the payroll system. <b>(Finding: System Unreliable for IRS Reporting)</b></li> </ul>
<p style="text-align: center;"><b>Low Risk</b></p> <p>Represents a <b>minimal</b> level of risk exposure to the city from inefficiencies or low-level non-compliance issues. Corrective action should occur as appropriate.</p>	<ul style="list-style-type: none"> <li>➤ Develop and implement a written set of policies and procedures for the payroll process. <b>(Finding: Lack of Controls and Supervisory Review)</b></li> </ul>



## **Scope and Methodology**

The scope of this performance audit is limited to payroll processing, tax remittance and payroll tax reports for all quarters beginning January 1, 2015 and ending June 30, 2019. In order to meet these objectives, we reviewed relevant internal and system controls; and developed audit procedures that included but were not limited to the following:

- Interviewing Departmental management and staff regarding controls
- Reviewing the rules and regulations of the Internal Revenue Service (IRS) and the Louisiana Department of Revenue (LDR)
- Conducting a walkthrough and documenting payroll and payroll tax processes
- Obtaining and examining copies of payroll tax reports, payments, penalty notices
- Obtaining directly from IRS and the Department of Revenue transcripts and other records of payments and penalties imposed
- Other procedures as necessary to properly complete the audit

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

***We thank the personnel in the Finance Department and the Information Technology Department for their cooperation and assistance in gathering information provided to us in our work on this project.***





# **FINDINGS AND RECOMMENDATIONS**

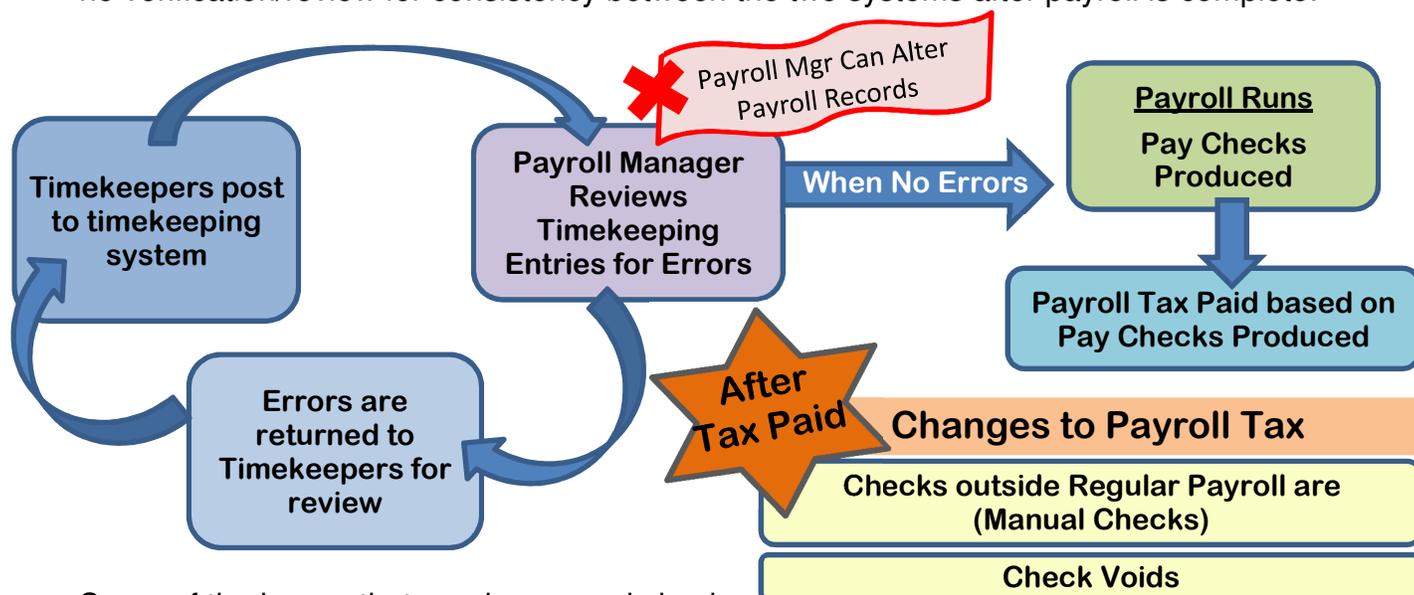


**Objective: Determine what controls are in place to ensure employees' salaries and hours worked are accurate and complete in the system when payroll is processed.**

**System Unreliable for IRS Reporting**

We found the system is unreliable when generating reports to be submitted to the IRS. Manual checks and voids that occur outside of a regular payroll create reporting issues within the payroll system. The payroll manager exports payroll data from the timekeeping system to the payroll system; and notifies timekeepers if corrections need to be made. If there are still errors or something is omitted after payroll is complete, then a void and/or a manual check are processed. Because manual checks are processed both on and in-between paydays, it is difficult to keep up with when the associated liabilities are due.

We found that the payroll manager has the ability to alter employee time and pay in the payroll system after the data has been imported from the timekeeping system. There is no verification/review for consistency between the two systems after payroll is complete.



Some of the issues that require manual checks:

- Timekeepers do not timely submit new-hire paper work to Human Resources.
- Supervisors allow new employees to start work before new-hire information is entered into payroll by HR.
- Supervisors do not review new-hire paper work for correct salaries and employee classification before it is submitted to HR for entry into the payroll system.
- Supervisors do not review employee time sheets and approve hours worked and/or leave taken during a pay period.

Some of the issues that require voided checks are:

- Semi-monthly employee terminates in the middle of a pay period without notification to payroll.
- Employee changes/closes the bank account setup for direct deposit without notifying payroll.



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**Recommendation 1:** Set a deadline for submitting check requests outside of regular payroll (known as manual check requests) each pay period. This will allow the Payroll Division time to verify that all tax liabilities are accurately reported and included on the right deposit schedule when making tax deposit payments.

**Management Response:** Management has implemented a policy to require all manual requests to be made prior to 12:00 pm. This will ensure the accuracy and the timely deposit of tax liabilities.

**Due Date:** **Less Than 6 Months**

**Recommendation 2:** City Administration does require all new-hire information to be complete and updated in the payroll system before employees begin work. However, there are some circumstances when it may not be feasible to do so; and a manual check would be required. We recommend that Finance make sure the tax deposits for all manual checks are made timely.

**Management Response:** Management is currently working with Human Resources, Department Heads, and timekeepers to stress the importance of processing all new-hires in timely manner. The implementation of electronic PAF, which is currently in the test stage, should improve the process.

**Due Date:** **Less Than 6 Months**

**Recommendation 3:** We recommend City Administration require supervisors to review employee time sheets and the data entered by timekeepers prior to its posting in the timekeeping system; and have IT restrict Payroll Division from editing employee hours/pay in the payroll system.

**Management Response:** Management will work with IT to test user restriction scenarios.

**Due Date:** **Less Than 6 Months**



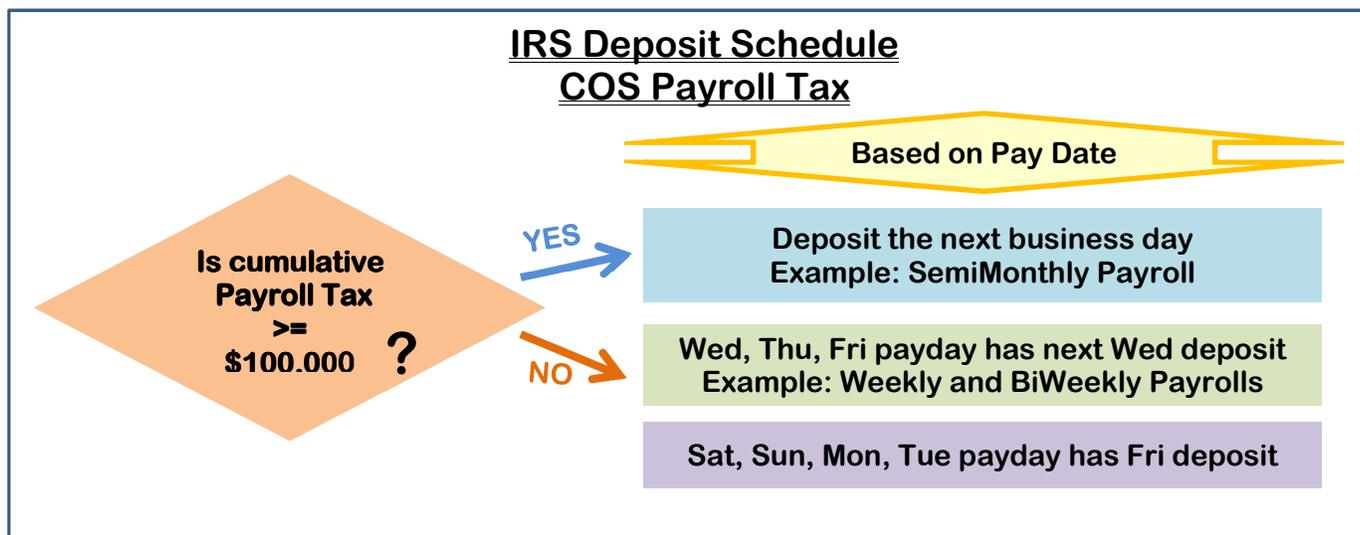
**Objective: Identify payroll tax penalties assessed and review the associated transactions for accuracy and proper authorization.**

**Lack of Controls and Supervisory Review**

**We found a lack of controls over accurate and timely reporting to the IRS and the LDR; and the Controller was not reviewing and correcting the reports before submitting to the IRS.** Internal Revenue Service (IRS) regulations and Louisiana Department of Revenue (LDR) requirements govern the withholding of payroll taxes from employees and the payment of these taxes to the taxing authorities. The City makes payments to each taxing authority based on the required schedules and then reports a summary of payments and liabilities at the end of each quarter.

The payroll system defaults to the payroll process date, not the pay date (as required by the taxing authorities) on the liability report. This date determines the date the tax deposit is due; and if it is not corrected before it is submitted to the IRS then it would appear as if the City made the deposit late, resulting in a late payment penalty.

Once checks have been voided in the system, even if they are replaced, the system will remove the associated tax liabilities from the original tax liability report. Payroll cannot go back and recreate a complete and accurate tax liability report. Therefore, it is important to keep documentation of each payroll transaction as it occurs.



**Types of IRS Penalties:**

- Failure to make proper deposit – payment is less than the total amount due
- Failure to pay – payment submitted after the due date
- Late filing – report submitted to IRS after due date

If the City can support the fact that a penalty is assessed in error, an amended quarterly report requesting abatement (removal) of the penalties can be submitted to the IRS.



### State Penalties

LDR requires all taxes to be deposited at the end of each month; and liability reports are due at the end of each quarter. Originally the external auditors reported the Finance Director did not timely file tax forms for three quarters in 2018. However, the State abated those penalties (see chart below) because the City was not registered as a governmental agency and the State does not charge penalties to governmental agencies. Therefore, the State abated and refunded the \$237,342 (see chart below) in penalties.

### Penalties Abated

Penalties are abated and/or refunded if the City provides documentation that the penalty was assessed due to a reporting error.

<b>COS Payroll Tax Penalties &amp; Abatements</b>			
<b>1ST QTR 2015 - 2ND QTR 2019</b>			
	<b>IRS</b>	<b>State</b>	<b>Totals</b>
Initial Penalty	\$219,993	\$237,343	\$457,336
Abated/refunded	(\$159,898)	(\$237,343)	(397,241)
Pending Abatement	(\$30,653)	0	(30,653)
Abated/refunded	<b>(\$190,551)</b>	<b>(\$237,343)</b>	<b>(\$427,894)</b>
Net Penalty Cost	\$29,442	-	\$29,442



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**Recommendation 4:** We recommend the Controller maintain a permanent record of each payroll run, with correct calculation of payroll tax liabilities, and the Director of Finance ensure tax deposits are made and reported on the correct due dates.

**Management Response:** The Controller will maintain payroll liability records. Director of Finance will verify that tax deposits are properly made and reports are timely submitted. Finance is current working with Taxpayer Advocate to abate additional penalties from 4th Quarter 2018.

**Due Date:** **6 to 12 Months**

**Recommendation 5:** A written set of policies and procedures for the payroll process should be developed and implemented. It should include each person's role in the payroll process and supervisory review of all payrolls, reports and liability payments.

**Management Response:** Management is currently working with GFOA and the new Controller to establish written policies and procedures.

**Due Date:** **6 to 12 Months**



Prepared by:

A handwritten signature in blue ink, appearing to read "AMJ".

April M. Jordan, CFE, CLEA  
Staff Auditor III

Approved by:

A handwritten signature in blue ink, appearing to read "Leanis L. Steward".

Leanis L. Steward, CPA, CIA  
City Internal Auditor

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c: City Council  
Clerk of Council  
Mayor  
Director of Finance  
Chief Administrative Officer  
Carr, Riggs & Ingram