

Assurance Report

1511 Pension Payroll

July 8, 2015

Cindy Rougeou, Executive Director
The LASERS Audit Committee

EXECUTIVE SUMMARY

Overall, the procedures and controls in place within the pension payroll process are effective. The following observations identified during the review would further enhance the effectiveness of this process:

1. Access to pension payroll payment files should be granted based on business need.
2. Federal income tax withholding setup and verification process for Deferred Retirement Option Plan (DROP) and Initial Benefit Option (IBO) payments could be improved.
3. Pension payroll exceptions should be reviewed and one improved.

BACKGROUND

This was a planned engagement on the fiscal year end (FYE) 2015 Audit Plan. The fieldwork for this engagement was completed on April 13, 2015.

The Pension Payroll section within the Fiscal Division is responsible for processing these main types of payments to LASERS members and benefit recipients:

- Monthly retirement benefit.
- Lump sum leave payout.
- Refund of contributions.
- DROP and IBO payments.

In addition to payment processing, staff are also responsible for processing federal tax withholdings and other voluntary deductions.

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Cindy Rougeou, Executive Director

SCOPE, OBJECTIVES, AND METHODOLOGY

The scope of the engagement was to review the pension payroll process beginning from payroll initiation focusing on regular and interim payroll types.

The primary objectives of this engagement were to determine if:

- Internal controls within the pension payroll process are adequate and functioning as intended.
- The pension payroll process is in compliance with applicable statutes, rules, and procedures.

Procedures used to complete this engagement included:

- Interviewing LASERS staff.
- Review of internal controls and procedures.
- Performance of independent calculations and testing.
- Review of applicable laws and regulations.
- Conducting other inquiries necessary to achieve engagement objectives.

This engagement was conducted in accordance with the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. ACCESS TO PENSION PAYROLL PAYMENT FILES SHOULD BE GRANTED BASED ON BUSINESS NEED

OBSERVATION

Appropriate segregation of duties is an important control in the pension payroll process to mitigate the risk of errors and fraud. The duties performed are segregated amongst the staff appropriately; however, the access to files on LASERS network could be further restricted to staff that perform the duties within the process.

During the pension payroll process, multiple files are automatically generated after the payroll has been approved and saved to various folders on LASERS network. One group of files are used to print checks for the payees and vendors that do not have direct deposit set up. The other group of files are submitted to the bank for processing using the Button-Enhanced ACH/PP Notification System (BEANS).

While reviewing the users that have access to either view and/or modify these files, it was identified that multiple people have access to these files that are not part of the pension payroll process (e.g., Fiscal staff in other sections than pension payroll and users in Member Services). Allowing users access to these types of files not based on business need increases the risk of exposure to sensitive information, unauthorized changes, and the potential for fraud.

RECOMMENDATION

Fiscal should work with IT to thoroughly review the network security access to the locations where these files are saved and identify who should have access and the type of access they should have. Appropriate access levels should be granted based on a legitimate business need and not whether

potential future access may be necessary. Also, Fiscal should periodically review access to these locations to ensure access remains limited to approved users.

RESPONSE

Fiscal agrees with this recommendation. Fiscal will work with IT to update the user access rights based on business need. The priority to address this recommendation has been set as medium with a target completion date of December 31, 2015.

2. FEDERAL INCOME TAX WITHHOLDING SETUP AND VERIFICATION PROCESS FOR DROP/IBO PAYMENTS COULD BE IMPROVED

OBSERVATION

According to the Request for Withdrawal from DROP and IBO Account form, if a member chooses to receive an annual DROP/IBO withdrawal payment then it is subject to a mandatory federal income tax withholding of 20 percent if not transferred directly to a qualified plan or account. As per Fiscal, a member can also directly request a different tax withholding percentage or amount. If nothing is specified, then LASERS will withhold 20 percent for this type of DROP/IBO withdrawal payment. It was observed during testing that five payees who chose this method of payment had federal taxes withheld at an amount less than 20 percent and no special request was submitted. Additional research determined that when the DROP withdrawal payment was scheduled, the tax amount derived was 20 percent; however, the tax amount derived as part of the payroll process was for a different amount. The payroll process should not derive a different amount than what is derived during the DROP/IBO withdrawal setup. Furthermore, the pension payroll process has a manual control in place to review the tax rate for DROP/IBO payments to make sure they comply with the rules mentioned above; however, this control did not work in these instances. LASERS and/or the member can face monetary penalties if the appropriate amount of income tax is not withheld and remitted to the Internal Revenue Service.

RECOMMENDATION #1

Fiscal should perform a review of the SOLARIS DROP/IBO Withdrawal module and business rules to determine areas needing improvement. The issue cited above should be investigated further during this review. Upon completion of this review, the necessary action should be taken to modify SOLARIS to address the issues identified. It should be noted that SOLARIS related TFS item 28442 is in the process of being addressed which is intended to improve the tax withholding setup process. However, it is unclear as to whether these changes will fully address the issues associated with this SOLARIS module.

RESPONSE

Fiscal agrees with this recommendation. For the five instances found, there really was not a consistent reason why the amounts were incorrect because others were set up exactly the same way, but calculated correctly. Currently there are 45 DROP yearly payments set up and all of the taxes have been updated to the correct fixed amount. Once TFS item 28442 is complete and the DROP yearly payments created, we will have to see if this issue is resolved. The priority to address this recommendation has been set as low with a target completion date of February 29, 2016. Fiscal will continue manual staff review and will verify the taxes on the December 1, 2015 payroll for these payments.

RECOMMENDATION #2

Fiscal should create a payroll warning exception that would identify instances when the tax withholding amount is not equal to the expected percentage generally prescribed for a non-rollover payment type (i.e., DROP yearly payment 20 percent, required minimum distribution payment 10 percent, refund payment 20 percent, etc.). This will formalize the current manual review process and help improve its overall efficiency and effectiveness.

RESPONSE

Fiscal agrees with this recommendation. TFS item 32243 was created to make the recommended changes. Fiscal staff will continue to manually review the tax amount until the warning exception is created. The priority to address this recommendation has been set as medium with a target completion date of December 31, 2015.

3. PENSION PAYROLL EXCEPTIONS SHOULD BE REVIEWED AND ONE IMPROVED

OBSERVATION

As part of the pension payroll process, the preliminary payroll information generated from SOLARIS data is compared to a set of pre-defined rules and any identified rule violations appear on the Pension Payroll Exception Report. The exceptions identified are classified as either an error or warning. Payees with an error exception are automatically removed from the list of payments scheduled to be included in the current payroll run. Payees with a warning exception require further review and corrective action may be required prior to the payment being approved for inclusion in the current payroll run. Fiscal staff is responsible for reviewing the exception report and taking the necessary action to ensure that all exceptions are properly resolved prior to final payroll processing.

Audit performed detailed testing on a sample of exceptions selected based on the type of exception and the frequency in which the exception occurred during the pension payroll process. While testing the payroll error exception that is designed to prevent paper checks from being issued to payees without a valid home address in SOLARIS, it was observed that interim payroll payments were issued to three payees that violated this exception rule. Error messages should have been generated and the payments should not have been issued until this issue was corrected in SOLARIS. These payees should have been on the exception report. Additionally, the addresses had to be manually added prior to the checks being mailed to the payees. The anomalies identified indicate that the computer programming logic for this exception could be improved to consistently identify all occurrences of this exception. It should be noted that during this review, SOLARIS related TFS item 32069 was created by Fiscal to address this issue.

RECOMMENDATION #1

Fiscal should review the existing payroll exceptions to ensure they are functioning as intended.

RESPONSE

Fiscal agrees with this recommendation. A review of the existing payroll exceptions will be performed to ensure that they are functioning as intended. The priority to address this recommendation has been set as low with a target completion date of December 31, 2015.

RECOMMENDATION #2

For the exception related to the missing addresses, Fiscal should monitor TFS item 32069 until it is resolved and ensure the issue noted is corrected.

RESPONSE

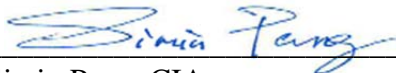
Fiscal agrees with this recommendation. Fiscal will monitor TFS item 32069 to ensure that the issue is corrected. We would like to suggest that Audit consider recommending to Executive Management that addresses be updated periodically utilizing Accurint or some other data source on an agreed upon schedule. (Possibly annually in October or November so that 1099 mailings will be accurate. The amount of returned mail for mass mailings is fairly significant.) The priority to address this recommendation has been set as low with a target completion date of February 29, 2016.

AUDITOR COMMENT


A review of the address update process was performed by Audit Services during FYE 2011 and a recommendation was given which would reduce the returned mail to LASERS. This recommendation is currently in an open status. Audit Services will revisit this recommendation and work with Member Services and Fiscal to develop a corrective action plan.

FOLLOW-UP

A follow-up to this engagement will not be scheduled at this time. Audit Services will maintain this information on a tracking report. These items will be tracked until they are closed.



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