Evaluation of Payroll Processes
August 16, 2016

Adams County, Colorado

Executive Summary

BACKGROUND

Eide Bailly LLP was engaged to evaluate the payroll processes of Adams County, Colorado as identified within our 2015 Executive Summary and Risk Assessment report as a project to be performed in 2016. Our evaluation included the processes and controls over the calculation of pay as well as the adequacy of the current pay cycle in place. This project was performed in conjunction with management's ongoing analysis of the payroll process and their considerations surrounding changing payment cycles and processes. Potential vulnerabilities were also considered within the current process in place and the potential planned timing of making changes to these processes.

OBJECTIVES AND SCOPE

Eide Bailly LLP performed a review of the processes and controls over payroll within Adams County. The overall objective of our review was to identify potential weaknesses and risks related to the process in place as well as identify potential alternatives to the current processes being used by the County.

The scope of our procedures included the following:

- Payroll processes and procedures related to all aspects of payroll of Adams County, which include the following areas that we were asked to evaluate:
  - The County's monthly pay cycle with time being estimated for the last few days of each month.
  - The County's process for calculating the amount paid, which includes a level pay calculation with both salary and hourly employees getting 12 equal payments throughout the year.

Procedures performed during this review included the following:

- Interviews with the Payroll Supervisor and the Finance Director to gain an understanding of the processes in place and identify key risks within the payroll process.
- Assessment and walkthrough of the key processes over payroll.
- Evaluation of risks and vulnerabilities within the current payroll processes in place.
- Identification of other methods to process payroll including frequency and timing.

EVALUATION OF RISKS AND VULNERABILITIES

- The current payroll process requires all employees to have their time entered for the entirety of the month on a set day within the County's payroll calendar. This date is always a few days before the end of the month and as a result, the time entered will be a mix of actual time worked up until this date and then estimated time to be worked for the remainder of the month. There are many risks associated with having employees estimating their time, including the following:
  - Employees are asked to be honest and ethical with updating their estimated timesheets in the following month to account for overtime, vacation, sick days, etc. within the days that were estimated at the end of the previous month. There is room for fraud within this process that is minimized with a system where time is paid in arrears and employees are only paid for time already worked.
  - As overtime is not estimated, updating time sheets for actual overtime worked is the reason for most updates to timesheets and prior month estimates. This overtime is difficult to approve as leave types are approved in a different system and a supervisor has to go back to and look at hours worked less vacation to ensure overtime is valid, which leaves room for errors to occur within overtime being inappropriately calculated and paid.
  - Supervisors review time monthly within the current system at the time that time is due. Over a month may go by between supervisor approvals related to the time that was estimated in the previous month and updated in the current month, relying on the supervisor to be accountable for accuracy of vacation, sick time, overtime, etc. This also adds to a risk for fraud to occur when supervisors are not looking back for an entire month as it is difficult to expect supervisors to be responsible for the accuracy of time that is from weeks prior to the approval of the current time.

- Based upon discussions with the Payroll Supervisor, she noted that this process makes it very difficult to get everyone's time submitted and approved the day it is due. The system is either open for everyone or nobody and they can't close it until all time is in. We discussed an edit report that is run the day after time is due. It was noted that this report has a minimum of twelve pages of unapproved time and at least ten supervisors that haven't gone in and approved their time on average when the edit report is run.
    - A system that is relying on supervisors to approve time a month after it occurs relies on supervisors to be bought into the process. With so many supervisors being late or not approving time at all, the risks for fraud noted above are elevated even higher.
    - Payroll staff are forced to proceed by approving time that is not approved by supervisors by a certain point in time to be able to close the system and get payroll processed in a timely manner. Payroll should not be involved in approving time at all. The system is set up where everyone should have a delegate or two to approve time that is not approved within the department/office of the time being entered.

- Payroll is processed using a module in JDEdwards which relies on a partially customized time entry process built by in house IT to make the process work. If a more standard payroll cycle is used, the standard JDE time entry module might be able to be used, resulting in a more efficient process.

- There are risks related to compliance with federal programs administered by the County, as time charged and estimated could possibly be projected into the wrong programs and not adjusted until the following month. This specific risk resulted in a material weakness (2014-003) in the 2014 single audit for the County.

- The current process results in inefficiencies related to paying terminated employees. As direct deposit has to be submitted two days before the pay day, final checks for terminated employees are always manual checks that are calculated on the pay date to be sure that they are accurate and do not include any estimated time.

- The payroll process results in additional inefficient manual processes that have been created by the Payroll Supervisor to mitigate possible issues that could occur that are unique to the pay frequency and calculations used by the County. The following are examples of these processes:
    - When processing pay for new hires in the first month, they will need to be changed to hourly regardless of their classification to be sure that they are only paid a partial month for the first month and not auto-paid for a full month by the system. Payroll must generate multiple reports each month to monitor and catch instances in which this occurs and an additional manual process is required to correct errors that are found.
    - Various reports have been created to ensure that the wrong pay types are not being used.

- Using a level pay calculation will result in hourly employees being paid for more hours or less hours than actual hours worked each month due to the leveling of hours throughout the year. This causes confusion for some new employees and could also result in too much or too little being paid to employees that were not employed by the County for the full year. Paying based on actual hours worked would eliminate this risk.

OTHER METHODS

The first consideration of the County is which pay frequency is best to use within the payroll process. The four basic payroll frequencies include the following:

1. Weekly
2. Bi-weekly
3. Semi-monthly
4. Monthly

Advantages and disadvantages related to each identified pay frequency option are listed below:

1. Weekly Pay Frequency
   - Advantages
     - Overtime paid closer to when earned
     - No look backs for overtime straddling pay periods
     - The employees are paid on the same day each week
   - Disadvantages
     - Because there are more payrolls, there is a larger cost to process payroll
     - Taxes must be paid for each payroll, which means there are more tax payments, which is more work for the payroll staff
     - More checks are written/direct deposits being completed which could lead to more paper, ink, and printer usage and/or banking fees
     - Depending on the workload there may need to be more staff to process the extra payrolls

2. Bi-Weekly Pay Frequency
   - Advantages
     - The pay periods and days are consistent, they end and start at the same time each week
     - There are no overtime overlaps and overtime calculations are simple and easy for payroll
     - This is a more common pay frequency of which is readily accepted by the majority of employees and payroll staff
     - There are fewer pay periods so processing costs are less than weekly pay frequency
   - Disadvantages
     - Accountants sometimes do not like this frequency as it makes their accruals more difficult
     - Processing is still more costly than semi-monthly or monthly payroll frequencies
     - Provides less consistency in personal budgeting, since some months will have three payrolls and others two
     - Different amounts for benefits calculations in some months

3. Semi-Monthly Pay Frequency
   - Advantages
     - Decrease operating costs because of fewer payrolls processed
     - This frequency is easier for finance to use because accruals are easier
     - This pay frequency works well with all exempt salaried payrolls
   - Disadvantages
     - Because of overlapping work weeks from one payroll to the next, overtime calculation and compliance is difficult. This is a time consuming payroll method for the payroll staff
     - Costs can be more than Bi-weekly because of the time spent on overtime calculations
     - The pay date can be on different days of the week because of the way time cuts off for semi-monthly payroll frequency

4. Monthly Pay Frequency
   - Advantages
     - Results are the fewest payrolls processed out of all the frequencies, therefore the processing costs are lower
     - Finance deems this type of payroll frequency easiest, as the accruals are noncomplex and less frequent
     - This pay period frequency works very well for all exempt salaried employees
   - Disadvantages
     - Overtime calculations are as cumbersome and time consuming payroll staff as the semi-monthly as the work weeks are not the same and there is overlapping time from one month to the next
     - Employees sometimes do not like this payroll much as there is too much time between payrolls

	Monthly	Semi-Monthly	Bi-Weekly	Weekly
Frequency (per year)	12	24	26 (sometimes 27)	52
Payroll Date	End of the Month	Typically 1st and 15th or 15th and 30th	Every two weeks usually on a Friday	Every week usually on a Friday
Hours per pay period (for hourly employees)	173.33	86.67	80	40
Payroll Processing Cost	Lowest	Low	Medium-Low	Medium
Implications to Accounting	Lowest	Low	Medium-Low	Medium
Implications to Benefits	Lowest	Low	Medium-Low	Medium
Processing Time	Lowest	Low	Medium-Low	Medium
Salaried Employees	*	*	*	*
Hourly Employees	Lowest Preference	Low Preference	Preferred	Most Preferred

* Salaried employees prefer being paid more frequently but the differences are minor. Most entities pay their salaried employees semi-monthly or biweekly.

The second consideration of the County is related to the timing of pay date versus the pay period within the payroll process. The timing options are as follows:

1. Pay in arrears
2. Pay in advance (current process)

Advantages and disadvantages related to each identified pay timing option are listed below:

1. Pay in arrears
   - Advantages
     - Fewer overpayments for terminated employees
     - Eliminates the need to estimate time
     - Fewer adjustments required to be made by the payroll staff
     - Process time shortened
     - Better controls for time entry
     - Overtime and regular time paid closer to when earned
     - Lowers time and cost of maintaining and upgrading system
     - Reduces the risk of errors in relation to cost accounting
     - Improved management oversight
   - Disadvantages
     - Difficult for employees to switch from current process due to wages being affected upfront

2. Pay in advance
   - Advantages
     - Better for your current employees who do not want change
     - Employees are paid for work that they just completed
   - Disadvantages
     - Less efficient
     - Requires many manual adjustments and reconciliations within the process
     - Process time lengthened
     - Increases risk of overpayment (including to terminated employees) and fraud
     - Increased opportunity for errors to occur
     - Inconsistent, difficult to understand