Department of the Treasury

Centralized Payroll

January 1, 1996 to June 30, 1997

Richard L. Fair
State Auditor
The Honorable Christine Todd Whitman
   Governor of New Jersey

The Honorable Donald T. DiFrancesco
   President of the Senate

The Honorable Jack Collins
   Speaker of the General Assembly

Mr. Albert Porroni
   Executive Director
   Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Centralized Payroll for the period January 1, 1996 to June 30, 1997.

If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair
State Auditor
August 11, 1997
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Department of the Treasury
Centralized Payroll

Scope

We have completed an audit of the Department of the Treasury, Centralized Payroll for the period January 1, 1996 to June 30, 1997. Our audit included the Centralized Payroll operations and its related processes for paying salary and other compensation to state employees, including financial activities accounted for in the state’s accounting system.

The Centralized Payroll pays approximately 73,000 employees biweekly during its regular and supplemental payroll cycles. There are more than 200 payrolls units. Gross salaries are approximately $3 billion annually.

Objectives

The objectives of our audit were to evaluate the policies and procedures relating to the payment of salary and other compensation to state employees. We focused on the adequacy of policies and procedures for processing regular and supplemental payroll; updating master payroll files through system interfaces, wage agreements and deduction authorizations; maintaining records in compliance with state and federal retention schedules; posting of accounting transactions for payroll expenses and employee deduction liabilities; and paying liabilities and reporting payroll related taxes.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview and observation and through our samples of transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the policies, goals, and internal control structure. Procedures that we considered significant were documented, and compliance with those procedures was
verified by interview and observation and through both statistical and nonstatistical sampling. Our samples of payroll transactions and events were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. We also extracted data from the master file and verified it to the source documentation in files at the agencies.

Conclusions

We found that policies and procedures relating to the payment of salary and other compensation were adequate and that the payments were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations meriting management’s attention.

Auditee’s Response

I am pleased to note that you find the annual issuance of two million payments grossing $3 billion is properly accounted for and that policies and procedures relating thereto are adequate.

Considering the longevity of the current Payroll System, it is a tribute to the Centralized Payroll and OTIS Personnel that we are able to maintain a high level of accuracy and quality service. Nevertheless we intend to improve upon this by installing a new modem system in the near future.
Automated Payroll Systems

The state payroll system issues 2 million payments annually, which total $3 billion in gross payroll. The payroll system is comprised of two automated components, the data entry system and the information processing system. Neither component is adequately safeguarded to ensure continuous processing and recovery in the event of processing interruptions. The following weaknesses were noted.

C There is no disaster recovery plan in effect for the data entry and storage system. This is especially significant because the system is out-dated and no longer produced or supported by the manufacturer. The agency has identified only 21 users of this system in the country and they rely on each other for spare parts. The system is scheduled to be replaced in approximately one year, but until that time the ability to process the payroll is at risk.

C The payroll processing component is maintained by the Office of Telecommunications and Information Systems (OTIS). The OTIS Technical Service Plan states that a disaster recovery plan must be tested at each data center at least once a year to ensure that it will satisfy a site’s processing requirement. The functions of such tests are to determine the ability to recover key processing components based on a documented set of instructions and assure that the measures in place will in fact enable recovery. The processing system’s recovery plan is not current. Nor has it ever been fully tested to verify that if a disaster occurred it could be restored and how long it would take.

Recommendation

We recommend that Centralized Payroll develop a disaster recovery plan for the data entry system, and request OTIS update the disaster recovery plan for the payroll system and test it annually.

Auditee’s Response

OTIS agrees with the recommendation made by the Office of Legislative Services to update the Disaster Recovery Plan for the resumption of processing of the Payroll System. OTIS is cognizant of the need for a business resumption/disaster recovery plan for all State systems, including the payroll operation. OTIS has purchased Sunguard’s Comprehensive Business Recovery software which will assist in developing plans for the recovery of priority systems which OTIS
operates. These plans are currently being developed and will describe the strategies and actions necessary to resume normal business following a serious outage or interruption.

OTIS is currently working on a major project which will consolidate the three major existing data centers into a single processing center. Disaster recovery/business resumption plans will be revisited and revised due to this consolidation. OTIS is also developing specifications to obtain disaster recovery processing services from a “Hot Site” vendor. Movement forward at that point will be contingent on sufficient funding being available to contract for these services. After a contract is established, testing of the resumption plans will occur.

Processing Controls

Because payroll processing involves numerous transactions and the repetitive sequence of various actions, adequate processing controls should be established to minimize errors. Certain control procedures established by Centralized Payroll are not being followed as noted below.

A payroll certification document accompanies each payroll proof, which is the payroll input source document, submitted by agencies. The certification requires two authorizing signatures, which attest to the validity and accuracy of the payrolls. As an internal control procedure, Centralized Payroll requires comparison of signatures to the signature cards of agency officials who are authorized to sign payroll certifications. However, Centralized Payroll routinely accepts only one signature and does not compare the signatures on the certifications with the cards. We tested two supplemental and two regular payrolls and noted that 17.5 percent of the certifications could not be verified because signature cards were not on file; the certifying signatures did not agree with those of the existing cards; or in some cases the current signature cards were located in the inactive file. The audit function reviews, scans and edits the payroll proofs to ensure the prompt detection and correction of errors. Procedures require that auditors initial the proofs as evidence of their review. However, we noted that 5 percent of the sample proofs did not contain audit review initials. It could
not be determined if the proofs had not gone through the review process or if the auditor failed to initial them.

Procedures require that supplemental payroll proofs be logged in. We noted that 6 percent of the proofs were not logged in and the log was not used to account for the proofs received or verify that they have been processed.

**Recommendation**

We recommend that Centralized Payroll review the nature and extent of established control procedures over the processing cycle to determine if they support its’ operating objectives. If the controls are deemed necessary, management should monitor their effectiveness to ensure they are being followed and functioning as intended.

**Auditee’s Response**

Centralized Payroll’s internal processing controls have been established for the purpose of providing accurate and timely payments to New Jersey State Employees. We deem them to be necessary in our efforts to accomplish this end, however extremely tight time constraints and the need for processing a biweekly avalanche of paper have contributed to the audit comment. We will increase our monitoring efforts to ensure the effectiveness of these internal controls.

\[\text{Supplemental Payrolls should be subject to garnishment.}\]

**Garnishments**

Currently some earnings of garnishees’ are not subjected to court orders of indebtedness, child support and tax levies as required by Title III of the Consumer Credit Protection Act. The act considers an employee’s earnings to be all compensation paid to the employee for personal services including overtime and bonuses. The payroll system does not deduct garnishments when paying employees on supplemental payrolls. Failure to withhold the required amounts and to make the payments in accordance with court orders can render the state liable for increased court costs, and to the employees’ creditors.

During the audit Centralized Payroll issued a work request to OTIS who has initiated the modification and enhancement of the automated system to deduct garnishments on supplemental pays. As of June 30, 1997, it had not been completed.
Recommendation

We recommend that Centralized Payroll complete the modification of the payroll system to properly handle garnishments in accordance with court ordered wage assignments and garnishment notices.

Auditee’s Response

Recently negotiated union contracts shifted overtime payments back from the regular payroll to the supplemental payroll. Prior to that, even though not in total compliance with garnishment regulations, we considered our exposure to be minimal. Immediate steps were taken to request the necessary programming. The first phase scheduled for September implementation will garnish support payments from those same overtime payments now paid on supplemental payroll. The second phase will encompass all garnishments from all supplemental payments and is scheduled for a later date.

Employees’ Withholding of Employees’ Pension Deductions

Each pay period, Centralized Payroll records the liability for the withholdings of employee pension contributions. On a monthly basis, the liabilities are relieved by the payment to the Division of Pensions and Benefits. This is not in compliance with the New Jersey Administrative Code 17:1-1.3g, which requires that payroll deductions for pension be remitted on a biweekly basis immediately following the payroll dates for state employees reported by the central payroll system. The practice of payment on a monthly basis allows the General Fund to retain the use of the funds and reduces the amount of investment earnings in the pension trust funds. We estimated lost investment earnings to the pension funds to be $1.4 million annually.

Although the funds were invested, the General Fund’s five year average investment rate was 4.66 percent, whereas the average five year investment rate of pension funds was 12.1 percent. Thus by investing the funds through the General Fund there is a loss of 7 percent earnings to the state.

We recommend that Centralized Payroll revise current procedures and relieve the pension liabilities on a biweekly
basis and promptly transfer the funds to maximize earnings in employee pension funds.

**Auditee’s Response**

Payments are being made on a biweekly basis. The procedures to remit payroll withholdings to the Division of Pensions were revised prior to the conclusion of the audit. In fact, a coordinated effort initiated by OMB with the Division of Investments and the Division of Pensions accomplishes these biweekly remittances by book entry transfer within the Cash Management Fund, thereby also eliminating the need for the actual transfer of cash.

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**Savings Bond Balance Account**

Funds to purchase U.S. savings bonds are deducted from participating employees’ pays and held in the employee bond deduction liability account until cumulative deductions are sufficient to purchase a bond. Amounts remaining in the liability account represents the balances after the purchase. The payroll system generates two subsidiary reports which should be used in the reconciliation process. One report contains bond balances of employees who have canceled their bond withholdings and the other report lists the balances of currently participating employees. The latter report is not totaled. Further review of the account found that Centralized Payroll did not reconcile the employee bond deduction liability account balance to the subsidiary records. Proper internal controls require that periodic reconciliations be completed to verify the accuracy of account balances.

**Recommendation**

Centralized payroll is currently developing a plan to reconcile account balances. We recommend that the plan include the periodic reconciliation of liability account balances with the subsidiary records.

**Auditee’s Response**

The bond deduction subsidiary detail amounts were considered to be within a relatively minor difference of the general ledger liability account balance, therefore we assigned this account a lower priority than the various other accounts on our ongoing reconciliation schedule. At the time of the audit this particular account had not been completed. The bond deduction account will be reconciled and the detail subsidiary reports will be totaled.
County Judicial Employees Overtime Rate

The master payroll file compiles all the information relating to state employees’ payroll records. Our test of the master file noted that the overtime rate for county judicial employees who became state employees on January 1, 1995 did not include clothing allowance as a component of its computation. The Fair Labor Standards Act states that clothing allowances must be included in calculating an employee’s base rate of pay unless such allowance constitutes reimbursements for items required by the employer or purchased primarily for the employer’s benefit. When they became state employees, Centralized Payroll programed the payroll system to override the clothing allowance when calculating the overtime rate. This exclusion resulted in the underpayment for overtime. Centralized Payroll identified 76 employees who could be receiving clothing allowances.

Recommendation

We recommend that Centralized Payroll correct the master file data for county judicial employees. They should reprogram the system to compute the overtime rate by including clothing allowances. We also recommend that overtime payments from January 1, 1995 to present be reviewed and that adjustments be made for underpayments to employees.

Auditee’s Response

Vicinage employees incorporated at the time of the Court Unification are not yet fully identified by unique negotiating units. Compounding the inability to determine payment eligibility, employees working in the same titles are represented by different bargaining unions based solely on the vicinage in which the employee works. The Judiciary is continuing to work with the Department of Personnel in grouping titles into a set of unique negotiating unit designations. This should allow for automated negotiated payments such as clothing/uniform maintenance allowances for appropriate contract periods. Any retroactive adjustments for current situations will be paid as certified by the Judiciary.