



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

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The Honorable
The Secretary of Health,
Education, and Welfare

Dear Mr. Secretary:

This report is the first of a series on our review of the Department of Health, Education, and Welfare's [HEW's centralized payroll system]. We are reporting our findings to you as soon as each segment of our review is completed so that timely corrective action can be taken.

Since 1969 the General Accounting Office (GAO), the HEW Audit Agency, and a special interagency payroll review panel have issued reports on HEW's centralized payroll system. As a part of our review, we have followed up on actions taken by HEW on recommendations included in these other reports.

Section 112(b) of the Budget and Accounting Procedures Act of 1950 provides that the accounting systems of executive agencies are subject to approval by the Comptroller General. In April 1970 the Comptroller General approved HEW's statement of principles and standards for its accounting system. We have been advised by HEW that they are planning to submit the central payroll system's design to the Comptroller General but a submission date has not yet been established.

This report covers that part of the payroll system related to HEW's procedures and practices for processing undeliverable payroll checks returned to the Department of the Treasury (Treasury) for cancellation, remail, or reissuance. We also examined the pay records and Wage and Tax Statements (W-2's) of selected employees whose checks had been canceled ^{1/} by the Treasury. This review was done at HEW's Division of Central Payroll in Washington, D.C. We also obtained information on HEW's undeliverable checks from the Treasury's Washington Disbursing Center.

^{1/}A check that is rendered not negotiable and its proceeds credited to the appropriation or fund account.

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The purpose of this report is to recommend corrective measures needed to (1) record canceled check adjustments accurately and promptly on pay records, (2) issue correct W-2's, and (3) improve and properly implement procedures for processing undeliverable checks.

HUNDREDS OF HEW EMPLOYEES' W-2's
AND PAY RECORDS WERE ERRONEOUS

Hundreds of Wage and Tax Statements and pay records for 1974 were erroneous because adjustments for canceled checks were not recorded in the proper year or were recorded twice. We estimate that the W-2's contained erroneous gross pay amounts of \$738,000 and the pay records contained erroneous gross pay amounts of \$1.1 million.

GAO's Policy and Procedures Manual for Guidance of Federal Agencies (6 GAO 4) states that an effective payroll system should provide for the timely preparation of adequate and reliable payroll records as part of the regular accounting system. Internal Revenue Service (IRS) regulations require the issuance of corrected W-2's when wages or taxes entered on a prior W-2 are incorrect.

As of July 14, 1975, we estimated that 7,200 payroll checks issued in calendar year 1974 were later canceled because the payees were not entitled to the proceeds. Using statistical sampling techniques, we selected 89 of these checks to determine if proper adjustments had been made on pay records and W-2's.

Adjustments for 47 of the 89 canceled checks, or 53 percent, were either not recorded or were recorded twice on the 1974 pay records. On the basis of our statistical sample, we estimate that 1974 pay records for 3,800 HEW employees were in error. HEW officials acknowledged that since pay records had been used by HEW to prepare retirement contribution reports and quarterly withholding reports to the Civil Service Commission and IRS, respectively, such reports were also erroneous.

The 1974 W-2's for 23 of the 47 employees with erroneous pay records were adjusted for the canceled checks, but the W-2's for the other 24 employees were not adjusted and thus were in error. On the basis of our sample, we estimated that HEW sent erroneous W-2's to 1,940 of the 3,800 employees whose pay records were incorrect.

Canceled check adjustments were not
recorded in the prior year's pay records

HEW did not record canceled check adjustments (reversing of pay entries) on about 3,300 of the estimated 3,800

erroneous 1974 pay records. Entries on 1974 pay records that should have been reversed were not reversed, resulting in gross pay being overstated by an estimated \$1 million. HEW did not record canceled check adjustments in the prior calendar year because of (1) delays in incorporating revisions to its automated data processing system and (2) its practice of recording adjustments in 1975 pay records for calendar year 1974 checks returned for cancellation in 1975. The remaining 500 erroneous pay records were caused by duplicate postings; however, central payroll has corrected this weakness.

HEW returns undeliverable payroll checks to the Treasury because of disputed entitlements, incorrect amounts, and deceased payees. The Treasury uses returned check notices to advise HEW that it has received the undeliverable checks. When HEW receives the notices, it advises the Treasury to re-mail, reissue, or cancel these checks. HEW uses an automated process to reverse the entry of pay and withholding data on the payees' pay records after the Treasury cancels the checks.

Needed revisions to computer programs for processing canceled check adjustments were not made for about 7 months. As a result, HEW made no canceled check adjustments to pay records from December 1974 to July 1975.

Furthermore, HEW's practice was to adjust the 1975 pay records for 1974 checks returned to the Treasury for cancellation in 1975. We estimate that the combination of this practice and adjustment delays resulted in an estimated 3,300 erroneous pay records for 1974.

HEW uses pay records to prepare retirement contribution reports for the Civil Service Commission and quarterly tax withholding reports for IRS. Since the 1974 and 1975 pay records contained erroneous data, the reports submitted to the Civil Service Commission and IRS for these periods were, therefore, incorrect.

HEW did not issue corrected W-2's according to IRS regulations

Although IRS regulations require corrected W-2's to be issued, HEW did not issue corrected 1974 W-2's to an estimated 1,940 employees. Gross pay on 1974 W-2's sent to these employees was overstated by an estimated \$738,000 mainly because of HEW's practice of including canceled check

adjustments for 1974 checks on 1975 W-2's. As a result, the amounts reported on W-2's for these employees were overstated for 1974 and understated for 1975.

The Internal Revenue Code of 1954 requires employers to furnish to each employee a written statement showing, among other items, the total amount of wages paid and the total amount deducted and withheld as tax. Further, IRS regulations state that a corrected statement shall be furnished with respect to a prior calendar year to show the correct amount of wages paid during the prior calendar year, if the amount of such wages entered on a statement furnished to the employee for such prior year is incorrect.

HEW included in 1975 W-2's adjustments for prior year checks returned for cancellation in 1975. On the basis of our sample, we estimated, however, that 730 of the 1,940 employees who did not receive corrected 1974 W-2's also did not receive 1975 W-2's because their pay records showed negative amounts or no pay record was prepared for 1975. These 730 employees had apparently separated or transferred from HEW before 1975, because there were no pay records for them showing payroll payments for 1975.

The remaining 1,210 employees received 1975 W-2's, but we estimate 240 received W-2's which did not include canceled check adjustments.

As a result of HEW's not issuing corrected 1974 W-2's, the 1,940 employees may have used incorrect pay and withholding information in filing their 1974 income tax returns. Further, an estimated 970 employees may have filed 1975 income tax returns using incorrect information because their 1975 W-2's included check adjustments for 1974 checks.

Examples of delayed canceled check adjustments

Below are two examples which show the effect of delayed canceled check adjustments on pay records and W-2's.

--An October 1974 payroll check amounting to \$316.74 (gross pay of \$422.56 less deductions of \$105.82) was returned for cancellation in January 1975 because the employee was not entitled to the proceeds. Because of HEW delays in revising its automated adjustment procedures and its practice for checks

returned after the issue year, the employee's 1975 pay record was adjusted for the canceled check in August 1975, 7 months after the check was returned for cancellation. HEW included the canceled check adjustment on the employee's 1975 W-2 instead of issuing a corrected 1974 W-2 as required by IRS regulations. The employee's 1974 records were, therefore, overstated while his 1975 records were understated.

- An October 1974 payroll check amounting to \$857.09 (gross pay of \$1,304.80) was returned for cancellation in January 1975 due to nonentitlement. Because of the reasons given in our example above, the employee's 1975 pay records were not updated until December 1975, 11 months after the check was returned for cancellation. However, HEW did not send the employee a 1975 W-2 because he left HEW before 1975. Recording the canceled check adjustment on a 1975 W-2 would result in a W-2 with negative pay and withholding amounts. Since the pay record had a negative amount, HEW did not prepare a W-2 for 1975. The employee's 1974 pay records and W-2 were, therefore, overstated by \$1,304.80.

CONCLUSIONS AND RECOMMENDATIONS

HEW needs to record canceled check adjustments more promptly and in the proper year's pay records. This would permit HEW to furnish accurate W-2's to employees and accurate reports to the Civil Service Commission and IRS. We recommend, therefore, that you instruct the Director, Division of Central Payroll, to:

- Record canceled check adjustments on pay records for the year in which the check was issued and provide employees with corrected W-2's where appropriate.
- Identify erroneous W-2's issued for 1974 and 1975 and meet with IRS officials to determine what corrective action, if any, should be taken.
- Give high priority to making revisions, when necessary, to the computer program used to process canceled check adjustments to prevent delays in adjusting pay records.

Also, we recommend that you have the Assistant Secretary for Administration and Management monitor the implementation of these recommendations.

Agency comments

In January 1976 a Division of Central Payroll official stated that the Division was currently operating the automated canceled check adjustment process biweekly, except during January when it prepares W-2's. According to this official, delays in revising the automated process occurred because of staffing limitations and the prolonged sickness of the assigned programmer.

The Special Assistant to the Division Director agreed that, on the basis of IRS regulations, HEW should issue corrected W-2's for a prior year when the previously issued W-2 is incorrect.

UNDELIVERABLE PAYROLL CHECKS CAN EASILY
BE LOST OR STOLEN WITHOUT DETECTION

HEW returned undeliverable payroll checks to the Treasury that were still negotiable, and we believe these checks could have been easily lost or stolen without detection. The Budget and Accounting Procedures Act of 1950 states that Federal agency accounting should provide effective control over and accountability for all funds, property, and other assets for which each agency is responsible. For calendar year 1974, HEW requested the Treasury to cancel about 7,200 checks and reissue about 600 checks. The 7,800 checks, amounting to an estimated \$2.3 million, were not adequately controlled and safeguarded by HEW. If checks were lost or stolen, we believe HEW could not have detected the loss or theft because it did not have effective recordkeeping procedures.

Designated agents have not
followed HEW procedures

Designated agents are HEW employees who have been delegated authority by the Treasury to act as agents for the purpose of receiving and distributing salary checks and savings bonds. HEW's Time and Leave Accounts Manual (ch. 6) requires designated agents to return undeliverable payroll checks directly to the Treasury and to advise the Division of Central Payroll that the checks have been returned.

On the basis of records maintained by HEW, we estimated that for 1974 the Treasury received 5,400 undeliverable payroll checks amounting to about \$1.6 million and the Division of Central Payroll received 2,400 undeliverable payroll checks amounting to about \$724,000 from designated agents.

The 2,400 checks received by the Division should have been sent directly to the Treasury by the designated agents.

The Division recorded the checks received from designated agents and according to a Division employee forwarded them to the Treasury but not always on the same day the checks were received. Therefore, when designated agents sent these checks to the Division instead of the Treasury, we believe HEW unnecessarily and inadequately handled, accounted for, and safeguarded the checks, thus increasing the time required for final disposition (re-mail, reissuance, or cancellation).

The Treasury and Division of Central Payroll employees said that they did not give receipts to designated agents when undeliverable checks were received from them. Designated agents, therefore, had no evidence that all returned payroll checks for 1974 were ultimately received by the Treasury and the Division.

A Division employee said that designated agents did not always notify the Division of Central Payroll of checks which they had returned to the Treasury. The Division, therefore apparently could not determine whether the Treasury had received all checks returned by designated agents.

The HEW Audit Agency reported these problems to HEW officials in March 1971 and again in July 1975. We believe that, since designated agents continue to send undeliverable checks to the Division, stronger action by a high-level HEW official is needed to stop this practice.

The Division of Central Payroll has inadequate control over returned checks

The Division did not adequately safeguard and control undeliverable checks received from designated agents. HEW can improve its controls substantially by (1) separating duties, (2) securing checks in locked cabinets, and (3) reconciling HEW and Treasury-returned check information.

GAO's Policy and Procedures Manual for Guidance of Federal Agencies (2 GAO 12) states that duties should be appropriately divided among officials and employees responsible for handling and keeping records of cash transactions, to provide routine checks on performance. Contrary to 2 GAO 12, one of the Division employees who had custody of undeliverable checks also recorded them in a returned check log when they were returned to the Treasury.

Further, the Division of Central Payroll did not reconcile its returned check log with the log listing returned check

notices received from the Treasury. The Division should require frequent reconciliation to determine if the Treasury received all returned checks sent by the Division.

We observed also that one of the employees left returned checks unattended on a desk instead of in a locked cabinet while the employee was out of the office.

CONCLUSIONS AND RECOMMENDATIONS

HEW needs to improve its procedures and practices to minimize the possibility of errors and irregularities involving undeliverable payroll checks. Also, HEW should comply with its procedures regarding the return of undeliverable payroll checks to the Treasury.

We recommend, therefore, that you instruct the:

1. Designated agents to:
 - Return all undeliverable checks directly to the Treasury, obtain receipts for them, and notify the Division of Central Payroll.
 - Compare receipts obtained from the Treasury with records showing which checks they sent to the Treasury and investigate the differences for further action.
2. Director of the Division of Central Payroll to:
 - Compare notifications received from designated agents with returned check notices received from the Treasury and investigate the differences for further action.
 - Adequately control and safeguard payroll checks when designated agents return them to the Division of Central Payroll and remind designated agents that undeliverable checks should be returned directly to the Treasury.
3. Assistant Secretary for Administration and Management to:
 - Take action to stop designated agents from returning undeliverable payroll checks to the Division of Central Payroll.
 - Monitor the implementation of the above recommendations.

AGENCY COMMENTS

The Director, Division of Central Payroll, told us:

--He sent a memorandum to designated agents reminding them to send payroll checks immediately to the Treasury if the checks cannot be delivered and to notify the Division of these checks.

--When designated agents send undeliverable checks to the Division, they are reminded again in writing to adhere to the procedures in the memorandum.

--The Division cannot effectively enforce these procedures because designated agents are under the supervision of the different HEW agencies.

Division officials have agreed to safeguard and control payroll checks returned to them by designated agents.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the above Committees; the Director, Division of Central Payroll; and the Director, HEW Audit Agency. We are also sending a copy to Congressman Mario Biaggi by agreement because of requests from constituents employed by the Social Security Administration for help in correcting pay and leave errors.

We wish to express our appreciation for the courtesies and cooperation extended our representatives. We would appreciate your comments and advice on any action taken or planned on the matters discussed in this report.

Sincerely yours,

Harold L. Scantlebury
D. L. Scantlebury
Director

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