



**Program Evaluation and Audit**

***Payroll Direct Deposit***

***Process Review and Cost-Benefit***

17 December 2010

# INTRODUCTION

## Background

The Council operates under a biweekly pay period system. The Metropolitan Council employs about 3,600 employees. The Council's biweekly payroll is approximately \$8,300,000. The Payroll Office within the Council's Department of Finance is responsible for the administration of payroll.

Direct deposit was required for all Council employees beginning in December, 2009 as allowed by Minnesota Statutes §471.426. Prior to that time, employees in most departments had the option of enrolling in direct deposit, but it was not mandatory. When the Council originally merged together several business functions in 1994, the payrolls for the various entities were left as they were. Therefore, until 2007, Payroll administered six different payrolls, all on different pay schedules. In the third quarter of 2007, all six of the payrolls were aligned to the same pay period to simplify the processing and to facilitate greater use of direct deposit. For example, bus operators were not able to participate in direct deposit until the Council instituted a two-week holdback with a Council-wide single pay period.

A payroll debit card, the AccelaPay Card, from US Bank is offered to employees that do not want wages deposited into a bank account.

Given that this conversion was relatively new at the time of the 2010 risk assessment and given that payroll can be a high risk area for any organization, this project was selected as part of the 2010 Audit Plan.

## Purpose

This audit was conducted to ensure the accuracy, security, and timeliness of direct deposit. The audit also evaluated the costs and benefits of the conversion to mandatory direct deposit.

## Scope

Audit reviewed the processes and controls for payroll direct deposit.

The evaluation of payroll direct deposit included an assessment of:

- Process controls,
- Security of employee financial information, and
- Costs and benefits of the conversion to mandatory direct deposit.

The time period under review was January, 2009 through October, 2010. Testing of direct deposit focused on 3<sup>rd</sup> Quarter, 2010.

## **Methodology**

To gain an understanding of direct deposit payroll, and to test the accuracy, security, and timeliness of direct deposit, the following methods of inquiry were used:

- Personnel were interviewed within Finance, Human Resources, Information Systems, and Metro Transit.
- Audit staff reviewed direct deposit procedures and processes including ACH transactions, printing advice slips, and changing employee accounts.
- A sample of direct deposit account requests was tested for accuracy.
- Audit staff performed a cost-benefit analysis of direct deposit compared to pay checks.

## **Assurances**

This audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* and the U. S. Government Accountability Office's *Government Auditing Standards*.

# OBSERVATIONS

## *Direct Deposit Process*

Payroll is run every two weeks. Five payroll groups are run biweekly. The pay groups are: Environmental Services, Regional Administration, Metro Transit Administration, Metro Transit Operators, and Metro Transit Mechanics/Office Workers.

Direct deposit requires an Automated Clearinghouse (ACH) file to be sent to the Council's bank by 6 p.m. on the Wednesday prior to the Friday payday. That deadline is adjusted when the payday is earlier due to a holiday. Five ACH batch files are transmitted by Payroll for the five pay groups. The ACH batch file is sent to the Council's bank through the bank's secured website for the purpose of authorizing transfer of Council funds to employees' direct deposit accounts. The ACH file contains each employee's banking information and amount of money for the Council's bank to transfer. The funds are in the employees' accounts that Friday morning.

During that week, pay advice slips are printed by Accounting and Metro Transit Finance staff in secured rooms at the Robert Street and Heywood buildings. The pay advice slips are distributed on Friday morning. Some pay checks are printed and distributed at the same time, either for new hires or when bank accounts have changed.

## *Employee requests to change bank accounts are entered accurately.*

Employees submit a paper application along with a voided check to request payroll direct deposit. Changes to direct deposit information may be made through the paper application or starting in 2010 through a web-based service for employees – Employee Self Service. The Council encourages employees to manage payroll information through electronic means, rather than using paper.

Employees may have their pay distributed among several bank accounts. Employees may specify any dollar amount or percentage of pay to direct to each account, however there must always be one account into which the balance of the pay will be deposited.

If a paper application is submitted, Payroll staff will enter the information into PeopleSoft HRMS. There is one primary staff person that enters employee information, with two Payroll staff persons as backup support. When the information is submitted through Employee Self Service, no further Payroll staff intervention is necessary.

Audit staff selected a random sample of 29 employee direct deposit requests by bank account made between July 1, 2010 and September 30, 2010. The sample size provided a 95 percent confidence level with a 5 percent error rate of all direct deposit requests during the time period. The sample included requests submitted by the paper application and through Employee Self Service (ESS). Requests submitted through Employee Self Service comprised 13 of the sampled requests. Audit staff tested for accuracy of the

information by comparing the direct deposit requests to the information stored in PeopleSoft HRMS.

All direct deposit records reconciled with the direct deposit requests in terms of banking information, employee identification number, dollar amount (if specified), and method to distribute pay.

Entry of the wrong bank routing number or bank account number would be discovered when the employee ACH file is bounced back to the Council's bank by the recipient bank. Additions or changes to direct deposit information will go through a pre-note process, which is a zero-dollar test transaction to verify the employee's new direct deposit information. The Council's bank will send Treasury a report of bounce backs the week following the pay day, and Payroll will contact the employee for the correct banking information. A paper pay check will be issued to the employee in the meantime.

***Adequate controls are in place to limit risk of duplicate payments.***

The duties for direct deposit account setup, payroll processing, and payroll verification are segregated at the Council. Furthermore, Payroll runs reports of employees paid in excess of 80 hours per pay period and employees paid in excess of \$10,000 per pay period, which together should help to identify duplicate payments.

Audit staff tested for duplicate payments by reviewing all direct deposit change requests from July 1 to September 30, 2010. Out of the 691 accounts reviewed, 12 accounts representing 3 employees required further review because the six pairs of accounts were identical. In those instances, the employees were assigned to a second pay group because they were in temporary job assignments; no duplicate payments were made.

***Adequate controls are in place to ensure timely payment through direct deposit.***

Payroll has detailed written procedures for the processing of payroll. During interviews with audit staff, Payroll staff frequently mentioned the timeframe in which the batch files must be transmitted to the Council's bank. Audit staff observations confirmed Payroll staff's adherence to the timeframe with regards to transmittal of ACH batch files. The bank sends an e-mail confirmation of receipt of a batch file within one hour of transmittal by Payroll. The confirmation e-mail is reviewed by Payroll staff for errors in the transmittal and Payroll will contact the bank if the transfer should be cancelled and another transmittal sent. Payroll staff will print the confirmation notice. Since the conversion to mandatory direct deposit, all payroll direct deposits were transferred to employees' accounts on time.

***Adequate controls are in place to secure employee financial information.***

Access to view and edit employee direct deposit information is limited to those Payroll staff that have a business need. Input of employee direct deposit information is through PeopleSoft HRMS, which is the application used for Payroll. Ten Payroll staff persons have view and edit permissions within PeopleSoft HRMS. Access is necessary for Payroll staff to conduct their work responsibilities. Furthermore, the Payroll manager's desire is to give Payroll staff access to the basic payroll components for the purpose of cross training and providing backup roles.

Five application developers within IS Enterprise Systems have access on an ongoing basis to PeopleSoft HRMS applications for support purposes. One developer, who no longer supported HRMS, was found during the course of the audit to still have access rights. Access was promptly removed. Access rights for these staff are limited to inquiry only in the production environment. The three Human Resources Information Systems (HRIS) staff persons have access for ongoing support of the applications.

The ACH files, which authorize transfer of funds between the Council's banks to the employees' accounts, contain the following information for each employee:

Savings or checking account code	Employee ID number
Bank routing number	Employee full name
Bank account number	Council's bank number
Amount of direct deposit	Advice slip number

An ACH file is generated as an output file as a result of payroll processing within the PeopleSoft HRMS system. The ACH files, once generated, are not editable by users. Ten Payroll staff persons have permission to view the ACH files, but are not able to edit the ACH file. Four of the Payroll staff persons have ongoing need to access the ACH files. Other Payroll staff persons continue to have permission to view the ACH files both for cross training purposes and also to respond to employee questions about the payments.

The same IS Enterprise Systems and HRIS staff that have access to PeopleSoft HRMS applications also have access to the ACH directory. Again, the purpose is for ongoing support of the Council's financial systems.

## ***Cost-Benefit Analysis***

Audit staff compared costs prior to and after mandatory payroll direct deposit. Between 70 percent and 80 percent of Council employees had elected to use direct deposit prior to the transition. Bus operators were given the option to choose direct deposit beginning in October, 2007, so an estimated 70 percent had already enrolled in direct deposit compared to higher enrollment for other Council divisions that had direct deposit as an option earlier. The cost estimates reflect that most of the Council's workforce had enrolled in direct deposit prior to the conversion to mandatory direct deposit, rather than provide a comparison between a true paper pay check process and a direct deposit process. Off-cycle checks were not included in the analysis both because the volume of those checks vary little year-to-year and the issuance of those checks is not impacted by direct deposit.

### ***Finance staff time decreased after the conversion to mandatory direct deposit.***

Calculation of staff time, for both pay checks and direct deposit, include the costs for printing & distribution, as well as reissuing lost pay checks. Pay check processes additionally include the Positive Pay process, which authorizes the Council's bank to honor specified pay check numbers. Direct deposit staff costs include the ACH batch file process and ACH file bounce backs. The analysis does not include costs from entry of time card information to the running of the final payroll register, which are identical processes and costs for both pay check issuance and direct deposit.

A comparison of estimated annual costs is below.

***Table 1. Comparison of Estimated Annual Staff Costs<sup>1</sup>***

	Pre-Mandatory Direct Deposit	Post-Mandatory Direct Deposit
Positive Pay	\$900	\$900
ACH Batch File	\$900	\$900
Printing & Distribution	\$15,100	\$15,100
Outstanding Checks Reissuance	\$14,800	\$2,100
ACH Bounce Backs	\$600	\$900
<b>TOTAL</b>	<b>\$32,300</b>	<b>\$19,900</b>

<sup>1</sup>Wages only; excludes benefits.

The transition to mandatory direct deposit has seen reductions in staff time devoted to the process for confirming lost pay checks and reissuing pay checks. Audit estimates that over 400 hours of staff time is saved annually with the reduction of the number of outstanding pay checks. Annually, the transition to mandatory direct deposit leads to approximately \$12,400 in staff cost savings, which allows for redeployment of staff resources to other duties.

***Printing, distribution, and related costs are unchanged.***

The process and distribution of pay checks and pay advice slips did not change after the transition to direct deposit. The printer, ink toner, and check stock are the same for both pay checks and pay advice slips. A comparison of the costs of printers, ink toner, and check stock showed no change between 2009 and 2010. The estimated annual cost for material, equipment, and software is \$16,000.

***Table 2. Comparison of Estimated Annual Material, Equipment, and Software Costs***

	Pre-Mandatory Direct Deposit	Post-Mandatory Direct Deposit
Material	\$13,450	\$13,450
Equipment	\$1,750	\$1,750
Software	\$800	\$800
TOTAL	\$16,000	\$16,000

Distribution of pay advice slips and pay checks had not changed after the transition to direct deposit. Employees receive paper pay advice slips on pay day. Most employees receive their pay checks or pay advice slips at their assigned place of work. Staff time and costs devoted to printing and distribution have not changed after the transition. The estimate annual staff cost for both printing and distribution of advice slips and pay checks is \$15,100.

Plans have been made to eliminate the printing of pay advice slips in 2011, but the announcement had not been made at the time of the writing of this report. Substantial reductions in printing and distribution costs in excess of \$20,000 annually are anticipated to result from that change. Pay checks that are printed will be mailed to employees' homes. Employees will view pay advice slips through Employee Self Service, which is a service that employees have had since the rollout of Employee Self Service.

***Bank charges declined after mandatory direct deposit***

The volume of paper pay checks processed by the Council's bank dropped from over 2,000 items monthly prior to mandatory direct deposit, to under 100 items monthly with mandatory direct deposit. The monthly bank charges were reduced by between \$400 and \$500, for an estimated savings of \$5,000 per year.



# CONCLUSIONS

1. *Adequate controls exist for accurate, secure, and timely transmittal of funds through payroll direct deposit.*

Procedures have been established that ensure that employees' wages are transferred through direct deposit to the correct accounts, in the correct amounts, and in time. System access is limited to Payroll and Information Systems staff with a business need for the information.

2. *The transition to mandatory direct deposit has led to efficiencies in staff time and bank charges.*

Estimated costs savings of \$15,400 annually have resulted from the transition to mandatory direct deposit. Further gains in efficiencies and savings in material costs could exceed \$20,000 annually if advice slips are no longer printed and distributed.