A photograph of a classical building facade with a pediment and columns, serving as the background for the report cover. The building is light-colored and features a prominent portico with several tall, fluted columns. The pediment above the columns contains a relief sculpture. The sky is clear and blue.

Office of Inspector General

City of New Orleans

Payroll Liabilities Performance Audit

AR11REP003

**E.R. Quatrevaux
Inspector General**

Issued February 5, 2013

Payroll Liabilities Performance Audit
AR11REP003

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EXECUTIVE SUMMARY

During the Payroll Internal Control Audit issued in 2011, the auditors noted several accounts with large older balances within the Payroll Clearing Fund, an Agency Fund¹. These accounts had little or no activity for several years.²

Due to the risk of under-stated accrued liabilities³ in the individual funds and older outstanding liabilities in the Payroll Clearing Fund, the auditors reviewed payroll liabilities to test for accuracy and completeness.

The audit revealed that the Payroll Clearing Fund had approximately \$1.5 million in liabilities that should have been written off in previous years. The auditors also noted \$107.1 million in debit balances and \$106.8 million in credit balances that appeared questionable after the original \$1.5⁴ million dollar adjustment was posted.

The City was unwilling to perform research to determine the accuracy of these balances when questioned by the OIG auditors.⁵

The auditors found that employees' annual and sick time was entered incorrectly into the Advantage Human Resource System (AHRIS)⁶ for 27 of the employees selected for testing resulting in an understatement of leave balances totaling \$206,747.

The recommendations in this report, if adopted, should improve the City's management of payroll liabilities, increase the accuracy of amounts recorded in the Payroll Clearing Fund and ensure correctness of accrued sick and annual leave balances recorded in the other respective funds.

Note: All responses from the City in the body of this report are direct statements and have not been modified.

¹ The Governmental Accounting Standards Board No. 34 defines an agency fund as a fund "used to report resources held by the reporting government in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments."

² Finding #4 of The Payroll Internal Control Performance Audit, issued October 28, 2011, stated that the balances "were in excess of \$1.2 million."

³ Accrued liabilities are expenses that occurred in one period but are not paid until a later period. In order to reflect expenses in the proper period, these expenses were accrued and shown as a liability on the balance sheet. Payroll, vacation and sick time expenses were accrued as they were earned and "banked" until the employee used them. The total amount accrued was based on the employee's department, start date, and years of service.

⁴ This difference is a combination of transactions which have remained for several years.

⁵ The auditors originally requested explanations of these accounts on June 30, 2011, which was more than two months before the September 19, 2011 issue date of the December 31, 2010 Financial Statements.

⁶ AHRIS is the City's DOS-based payroll processing system.

I.OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of the audit was to evaluate the accuracy of the Payroll Clearing Fund as well as the completeness and accuracy of the annual and sick time accruals. The audit covered the period January 1, 2010 through December 31, 2010.

This performance audit was conducted in accordance with the *Principles and Standards for Offices of Inspector General* (the Green Book⁷) and *Generally Accepted Governmental Auditing Standards* (GAGAS or the “Yellow Book”).

To accomplish the audit’s objectives, the auditors:

1. Conducted interviews with payroll and accounting personnel responsible for payroll functions;
2. Attempted to evaluate the Payroll Clearing Fund to determine the accuracy of the balances in the Fund;
3. Obtained a listing of all employees paid during 2010;
4. Selected employees to test from the listing and performed the following:
 - a. Obtained and compared approved timesheets to AHRS to determine if the annual and sick leave were entered correctly;
 - b. Recalculated annual and sick time to determine if time was recorded in compliance with Civil Service Rules; and
 - c. Recalculated the balances for annual and sick time to determine if the balance was calculated in compliance with Civil Service Rules.

A finding indicates a material or significant⁸ weakness in controls or compliance that was not detected or corrected by the City of New Orleans in the normal course of performing its duties. Findings in a performance audit can be any one or a combination of the following:⁹

1. Significant deficiencies in internal control,
2. Fraud and illegal acts,
3. Violations of contract and grant agreements, and/or
4. Abuse.

This audit includes findings, observations, recommendations, and conclusions relating to the controls in place over payroll liabilities.

Computer-processed data was provided and relied on during testing, which provided information on payroll liabilities for the period of the report. Although a formal reliability assessment of the computer-processed data was not performed, the auditors determined that hard copy documents reviewed were reasonable and generally agreed with the information contained in the computer-processed data. No errors were found that would preclude us from using the computer-processed data to meet the report’s objectives or that would change the conclusions of this report.

⁷ Published by the Association of Inspectors General, July 2007.

⁸ Significance is a “judgment call” by the auditor and is usually based upon the frequency and magnitude of the deficiency.

⁹ General Accounting Office. (July 2007 Revision). *Government Auditing Standards* (p. 165) United States Government Accountability Office by the Comptroller General of the United States.

II. INTRODUCTION

The City of New Orleans (the City) processed payroll for its employees which included employees under the direct supervision of the CAO and employees of selected component entities and separately elected officials (other entities). For purposes of this report the other entities¹⁰ were excluded from the sampling and testing results in this report. The departments included in this audit are: CAO's Office; City Council; City Planning Commission; Civil Service; Office of Community Development; Finance; Fire Department; General Services; Health; Historic Districts & Landmarks Commission; Law Department; Mayor's Office; Mosquito, Termite & Rodent Control; Parks & Parkways, Police Department; Property Management; Public Works; New Orleans Recreation Development Commission; Safety & Permits; Sanitation; and Vieux Carré Commission.

The distinction between these employees is important because the policies and procedures may vary based on an individual's classification. The City considers employees under the CAO's control, component entity employees and employees who work for elected officials, to be City employees.

The City's employee definition varied depending upon whom the auditors questioned. One or more of the following definitions were given by City employees and or Civil Service:

1. The City processed the payroll for these employees;
2. These employees were in the Civil Service system;
3. These employees participated in the New Orleans Municipal Employees Retirement Plan;
4. These employees participated in the City's health insurance plan;
5. The City budgeted payroll for these entities; or
6. The Mayor controlled these other entity employees by appointing the majority of its board, etc.

Some of the ordinances cited in this report only apply to the Executive Branch of the City of New Orleans.

This performance audit was focused on the Payroll Clearing Fund of the City of New Orleans and the sick and vacation accruals of employees under direct control of the Executive Branch of the City.

The Payroll Clearing Fund was used to disburse the City's payroll and payroll related amounts. Payroll amounts were deposited into the Payroll Clearing Fund from various other funds (including the General Fund) and subsequently disbursed once payroll was processed. When disbursements were made from the Payroll Clearing Fund, the balances should periodically

¹⁰ The other entities excluded from the 2010 payroll listing provided by the City included 743 employees and \$24,890,458 of gross payroll.

equal zero as payroll related liabilities¹¹ are paid. Any remaining balances required research and resolution by management.

¹¹ Payroll liabilities are created for federal withholding, state withholding, social security, health insurance, etc.

III. PAYROLL CLEARING FUND FINDINGS

Finding #1:

Condition: As of December 31, 2010, the Payroll Clearing Fund had outstanding asset and liability balances dating back to 2005. These differences were not researched and resolved in previous years by the Finance Department. See the Appendix for details of the adjustment made by the Finance Department as a result of this finding.

Cause: The Finance Department did not reconcile the Payroll Clearing Fund account in a timely basis in prior years.

Criteria: According to the GAO's Standards for Internal Control, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."¹²

Government Auditing Standards (The Yellow Book) also states that "controls over the safeguarding of assets and resources include policies and procedures that the audited entity has implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of assets and resources."¹³

Effect: Liabilities were overstated by \$1,483,379.¹⁴ The adjustment to these accounts resulted in a net increase of \$855,941 to Fund Balance or Other Income which the City was unable to use in the General Fund for other needs from 2005 to 2011.

Recommendation: All balance sheet accounts should be reconciled on a regular basis.

City Comment: *"...The Landrieu Administration and City Council invested additional funds in the Finance Department, increased the salary structure for the accounting series personnel, and succeeded in recruiting and hiring nine (9) new employees in 2011....Furthermore, the Finance Department is currently up to date in reconciling the Payroll Clearing Fund."*

¹² GAO Standards for Internal Control in the Federal Government, November 1999.

¹³ GAO Government Auditing Standards, July 2007 Revision.

¹⁴ This difference is a combination of transactions which have remained for several years.

Background: After the inactive accounts from Finding #1 were adjusted, the remaining balances of the Payroll Clearing Fund were evaluated to determine if they contained more than one month's activity. Explanations were then requested for those accounts that had more than one month's activity in the ending balance.

Finding #2:

Condition: As of December 31, 2010, the Payroll Clearing Fund contained many accounts with balances consisting of more than one month's activity.¹⁵ When questioned about these balances by the auditors, the finance department was unwilling to research and determine the accuracy of the account balances remaining in the fund.

Cause: The City did not reconcile the Payroll Clearing Fund in a timely basis.

Criteria: According to the GAO's Standards for Internal Control, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."¹⁶

According to The Yellow Book, "controls over the relevance and reliability of information include policies, procedures, and practices that officials of the audited entity have implemented to provide themselves reasonable assurance that operational and financial information they use for decision making and reporting externally is relevant and reliable and fairly disclosed in reports."¹⁷

Effect: The Payroll Clearing Fund could have been overstated by as much as \$106.8 million and could have allowed the City to use these funds for other purposes. The Payroll Clearing Fund could have also been understated by \$107.1 million which could have required the City to provide additional funds to cover additional payroll expenses as shown in Table 1.

Table 1: Total Questioned Balances

	Number of Accounts Affected	Dollar Amount
Debit Balances	17	\$ 107,108,359
Credit Balances	24	\$ (106,809,741)
Total	41	\$ 298,618

Recommendation: The finance department should reconcile all balance sheet accounts on a regular basis.

¹⁵ Payroll Clearing Fund accounts should be cleared (zeroed out) soon after payroll has been processed.

¹⁶ GAO Standards for Internal Control in the Federal Government, November 1999.

¹⁷ GAO Government Auditing Standards, July 2007 Revision.

City Comment: *“...The Payroll Clearing Fund was fully reconciled prior to the completion of this report. The OIG report suggests that the Payroll Clearing Fund balance could have been overstated and/or understated. We find that statement to be misleading because the two payroll liability fund accounts act as contra (offsetting) accounts. This means the payroll liability fund accounts cannot be analyzed one at a time without netting the account balance of one against its offsetting account. As shown in the Table in the OIG report, when this "netting" is done the result is a much smaller net balance of \$298,618, which represented less than one percent of the debit balance. That there was a net balance is simply representative of the fact that the payroll liability reconciliation had not been fully completed during the time period this chart illustrates.”*

OIG Comment: *This finding described the scope limitation created by the City’s refusal to answer the auditors’ questions regarding the balances in the Payroll Clearing fund. The City’s refusal to research the remaining differences identified by the auditors created a scope limitation.¹⁸ A full explanation of the inconsistent accounting practices¹⁹ within the Payroll Clearing Fund was not forthcoming from the City until the exit conference in December of 2012, over eight months after the initial inquiry.*

¹⁸ *The AICPA defines a limitation on the scope of an audit as “the auditor’s inability to obtain sufficient appropriate audit evidence, which may arise from... limitations imposed by management.”*

¹⁹ *The City offsets some accounts in the Payroll Clearing Fund while other funds were netted. The City did not disclose this fact until the December 2012 exit conference.*

IV. PAYROLL ACCRUALS FINDING

Background: A sample of 322 employees²⁰ was divided into two groups. 1) Employees with an accrual balance greater than \$140,000 and 2) employees with an accrual balance less than \$140,000. Sixty-one employees had an accrual balance greater \$140,000, and one hundred percent of these employees were tested. The other 261 (322-61) employees were randomly sampled. Projections were included for the errors found on 261 sampled employees; actual data was used for the 61 employees tested at 100%.

Finding #3:

Condition: A net total of 758 hours of leave was taken and recorded on a timesheet by employees tested that were not entered into the payroll system. The projected monetary misstatement for this exception totaled \$206,747. See Table 2 below for details.

Table 2: Financial Effect of Incorrectly Entered Timesheets

	Employees Tested at 100%		Employees Randomly Sampled		Total Errors	
	# of Errors in 100% test	\$ Errors in 100% test	# of Errors In Sample	\$ Errors In Sample	Total # of Errors	Total \$ Error
Leave Taken - Overstated²¹:						
100% Tested Misstatement	4	\$ 1,206	2	\$ 127	6	\$ 1,333
Projected Misstatement			35	\$ 2,084	39	\$ 3,290
Leave Taken -Understated²²:						
100% Tested Misstatement	6	\$ (3,409)	15	\$ (12,624)	21	\$ (16,033)
Projected Misstatement			265	\$ (206,628)	271	\$ (210,037)
Grand Total (Understated Leave)	10	\$ (2,203)	300	\$(204,544)²³	310	\$ (206,747)

Cause: Time entered into AHRS was not verified against employee timesheets.

Criteria: CAO Policy Memorandum No. 72(R) stated, “Appointing Authorities shall ensure that hourly city employees record, for audit and payroll purposes, their time of arrival and time of departure on an official departmental Daily Sign In-Out Attendance/Time Sheet, Time Clock or some other documented form of daily attendance. All exempt²⁴ employees shall indicate daily attendance on an official departmental form if prescribed by the Appointing Authority.

²⁰ From a total employee population of 4,672.

²¹ Overstatements in the City’s time keeping system, AHRS, indicated that more hours were recorded than should have been in AHRS.

²² Understatements in the City’s time keeping system, AHRS, indicated that there were not enough hours recorded for the employee in AHRS.

²³ Projected.

²⁴ Exempt employees are salaried.

This documentation will be used in conjunction with the employee's payroll time sheet form for payment of all hours reported by the employee and approved by the supervisor for issuance of payroll earnings."

Effect: For the employees tested, a net of \$14,700²⁵ worth of sick and annual leave was not reduced from the employees' accrued benefits in AHRS²⁶ and the City paid these employees as if they earned regular/overtime hours. When the sampled employees were projected to all City employees, the projection revealed \$206,747 in leave taken and not reduced from the employee's leave balances in AHRS.

Recommendation: Designated employees should verify the time entered into AHRS agrees to the employees' time records.

City Comment: *"The City agrees that paper and electronic system payroll records should agree, and that exceptions should be identified and resolved... While we do not dispute the facts identified by the report or disagree that the issues identified need to be addressed, we nonetheless do not believe that the methods used for sampling and projecting these exceptions on a citywide basis were properly done. Since many City departments enter time into the payroll system, the sample should have been stratified by department. Doing it that way should yield a different and more accurate result, since any differences are likely to be concentrated in certain departments especially if they result from certain routine practices in payroll processing.*

Similarly, the methods used to project the impact of exceptions likely overstates the projected total amount by a significant margin.... The City believes it would be more appropriate to think of the events as the number of pay periods multiplied by the number of employees...."

OIG Comment: *The auditors' goal was to test the vacation and sick time accruals on a citywide basis to determine the accuracy of the overall payroll accrual amount, not to identify problem departments. As such, a random sampling program was used to select a testing sample representative of the overall employee population. The errors were calculated based on the dollar amount of each error, not the number of employees tested. The total dollar amount of the error in the sample was then projected to the employee population that was subject to sampling.²⁷*

The auditors' sample was not selected using a stratified methodology and therefore it would be incorrect to project the results on a stratified basis. However, if the error found in the sample was projected by department instead of citywide as suggested by the City, the projected error would have been larger, not smaller, with a projected error of \$291,125.

²⁵ The misstatement of the 100% test resulted in an AHRS overstatement of \$1,333 combined with the random test understatement of \$16,033 and equals a net understatement of \$14,700.

²⁶ The actual cost could be higher as this calculation does not include overtime hours.

²⁷ Employees who were deemed significant were tested at 100% and removed from the sampling population. Errors found in significant employees were not included in the projected error, but were included in the total misstatement.

V. PAYROLL ACCRUALS OBSERVATION

Background: Rule 8, Sections 1.1(l) & 2.1(j) of the Civil Service Rules state that when an employee changes from one type of leave day to another (for example from a 7-hour work day to an 8-hour work day) their leave balance will change to reflect the new work day.

Observation: In our testing of 322 employees, one employee changed from a 12-hour work day to an 8-hour work day without an adjustment to the hours of accrued annual or sick leave accumulated while working 12-hour days. This change in working hours increased the employee's number of leave days available by 50%, or 2,412 hours, with a potential additional compensation of \$76,346. Three other employees changed from 8-hour work days to 8.55-hour work days, and no adjustment was made to their accrued annual or sick leave. The change in working hours resulted in the employees losing a total of 25 hours and lost compensation totaling \$418 as shown in Table 3.

Table 3: Effect of Unadjusted Sick and Annual Leave in AHRS

	Difference (in hours)	Hourly Rate	\$ Effect
Overstated			
Employee A	2,412.2	\$ 31.65	\$ 76,346
	Potential Overstatement		\$ 76,346
Understated			
Employee B	(8.3)	\$ 16.86	\$ (140)
Employee C	(9.9)	\$ 16.86	\$ (167)
Employee D	(6.6)	\$ 16.86	\$ (111)
	Potential Understatement		\$ (418)
Net Overstatement			\$ 75,928²⁸

²⁸These balances are accrued and the leave has not been taken. The condition is an observation because the over/under compensation has not occurred. Once the City corrects the balances the potential for error will be eliminated.

VI. CONCLUSION

The audit revealed that as of December 31, 2010, the Payroll Clearing Fund had approximately \$1.5 million in liabilities that should have been written-off in previous years. These unreconciled accounts prevented the City from accessing \$855,941 in the General Fund for other needs.

After the \$1.5 million adjustment, other questioned accounts in the Payroll Clearing Fund could have been overstated by as much as \$106.8 million and could have allowed the City to use these funds for other purposes. The Payroll Clearing Fund could have also been understated by \$107.1 million which could have required the City to provide additional funds to cover additional payroll expenses. The Payroll Clearing Fund should be reconciled regularly so the City has an accurate accounting of the funds needed and available to fund payroll.

The controls in place for tracking employees' annual and sick leave were not operating efficiently. The audit determined that employees' annual and sick time was entered incorrectly into AHRS for over 8% of the employees selected, resulting in a projected cost to the City of approximately \$206,747.

The City stated in its response to the Payroll Internal Control Performance Audit dated October 20, 2011, that "[it] issued a request for proposals seeking completely hosted [outsourced] Payroll, Time/Attendance Services to replace the AHRS system." However, the outsourced system will still be dependent on the data received and entered by the City. Even with a new outsourced payroll system, the City must enter accurate time data so that the data output of the new system is also accurate.

A follow-up review to determine the status of the findings in this report will be conducted within 18 months.

VI. APPENDIX

Appendix 1: City's Adjustment to Payroll Clearing Fund

Accounts with non-zero balances and no activity since 2004 year-end		
Accounts with no activity in 2009		
Description	Account	Correcting Entry Made by the City
A050 REC IN TRANS	01A050	(518.88)
A260 ACCTS REC	01A260	(175,388.69)
0292 DUE FM EMPS	010292	(155.13)
0293 MISC A/R	010293	(24.74)
A510 ACCTS PAYBLE	02A510	638,743.05
0294 DUE REC/OETD	020294	110.80
0295 EN-SEIU L100	020295	(32.29)
0296 GA-UWAY	020296	(924.45)
0300 HB-BROWN'S	020300	3,863.58
0301 HC-JEFF HABE	020301	36.26
0303 HH-PROF/IMAG	020303	20.02
0304 HI-COPS	020304	14,889.70
0305 ATTORNEY FEE	020305	23,149.95
0307 FSA-MEDICAL & DEPENDANT CARE	020307	41,197.79
0323 AMERICAN HEA	020323	(38,047.36)
0325 WASHINGTON	020325	(171,301.29)
0327 MUT SAVS INS	020327	144.44
0328 GUARANTEE TR	020328	(30,351.81)
0331 GUARDIAN LIF	020331	3,275.65
0332 CAF PLAN ADM	020332	(873.28)
0333 AMER NATL IN	020333	(3,254.68)
0334 TMS LOCL#270	020334	(2,424.71)
0335 NO FRFGHTR	020335	(15,202.65)
0336 PEA	020336	2,121.71
0337 PANO	020337	23,592.98
0338 FOP	020338	64,498.13
0340 POL&FIRE-EJ	020340	5,924.76
0341 POL MUTL BEN	020341	16,413.69
0342 BLK ORG POL	020342	12,233.79
0343 BLACK ASSN	020343	1,115.09
0349 FIT WITHHELD	020349	597,696.63
0353 ADV EIC	020353	(183,851.84)
0354 MED EMPLOY	020354	(640.63)
0355 MED EMPLOYR	020355	(4,706.51)
0357 AETNA LIFE	020357	7,816.14
0359 COM ALB PANO	020359	15,651.18
0360 UNCF	020360	56.84
0361 EMPLOYEE ASSN	020361	9.75
0362 UNITED FUND	020362	6,385.59
0365 UNIFORM&TOOL	020365	(13,651.91)
0367 FRE 68 PLN	020367	110,666.88
0371 DED SVC CHGS	020371	87,842.38
0372 PAN AMERICAN	020372	26,585.50
0373 DUE TO CNO	020373	27,534.08
0377 NET PAY	020377	405,111.78
3294 BLK FIREFT	023294	(518.00)
3295 MAINTENANCE	023295	(4,532.87)
3297 U S SAVINGS	023297	(92.50)
3737 SNO MOTION	023737	(226.90)
4922 SUGAR DOLLS	024922	(1,167.12)
4993 CAPITAL AMER	024993	(264.50)
4994 P O WOMAN OF	024994	34.74
4995 DAVIS KENYON	024995	(2,652.00)
5907 L&D SALES	025907	(6,988.80)
7364 GROUP HEALTH PLAN 1990,1991	027364	5,527.25
A740 FUND BAL	03A740	3,806.40
3837 COMMONWEALTH	033837	773.21
3838 FINES	033838	5,647.45
		1,494,683.65

VIII. OFFICIAL CITY COMMENTS

City Code Sec. 2-1120(8)(b) provides that “Prior to concluding an audit or evaluation report, which contains findings as to the person or entity which is the subject of the audit or evaluation, the Office of Inspector General shall provide the affected person or entity with an Internal Review Copy of the report. Such person or entity shall have 30 days from the transmittal date of the report to submit a written explanation or rebuttal of the findings before the report is finalized, and such timely submitted written explanation or rebuttal shall be attached to the finalized report.”

An Internal Review Copy of this report was distributed to the City of New Orleans on December 10, 2012, to provide an opportunity to comment on the report prior to the public release of the Final Report. The comments were due on January 9, 2013, and were received on January 24, 2013. The City’s comments are included in the body of this report behind each finding and in its entirety behind this Section.

CHIEF ADMINISTRATIVE OFFICE
CITY OF NEW ORLEANS

MITCHELL J. LANDRIEU
MAYOR

ANDREW D. KOPPLIN
FIRST DEPUTY MAYOR & CAO

January 24, 2013

Mr. Edouard Quatrevaux
Inspector General
City of New Orleans
525 St. Charles Avenue
New Orleans, LA 70130

Re: OIG Report on Payroll Liabilities Performance Audit

Dear Mr. Quatrevaux:

We are in receipt of the Office of Inspector General's draft, "Payroll Liabilities Performance Audit." This report focuses on the balances of payroll liability accounts at the end of calendar year 2010.

The Landrieu Administration certainly agrees that close monitoring of the balances in payroll liability accounts, in which the City tracks such items as employee health care contributions, is important. For this reason and many others related to the accounting of City operating and capital funds—most especially the fact that the City only once met the Legislative Auditor's deadline for submission of its annual audit between 2006-2010—the Landrieu Administration requested and the City Council approved significant additional investments for the Department of Finance in our first budget proposal for fiscal year 2011. That these investments were proposed at a time when we were reducing overall general fund spending from prior years underscores the importance the Landrieu Administration placed on enhancing our accounting capabilities within the Finance Department. And these investments have paid off. The City submitted its 2011 audit ahead of the Legislative Auditor's deadline and accomplished many other tasks, including making a full reconciliation of the payroll liability accounts that are the subject of this report, something we will continue to do annually from this point forward.

Nonetheless, it is important to recognize that immediately following Hurricane Katrina most City departments, including Finance, lost nearly half of their staff members due to dramatic budget reductions. As a result of these cuts, the Finance Department was forced to prioritize its most important work and chose to monitor its payroll liability accounts by assessing the net amount in



these accounts, which operate as matched accounts, rather than conducting a full reconciliation. While clearly not ideal, this approach was accepted by the City's auditors so long as the net amount was a small proportion of the overall fund's size, and a full reconciliation was not completed annually due to higher priority for limited staff resources being placed on other areas which had greater material impact on the overall audit.

Again, with additional accounting investments made by the Landrieu Administration during 2011, as the report notes, a full reconciliation of these payroll liability accounts has been completed and will be undertaken on an annual basis going forward. In summary, Findings #1 and #2 relate to the situation the Landrieu Administration found when we took office and which we have addressed.

As always, we understand that the recommendations proposed by the Office of Inspector General are developed to help improve internal controls and eliminate waste/abuse, and we appreciate our effective working relationship with the Office of Inspector General and benefit from your reports and their recommendations. Below is our response to the findings in this report.

Finding #1: "The Payroll Clearing Fund had outstanding asset and liability balances in excess of \$1.5 million, some balances dating back to 2005."

The OIG's auditor noted that the payroll clearing fund had outstanding asset and liability balances dating back to 2005. Again, as noted earlier, the Landrieu Administration and City Council invested additional funds in the Finance Department, increased the salary structure for the accounting series personnel, and succeeded in recruiting and hiring nine (9) new employees in 2011. The new staff is continuing to train in the areas of cash reconciliations, accounts payable, financial reporting functions and preparation of financial statements, and is making significant progress.

As noted in the OIG report and due the hard work of the veteran and new staff in the Finance Department, the adjustment to correct the payroll liability account balances was completed prior to issuance of this report and, significantly, was completed for the first time since Hurricane Katrina. Furthermore, the Finance Department is currently up to date in reconciling the Payroll Clearing Fund.

Finding #2: "After adjustment for finding #1, the Payroll Clearing Fund still contained many accounts with balances consisting of more than one month's activity."

As stated in Finding #1 the Payroll Clearing Fund was fully reconciled prior to the completion of this report. The OIG report suggests that the Payroll Clearing Fund balance could have been overstated and/or understated. We find that statement to be misleading because the two payroll liability fund accounts act as contra (offsetting) accounts. This means the payroll liability fund

accounts cannot be analyzed one at a time without netting the account balance of one against its offsetting account. As shown in the Table in the OIG report, when this “netting” is done the result is a much smaller net balance of \$298,618, which represented less than one percent of the debit balance. That there was a net balance is simply representative of the fact that the payroll liability reconciliation had not been fully completed during the time period this chart illustrates.

Finding #3: “A net total of 758 hours of leave was taken and recorded on the employee time records that were not entered into the payroll system.”

The City agrees that paper and electronic system payroll records should agree, and that exceptions should be identified and resolved. The OIG report reviewed certain samples of paper and electronic payroll system records, identified exceptions, and projected that the possible monetary misstatement for this exception totaled \$206,747. While we do not dispute the facts identified by the report or disagree that the issues identified need to be addressed, we nonetheless do not believe that the methods used for sampling and projecting these exceptions on a citywide basis were properly done. Since many City departments enter time into the payroll system, the sample should have been stratified by department. Doing it that way should yield a different and more accurate result, since any differences are likely to be concentrated in certain departments especially if they result from certain routine practices in payroll processing.

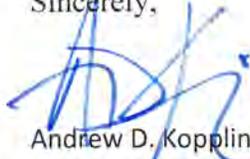
Similarly, the methods used to project the impact of exceptions likely overstates the projected total amount by a significant margin. For example, the OIG’s auditor stated that sixteen employees in the CAO’s office were chosen for a sample and two errors were found for what the report described as an error rate of 16.7%. The City believes it would be more appropriate to think of the events as the number of pay periods multiplied by the number of employees. Therefore, sixteen employees multiplied by 26 pay periods per year produce 416 events. Two errors divided by 416 events produces an error rate of less than 1%. A less than 1% error rate projects a much smaller exception rate than 16.7%.

Finally, it should be noted that the City’s Finance Department has timely reconciled the Payroll Liability Fund since June 2012.

Looking to the future, the Landrieu Administration is presently in the process of implementing a modern web-based payroll system by ADP, which was budgeted for in 2013 by the Mayor and City Council. This exciting new system will enhance payroll controls, reduce the time spent conducting future reconciliations, and allow supervisors and staff to focus more on analyzing and resolving payroll issues rather than entering data and managing paper and manual input as is the dominant work effort in our present payroll environment.

As always, we appreciate our partnership with the Office of Inspector General and your review and counsel as we work to improve the operational efficiency and effectiveness of our City government.

Sincerely,



Andrew D. Kopplin
First Deputy Mayor and Chief Administrative Officer
City of New Orleans

Cc: Norman Foster