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AUDIT OF
NEW AMERICAN PAYROLL
SYSTEM (NAPS)

AUDIT REPORT NO. 9-000-88-1

OCTOBER 5, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D C 20523

October 5, 1987

MEMORANDUM FOR M/FM, Curtis W. Christensen

FROM: IG/PSA, *William C. Montoney*
William C. Montoney

SUBJECT: Audit of New American Payroll System (NAPS)

The Office of Programs and Systems Audits has completed its audit of the New American Payroll Systems (NAPS). Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains two recommendations. Both recommendations are resolved but will not be closed until completion of planned or promised actions. Please advise me within 30 days of any additional actions taken to implement Recommendation Nos. 1 and 2.

I appreciate the cooperation and courtesy extended to my staff during the audit.

EXECUTIVE SUMMARY

The New American Payroll System (NAPS) is the Agency's centralized, GAO-approved automated pay and allowance system. Implemented in 1972, it computes the pay for over 4600 U.S. direct hire employees. The original system has been enhanced to accommodate changing Federal government policy and other statutory changes affecting payroll administration. In 1986, the system processed \$170 million in employees' pay and allowances.

The Office of Programs and Systems Audits made a financial and compliance audit of NAPS. The objectives of this audit were to determine if management's policies and operating procedures were effective, system controls provided adequate audit trails, and system security controls prevented loss or error.

The payroll system was operating well and employees were being paid in a proper and timely manner. In general, policies were adequate and effective and were carried out in an efficient manner. Audit trails were judged adequate and the system included controls to prevent loss or error.

For the payroll cases reviewed, no ineligible employees were paid. For over 4600 employees paid in 1986, no significant problems were found concerning the withholding of Federal income and Medicare taxes. The audit also showed that no employee's base or gross pay exceeded the maximum statutory limits. However, the audit showed that several manual pay adjustments had no evidence of second party supervisory review or approval and that many Washington-based employees did not have withholding certificates on file and no state taxes were being withheld.

For calendar years 1984 through 1986, 66 pay adjustments were selected for review to determine if manual adjustments were properly documented and approved. Twenty-one cases had no evidence that the pay adjustments were reviewed and approved by a person other than the preparer. Internal control procedures require that payroll adjustments be adequately reviewed to ensure proper processing. Written procedures had not been developed explaining how manual adjustments to pay were to be prepared and approved. Because these adjustments bypassed normal automated input processing controls, the risk of making erroneous payments was increased. The Office of Financial Management (FM) should develop and implement procedures to ensure that manual pay adjustments are prepared and reviewed. FM agreed with the finding and recommendation and stated that written procedures would be developed and implemented.

In calendar year 1986, the automated payroll system showed no State of residency for 155 Washington-based employees. Of these employees, 31 were selected for review and 26 did not have State or District withholding certificates on file and no

taxes were being withheld. Federal regulations require Government employees to file tax withholding certificates so that State or District taxes may be withheld by A.I.D. The Office of Financial Management did not have any procedures for follow-up on employees not filing required certificates. As a result, the District and neighboring States may have lost tax revenues from employees who did not file State income tax returns. FM should develop and implement procedures to ensure that the required tax certificates are filed. FM concurred with the finding and recommendation and stated that the audit recommendation would be implemented.

Office of the Inspector General

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AUDIT OF
NEW AMERICAN PAYROLL
SYSTEM (NAPS)

PART 1 - INTRODUCTION

A. Background

The New American Payroll System (NAPS) is the Agency's automated pay and allowance system. It was implemented at A.I.D. in 1972 and computes the pay for approximately 4600 US direct hire employees. Nearly 1700 of these employees are located overseas. In 1986, the system processed \$170 million in employees' pay and allowances.

NAPS is a centralized, GAO-approved automated system. It includes a personnel system interface; time and attendance processing; pay computation; production of check and bond insurance files; and reports pertaining to pay, benefits, and taxes.

The original system has been enhanced to add retroactive pay calculation, retirement processing, improved labor cost reporting and interfaces, and online data entry and file maintenance. Other system enhancements have been implemented to accommodate changing Federal government policy, which includes the Fair Labor Standards Act, Omnibus Reconciliation Act, Civil Service Reform Act of 1978, Foreign Service Act of 1980, and other statutory changes affecting payroll administration.

The Compensation and Accounting Control Branch within the Washington Accounts and Operations Division of the Office of Financial Management was responsible for processing the Agency's biweekly payrolls. The Branch has nine employees - one Branch Chief, an accounting technician, two payroll technicians, three payroll clerks, and two typists.

B. Audit Objective and Scope

The Office of Programs and Systems Audits made a financial and compliance audit of the New American Payroll System (NAPS). The audit period was January 1, 1984 through December 31, 1986. The audit was done during the period May 1, 1987 through August 19, 1987.

The objectives of the review were to determine if (i) management's policies and operating procedures were being adequately carried out in an efficient manner and were effective; (ii) system controls provided adequate audit trails for management and operational reviews; and (iii) the system included security controls to prevent loss or error.

Audit work included a review of the New American Payroll System's general and detailed system flowcharts, operating procedures, file and record layouts, and selected daily transactions and output reports. Office of Financial Management personnel, as users of NAPS, and the Office of Information Resources Management's contractor personnel who maintained the system were interviewed. Computer runs were made to select various payroll items for detailed review. These items included verifying that only eligible employees were paid; evaluating manual adjustments to employees pay; and testing (1) the withholding of Federal and state income and Medicare taxes, and (2) the statutory limits of base and gross pay calculations. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The payroll system was operating well and employees were being paid in a proper and timely manner. In general, policies were adequate and effective and were carried out in an efficient manner. Audit trails were judged adequate and the system included controls to prevent loss or error.

For the cases reviewed, no ineligible employees were paid. For over 4600 employees paid in 1986, no significant problems were found concerning the withholding of Federal income and Medicare taxes. The audit also showed that no employee's base or gross pay exceeded the maximum statutory limit for the items reviewed.

However, for 66 manual pay adjustment cases selected for review, 21 had no evidence of second party supervisory review or approval. Further, the payroll system showed no State of residency for 155 Washington-based employees. Of these employees, 31 were selected for review and 26 did not have withholding certificates on file and no taxes were being withheld. The Office of Financial Management should develop and implement procedures to ensure that manual pay adjustments are properly prepared and reviewed and that the required tax certificates are filed and State taxes are withheld.

A. Findings and Recommendations

1. The Office of Financial Management Should Develop Written Procedures for Manual Adjustments to Employee Pay

Sixty-six pay adjustments were selected for review to determine if manual adjustments were properly documented and approved. Twenty-one cases had no evidence that the pay adjustments were reviewed and approved by a person other than the preparer. Internal control procedures require that payroll adjustments be adequately reviewed to ensure proper processing. Written procedures had not been developed explaining how manual adjustments to pay were to be prepared and approved. Because these adjustments bypassed normal internal controls, the risk of making erroneous payments was increased.

Recommendation No. 1

The Office of Financial Management should develop and implement written procedures which explain how manual pay adjustments are to be prepared and reviewed.

Discussion

During calendar years 1984 through 1986, over 53,000 adjustments were made to employee pay. For the three years, adjustments which increased gross pay totalled 6,686. Of these, we selected for review 66 adjustments to determine if non-automated adjustments were properly documented and approved. Twenty-three adjustments were for cash award payments which were subject to automated input controls. Five other payroll files had been retired and the file documents were not reviewed. Of the remaining 38 cases, 21 had no evidence of review and approval.

Internal control standards for government entities require that authorizing, processing, recording, and reviewing of transactions be separated among individuals. Thus, manual payroll adjustments should be reviewed by someone other than the preparer to ensure proper processing.

The Office of Financial Management (FM) used a "Payroll Change Slip", A.I.D. Form 760-43, to document many payroll adjustments. However, written procedures were not developed explaining how manual adjustments to pay were to be prepared and approved in conjunction with this form. Further, because of a high turnover of payroll clerks, these written procedures would serve as a useful instructional tool for new staff.

The 21 cases which had no evidence of review and approval were evenly distributed among the various types of adjusting transactions: base pay, Sunday pay, post differential, lump sum payments, danger pay, and miscellaneous non-taxable payments.

Manual adjustments to employee gross pay of \$3.9 million annually were made during 1984 through 1986 and because these adjustments bypassed normal automated processing controls, the risk of making erroneous payments was increased.

Management Comments

The Office of Financial Management in the written response to the draft audit report agreed with the finding and recommendation. The response stated that written procedures concerning manual pay adjustments would be developed and implemented.

2. The Office of Financial Management Should Obtain State or District Income Tax Certificates From All Washington-based Employees

In calendar year 1986, the automated payroll system showed no State of residency for 155 Washington-based employees. Of these employees, 31 were selected for review and 26 did not have State or District withholding certificates on file and no taxes were being withheld. Federal regulations require Government employees to file tax withholding certificates so that State or District taxes may be withheld by A.I.D. The Office of Financial Management (FM) did not have any procedures for following-up on employees not filing required certificates. As a result, the District and neighboring States may have lost tax revenues from employees who did not file State income tax returns.

Recommendation No. 2

The Office of Financial Management should:

- a. design edits into the automated system which identify Washington-based employees who have not filed required State and District withholding certificates;
- b. develop and implement procedures to periodically follow-up on employees to ensure that required certificates are filed; and
- c. take action to ensure that the required certificates are on file for all current employees including the remaining 124 cases, identified but not reviewed during audit.

Discussion

For calendar year 1986, the automated payroll system had pay records for about 2900 Washington-based employees. Of these, 155 were employees who, at the end of the year, were not having State or District income taxes withheld. The gross taxable pay during 1986 for these employees was nearly \$8 million. Thirty-one of these employees were sampled to determine if State or District income tax withholding certificates were on file. Twenty-six did not have the certificates on file and taxes were not being withheld by A.I.D.

A.I.D. Handbook 26 states that the withholding of State or District taxes is mandatory for Washington-based employees. Treasury requirements call for employees to complete a withholding certificate as the basis to properly withhold State taxes.

While Agency procedures require that State tax withholding certificates be given to all new employees and to all employees returning from overseas assignments, FM had no system for following-up to ensure that employees completed and submitted these forms.

Twenty-six employees reviewed did not have certificates on file and A.I.D. was not withholding any State taxes. The audit did not determine whether these employees filed State income tax returns. However, since A.I.D. was not withholding any State taxes, the District and neighboring States may have lost tax revenues for employees who did not file State income tax returns. Therefore, FM needs to establish and implement procedures for following-up on employees not filing the required certificates.

Management Comments

In the written response to the draft audit report, the Office of Financial Management concurred with the finding and recommendation. The management response stated that steps would be taken to ensure that tax withholding certificates are on file for all AID/W based employees.

B. Compliance and Internal Control

Compliance

The audit showed noncompliance in the area of State or District income tax withholding certificates for Washington-based employees. This issue was discussed in Section A of this report and occurred because the Office of Financial Management (FM) did not have any procedures for following-up on employees not filing the required certificates.

For other areas reviewed, the audit showed no other instances of noncompliance with laws or regulations.

Internal Control

Two areas of internal control weaknesses were noted during the audit. Manual pay adjustments were not always reviewed and approved by persons other than the preparer of the adjustments and the automated payroll system had no edits to identify Washington-based employees who had not filed State or District income tax withholding certificates. Recommendations that FM develop and implement procedures to ensure that manual pay adjustments are prepared and reviewed and that the required tax certificates are filed should prevent these conditions from recurring.

C. Other Pertinent Matters

The Payroll System produces Statements of Earnings and Leave to provide each employee with information on biweekly pay. The audit showed that the Statement of Earnings and Leave had no cover sheet to protect employees' private information as required by the Privacy Act. The process now used to produce the statement is a copying process rather than a printing process. The Office of Financial Management (FM) and the Office of Information Resources Management (IRM) jointly evaluated the use of a cover sheet to protect employee information under the current process and concluded that the use of a cover sheet was not practical. Consequently, the privacy of employee information was not ensured. FM and IRM should continue their efforts to find an alternative process which ensures the privacy of employee information.

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PART III - APPENDICES

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

MEMORANDUM:

October 1, 1987

TO : IG/PSA, Mr. William C. Montgomery
Room 5143, SA-16

FROM: M/FM/WAOD, George L. Smith
Room 614, SA-12

SUBJ: Review of New American Payroll System (NAPS)
Audit Report No. 9-000-87 September 1987

We appreciate the professional manner in which the audit was conducted.

We will develop and implement written procedures concerning manual pay adjustments. We will also take steps to ensure that tax withholding certificates are on file for all AID/W based employees.

1987 OCT -2 AM 9:39

APPENDIX BReport Distribution

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