



CITY AUDITOR'S OFFICE

To: Mayor Coviello and Council Members

From: Andrea R. Russell, City Auditor *ARR*

Date: February 3, 2020 (Fully released 5/5/2020)

Subject: Financial Services- Second Payroll Inquiry 1/1/2017-3/31/2018 and 10/1-11/7/2019

During September 2019, the Financial Services Director was made aware of late filing, and interest and penalties incurred for IRS Form 941 used to report payroll taxes (social security, Medicare and withholding). At the request of the Mayor, the City Auditor's Office reviewed the Form 941 filings to determine:

- If IRS Form 941s were filed accurately and in compliance with IRS filing deadlines
- Penalties and interest incurred as a result of any late or inaccurate filing

We issued a memo on 12/6/2019 for the period 4/1/2018-9/30/2019. While we noted required deposits were inaccurate, incomplete or not filed in accordance with IRS deadlines, all payroll taxes due were remitted for the scope of the review. Also, the results of this review indicated there was no need for a criminal investigation or forensic audit at this time. Further details can be found in the Financial Services-Payroll Inquiry Memo dated 12/6/2019.

We completed this engagement as a non-audit service/ agreed upon procedures and the review did not constitute an audit performed in compliance with generally accepted government auditing standards (GAGAS). However, the work was performed in compliance with GAGAS as they relate to non-audit services.

BACKGROUND

The City's Payroll division is responsible for depositing bi-weekly payroll tax amounts via EFTPS. Reports are run and supporting documentation is compiled to properly report and deposit Federal withholding, social security and Medicare taxes. A wire transfer form is prepared by an individual in Payroll and approved by the Payroll Supervisor, Senior Accounting Manager, Deputy Financial Services Director and Financial Services Director.

Once complete the wire transfer packet is submitted to Accounts Payable and the transfer is completed by Payroll.

Quarterly, a Form 941 and accompanying Schedule B is prepared and mailed via certified mail to the IRS processing center. All information on the quarterly Form 941's should agree to the biweekly deposits submitted throughout the quarter. The Payroll Supervisor completes a memo coversheet addressed to the Senior Accounting Manager for each Form 941 and accompanying Schedule B for review and approval. Once the forms are reviewed and approved by the Senior Accounting Manager, they are provided to the Financial Services Director for signature and filing via certified mail. Form 941's are due to the IRS by the end of the month following the last month of the quarter reported. For example, the forms for the quarter ended 3/31/2019 must be filed by 4/30/2019 or penalties and interest are assessed.

IRS Transcripts and Fines

The IRS will only provide 10 transcripts per request. Based on this policy, and the timing of the inquiry, only three transcripts were not received: one for the Charter School Q1 2019; one CRA Q1 2017; and one City Q3 2019; however, we have the subsequent transcripts and there appear to be no penalties or fines assessed. Based on this information we did not submit any additional requests.

Fines are calculated based on the amount of the tax liability; therefore, amounts are large due to the liability due to the IRS.

SCOPE and METHODOLOGY

The scope of our inquiry included IRS Form 941's and supporting documentation filed between 1/1/2017 through 3/31/2018 and 10/1-11/7/2019. We tested 100% of the transactions for payroll included in our scope period.

Our review focused on the biweekly payroll tax deposits made through EFPTS, Form 941's and supporting documentation submitted to the IRS for the City, Charter School and CRA, and IRS transcripts.

As part of our review of bi-weekly payroll deposits, the following was performed:

- Verified all information submitted to the IRS was accurate and complete for biweekly payroll taxes (withholding, Medicare, social security).
 - This included a review of supporting documentation for accuracy, approval and review.
- Verified the amounts per the wire transfer form agreed to general ledger amounts.
- Reviewed signatures for preparation and approvals on wire transfer form.

As part of our review of the Form 941 filings, the following was performed:

- Verified total Schedule B amounts for the quarter as reported agreed to the general ledger totals for the quarter.
- Verified all totals on Form 941 to supporting documentation.
- Reviewed preparer signatures and approvals per Form 941 cover sheets that accompany the filing forms.
- Agreed payments on Schedule B Form 941 attachments to bi-weekly deposit amounts.
- Reviewed certified mail receipts for Form 941 mailing.

As part of our review of the IRS transcripts, the following was performed:

- A review of current account balance, accrued interest, and accrued penalty.
- Matched the amounts on the transcript to the bi-weekly amounts recorded within the general ledger.
- Reviewed the tax return filled amount and matched to 941 and bi-weekly amounts.
- Reviewed dates provided to indicate if 941 was received on time.

We reviewed the bank reconciliations completed by the City to determine if funds were appropriately deposited.

RESULTS

Based on our review we determined the following:

➤ Bi-Weekly Review Results

Tax liabilities totaling \$100,000 or more must be made by the end of the following business day.

- One of 141 were paid late for the City
 - *One of 141 was missing the deposit confirmation so we were unable to determine if paid on time*
- *Three of 141 where documentation was incomplete so EIN couldn't be verified. Two of the three were verified using IRS transcripts; however, the correct documentation was not present*
- Overall, preparer and approver signatures were consistent. The bi-weekly was prepared by staff and approved by an individual at a higher level of authority (i.e. Senior Accounting manager, Deputy Finance Director or Finance Director).
 - 138 of 141 of the wire transfer forms were prepared by Payroll staff
 - Three of 141 did not have a prepared by signature
 - Six of 141 had no approval signature above Senior Accounting Manager
- One of 141 where the EFTPS deposit was made to the incorrect the tax period. This did not result in any penalties/ fines.

➤ **Quarterly 941 Results**

- All Schedule B amounts agreed to the biweekly submissions and/or the general ledger amounts.
- The sample included 15 Form 941's.
- Form 941s are due by the end of the month following the last month of the quarter. For example, for the quarter ended March 31, the 941 is due by April 30.
 - One of 15 was received late by the IRS.
- Form 941s are accompanied by a coversheet indicating preparation and Senior Accounting Manager approval for final signature by the Financial Services director.
 - All of the 15 were prepared by a Payroll Specialist or designee.
 - All of the 15 were signed by the Payroll Supervisor or designee.
 - 9 of the 15 were signed by the Financial Services Director.
 - Three of the 15 was signed by the Deputy Financial Services Director.
 - Three of the 15 had no signature.

➤ **Bank Reconciliations**

We reviewed bank reconciliations to determine if there were any misappropriation of funds. We noted no outstanding reconciling items from the reconciliations, thereby indicating that all funds were properly deposited for payroll tax liabilities.

➤ **Fines and Penalties Incurred**

Based on a review of the IRS transcripts received as of 1/13/2020, it does not appear that any fines or penalties were incurred during the scope of this engagement.

As of the date of issuance of this memo, the updated total for fines and penalties as reported in the 12/6/2019 memo is currently estimated at \$190,112. Financial Services expects this total to continue to be adjusted as the IRS reviews information submitted by the City.

CONCLUSION

Although, required deposits and reports were inaccurate, incomplete or not filed or made in accordance with IRS deadlines, all funds associated with Form 941 were remitted to the IRS payroll taxes due were remitted for the period included in the scope of the review.

A lack of policies and procedures and proper review of submissions contributes to the inaccuracies identified. Based on the test work performed we noted areas which represent opportunity for improvements. For further details see the Findings and Recommendations section.

FINDINGS AND RECOMMENDATIONS

FINDING 2020-01: Biweekly payroll deposits and Form 941 processing and policies and procedures

Rank: High

CONDITION: (Describe "What is the existing situation")

- No formal detailed policies and procedures exist for the bi-weekly payroll deposit processing and IRS Form 941
- Wire transfer voucher due dates do not reflect the actual due dates of the deposits but rather the date the voucher was processed
- Reviewer signatures were often missing from wire transfer vouchers or Form 941 coversheets. Also, sometimes the individual signatures present on the forms weren't in the correct location. For example, we noted instances where the Financial Services Director signed on the Deputy line and didn't sign on the Financial Services Director line.
- No attestation statement on the coversheets for the review completed
- Wire transfers for biweekly payroll deposits to the IRS are completed by a Payroll division employee
- Lack of formal payroll process specific training

CRITERIA: (Describe "what should be required or expected: e.g. laws, regulations, contracts, agreements, etc.)

- GAO's Standards for Internal Control in Federal Government 12.02: "Management documents in policies the internal control responsibilities of the organization." Section 12.03 also states management should document "policies in the appropriate level of detail to allow management to effectively monitor the control activity." An effective all-encompassing policy and procedures manual is an essential management tool and provides a roadmap for day to day operations.
Policies and Procedures manuals:
 - Ensure business continuity
 - Identify specific methods and standards for how work is performed, and documented
 - Provide process consistency and structure
 - Should be periodically reviewed and updated
 - Organizational consistency and efficiency
 - Sufficient governance over processes
- Including the actual due date for deposits will assist in the review process to identify late filing

- Information should be reviewed to the appropriate level of detail and by the appropriate individuals
- Attestation statements serve to confirm and provide more evidence than a signature to support the review was performed
- In order to have proper segregation of duties, an individual outside of the immediate process should perform wire transfers based on information provided by Payroll
- Proper training provides a structured way to deliver appropriate details for performing job duties

CAUSE: (Explain why condition occurred)

- Lack of formal documented policies and procedures
- Insufficient information
- Ineffective review process
- Improper segregation of duties
- Inadequate training

EFFECT: (Quantify or measure the adverse results)

- Late, incomplete or inaccurate IRS filing
- Inaccurate or incomplete review

RECOMMENDATION: (Describe corrective action needed)

2020-01 a. Formalize policies and procedures for completion and submission of biweekly payroll deposits and IRS Form 941. Policies and procedures should include:

- Detailed steps to process bi-weekly deposits
- Applicable due dates for bi-weekly deposits and Form 941
- Established cut off dates for payroll information
- Individual positions involved in the process including their responsibilities, roles and assigned duties
- Detailed steps for EFTPS submissions
- Detailed steps for filing Form 941
- Details for review of biweekly information and Form 941 before submission

2020-01 b. Review the process to remove unnecessary reviewers and update wire transfer cover sheet and Form 941 coversheet to reflect the changes.

2020-01 c. Include the IRS due dates and a formal statement on the bi-weekly wire transfer review coversheet and 941 review memo to attest to the completed review for each individual

involved in the review process, including the Payroll Supervisor, and any other individuals involved in the review.

2020-01 d. Have the Payroll Supervisor or designee complete the wire transfer for the biweekly deposits and verify the transaction is complete.

2020-01 e. Provide formal training on the updated policies and procedures to all Payroll staff and Financial Services staff involved in the process directly or as backups. Maintain documentation to demonstrate training for all necessary staff, such as a sheet attesting to the completion of training for each individual.

MANAGEMENT ACTION PLAN:

2020-01 a. The Payroll division currently has various procedures documented for the submission of payroll taxes and 941 quarterly reporting. However, these procedures are currently being reviewed, updated and consolidated into one document. The Payroll division will update internal procedure documents to include the suggested framework to ensure proper segregation of duties, timely submission and payment and improve the review and reporting process.

2020-01 a. Responsible Person: Chris Phillips, Acting Financial Services Director & Britt Martin, Financial Projects Manager

2020-01 a. Anticipated Completion Date: 06/30/2020

2020-01 b. Management agrees that there are too many levels of review and approval. Management will update the policies and procedures to reflect a more efficient and effective process. An attestation will be added for approvers to include the acknowledgement of the review and the due date to the IRS. The 941 coversheets will also be updated to include an attestation acknowledging review and due date.

2020-01 b. Responsible Person: Chris Phillips, Acting Financial Services Director & Britt Martin, Financial Projects Manager

2020-01 b. Anticipated Completion Date: 06/30/2020

2020-01 c. Management agrees and has been providing a detailed memo and reconciliation to the Financial Services Director for review.

2020-01 c. Responsible Person: Diana Quackenbush, Payroll Supervisor & Britt Martin, Financial Projects Manager

2020-01 c. Anticipated Completion Date: Completed January 2020

2020-01 d. The Payroll Specialists will prepare the IRS Wire Transfer form and include all required supporting documentation. The documents will be submitted to the Payroll Supervisor for review and approval. The Payroll Supervisor will initiate the wire on the IRS EFTPS website. Current processes include that the Senior Accounting Assistant notifies the Payroll Division once the wire has been completed.

2020-01 d. Responsible Person: Diana Quackenbush, Payroll Supervisor

2020-01 d. Anticipated Completion Date: 06/30/2020

2020- 01 e. The Payroll Supervisor and the Financial Projects Manager will review the updated procedures and forms with the Payroll Specialists.

2020- 01 e. Responsible Person: Diana Quackenbush, Payroll Supervisor & Britt Martin, Financial Projects Manager

2020- 01 e. Anticipated Completion Date: 06/30/2020

FINDING 2020-02: IRS Form 941 submission

Rank: High

CONDITION: (Describe “What is the existing situation”)

- Schedule B’s attached to the Form 941 do not agree with the filing.
- Schedule B’s are completed at the end of the quarter.
- Payroll division and Finance Department employees are not familiar with Form 941 filing requirements and timelines.
- City contact information for the IRS is not current.

CRITERIA: (Describe “what should be required or expected: e.g. laws, regulations, contracts, agreements, etc.)

- Schedule B should support and agree to the general ledger and amounts filed on quarterly form 941
- All individuals involved in filing of Form 941 should be familiar with requirements and filing deadlines
- Contact information should be current

CAUSE: (Explain why condition occurred)

- Lack of comprehensive policies and procedures
- Unfamiliarity with requirements
- Inattention to detail

EFFECT: (Quantify or measure the adverse results)

- Incomplete, incorrect and/or late filing of Form 941
- Potential interest and penalties
- Inaccurate contact information

RECOMMENDATION: (Describe corrective action needed)

2020-02 a. Research electronic filing of IRS Form 941, including establishing an IT liaison for assistance with technology.

2020-02 b. Update contact information with the IRS to current Financial Services Director.

2020-02 c. Document differences between schedule B, the general ledger, and IRS Form 941 on the Form 941 cover memo.

2020-02 d. The Financial Projects Manager will ensure all Payroll division and Finance Department employees involved in the filing process review Publication 15 and Form 941 instructions annually, when released by the IRS, to familiarize themselves with updates or changes for the year.

2020-02 a. The Financial Services Department will research the ability to file Forms 941 and 945 electronically through e-Services.

2020-02 a. Responsible Person: Chris Phillips, Acting Financial Services Director & Britt Martin, Financial Projects Manager

2020-02 a. Anticipated Completion Date: 6/30/2020

2020-02 b. Form 8822-B was submitted to the IRS for the Charter School in October 2019. The City and CRA have been updated.

2020-02 b. Responsible Person: Chris Phillips, Acting Financial Services Director & Britt Martin, Financial Projects Manager

2020-02 b. Anticipated Completion Date: Completed in October 2019.

2020-02 c. Any differences between the liability on Schedule B and the Deposits paid to the IRS are to be detailed in the 941 Transmittal Memo to the Director for signature and approval.

2020-02 c. Responsible Person: Chris Phillips, Acting Financial Services Director & Britt Martin, Financial Projects Manager

2020-02 c. Anticipated Completion Date: Completed January 2020

2020-02 d. The Payroll Supervisor and the Financial Projects Manager will review IRS Publications 15 (Circular E) annually with the Payroll Specialists to assess any tax changes. The payroll system will be updated if necessary.

2020-02 d. Responsible Person: Diana Quackenbush, Payroll Supervisor & Britt Martin, Financial Projects Manager

2020-02 d. Anticipated Completion Date: 06/30/2020

FINDING 2020-03: IRS Communications

Rank: High

CONDITION: (Describe “What is the existing situation”)

IRS notices were not brought to the attention of Financial Services management in a timely manner.

CRITERIA: (Describe “what should be required or expected: e.g. laws, regulations, contracts, agreements, etc.)

- Management should be kept informed of important communications from the IRS.

CAUSE: (Explain why condition occurred)

- Improper tracking of notices.

EFFECT: (Quantify or measure the adverse results)

- Delay in addressing situation in notice.
- Potential fines and penalties.

RECOMMENDATION: (Describe corrective action needed)

- **2020-03** The Financial Services Senior Administrative Specialist should log and track all notices from the IRS including information for date received, Notice Number (i.e. CP134B), Tax Period, Notice Date, Employer ID, individual delivered to, and maintain

a copy of the notice. Notices should be given to the Deputy Financial Services Director or the Financial Services Director for dissemination to the appropriate individual.

MANAGEMENT ACTION PLAN:

2020-03 The Financial Services Senior Administrative Specialist will prepare a spreadsheet to track the information noted above and will deliver all notices to the Deputy Financial Services Director for dissemination to the Financial Projects Manager to review with the Payroll Supervisor.

2020-03 Responsible Person: Suzanne Lopez, Senior Administrative Specialist

2020-03 Anticipated Completion Date: 02/28/2020

C: Audit Committee Chairperson