



093906

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON REGIONAL OFFICE
FIFTH FLOOR
803 WEST BROAD STREET
FALLS CHURCH, VIRGINIA 22046

FEB 6 1973

Dear Mr. Kleppe

We have completed a review of the payroll and leave operations of the Small Business Administration for the period January 1971 through July 1972. Our review included an examination and verification of time, pay, and leave records for selected employees during the leave year ended January 8, 1972, a limited amount of testing in subsequent periods for specific types of pay actions, an evaluation of administrative procedures and internal controls, including internal audit, and an evaluation of automatic data processing controls.

On the basis of our review, we believe that some of the Administration's payroll procedures and internal controls should be strengthened. We found that the payroll system has deviated somewhat from the system approved by the Comptroller General in August 1970 in that certain agreed-on controls have not been implemented while others, included in the approved system, were discontinued. In addition, we found certain weaknesses in internal controls over payroll activities and automatic data processing operations and a need for improvement in the maintenance of leave records. These matters, together with pertinent actions and comments of Administration officials, are discussed more fully in the enclosure to this letter and are being brought to your attention so that you can take appropriate action.

We wish to acknowledge the courtesies and cooperation extended to our representatives during the review. We shall appreciate your comments concerning any action taken or planned by you on the matters discussed in the enclosure.

The payroll and leave records through January 8, 1972, may be stored in accordance with your records retention and disposal program.

A copy of this letter with enclosure is being sent to the Administration's Assistant Administrator for Administration.

Sincerely yours,

H. L. Krieger

H. L. Krieger
Regional Manager

Enclosure

The Honorable Thomas S. Kleppe, Administrator
Small Business Administration

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NEED TO IMPROVE CERTAIN PAYROLL
PROCEDURES AND INTERNAL CONTROLS

The Administration needs to (1) issue a revised payroll procedures manual, (2) establish adequate controls to prevent the issuance and distribution of erroneous paychecks, (3) strengthen certain internal controls over payroll activities and automatic data processing operations, and (4) emphasize the need for accuracy in computing and recording employees' leave.

DEVIATIONS FROM APPROVED PAYROLL SYSTEM

The Administration's accounting system, including its payroll system, was approved by the Comptroller General in August 1970. The payroll system was approved with the understanding that the Administration would issue a revised payroll procedures manual and would put into effect certain additional internal controls over the processing of payroll data as agreed on between General Accounting Office (GAO) and Administration officials.

We found that the revised payroll manual was not issued, that the agreed-on additional controls were not implemented, and that certain other controls included in the approved system were discontinued. These deviations from the approved system are summarized as follows:

1. Use of unapproved payroll manual.
2. Lack of adequate controls to prevent the issuance and distribution of erroneous paychecks
 - a. Nonuse of predetermined control totals
 - b. Nonuse of document controls for pay allotment data.
 - c. Lack of adequate control to insure timely processing of employment termination data.
 - d. Lack of adequate control over the transmission of source documents.

These matters are discussed in more detail below.

Use of unapproved payroll manual

The Administration's payroll system was approved on the basis of a draft of a revised payroll manual provided by the Administration and reviewed by GAO. This draft contained numerous revisions designed to aid Administration personnel in correctly computing and recording payroll data.

The Administration has not issued the revised (approved) manual but has continued to use its previous (unapproved) payroll manual. As a result, the Administration's payroll clerks are handicapped in correctly interpreting pertinent laws and regulations and in accurately processing employees' pay.

Lack of adequate controls
to prevent the issuance and
distribution of erroneous paychecks

When the Administration's payroll system was approved, it contained certain internal controls designed to guard against the issuance and distribution of erroneous paychecks. One of these controls was the practice of hand delivering all checks to payees. This practice enabled the payroll office to exercise a type of control (by checking payroll data against source documents before the checks were delivered to payees) which guarded against the distribution of erroneously issued checks.

The practice of hand delivering all paychecks was discontinued about January 1972. Under current procedures most paychecks are mailed by the Treasury Department to the payees or designated agents. As a result, the Administration--which did not establish any alternate control to prevent the distribution of erroneously issued paychecks--lost control over withholding a check to which an employee is not entitled.

The Administration's records show that, during the 14-week period beginning April 2 and ended July 8, 1972, 49 salary payments totaling about \$12,600 were canceled or refunded because the paychecks had been issued in error. Twenty-seven of these payments, totaling about \$8,000, had been made to persons whose employment had terminated. The remaining 22 payments consisted of payments to employees who were on leave without pay, duplicate payments, a payment to a deceased employee, erroneous lump-sum payments, and payments to other persons not entitled to be paid.

Nonuse of predetermined control totals

Another important control in the Administration's approved payroll system, which guarded against the issuance of erroneous paychecks, was the use of predetermined control totals to verify the accuracy of data processed in the preparation of regular payrolls.

The GAO Policy and Procedures Manual for Guidance of Federal Agencies (GAO Manual) (6 GAO 15.2) provides that suitable control procedures shall be incorporated in each payroll system to provide effective checks that the processing of payroll data is accurately performed. These procedures are

necessary to insure that all data are considered in the processing, that results of the processing are accurate, and that no unauthorized alterations are made to transactions and records during the various processing stages. The manual suggests the use of predetermined control totals as an effective method of verifying the accuracy of payroll data processed by automatic data processing systems

When predetermined control totals are used, arithmetic totals are taken before data are introduced into a computer system for processing. Corresponding totals are accumulated independently during the data processing operation. These independently accumulated totals are then compared with, and must be equal to, the predetermined control totals. Unequal totals indicate that all data were not processed or that the data were not processed correctly. Appropriate action can then be taken to identify and correct errors before any further processing is done.

The Administration's payroll manual provides for obtaining predetermined control totals of the various elements of payroll computations (gross pay, deductions, and net pay) by means of a manually maintained payroll control register and for using these totals to verify the accuracy of payroll computer runs.

We found, however, that the payroll office has discontinued the use of independently computed totals in posting data to the payroll control register for regular payrolls but, instead, posts totals to the register from computer runs. Thus, predetermined control totals are not obtained and used for checking the accuracy of the regular payroll runs and for preventing the erroneous issuance of paychecks.

Nonuse of document controls
for pay allotment data

Another control in the Administration's approved system which was discontinued was the use of document control totals for verifying the accuracy of payroll input data relating to employees' allotments of pay (including allotments of net pay to financial institutions, other allotments of pay, and allotment and net pay stop actions).

The payroll manual provides for the preparation of dollar totals and hash totals of social security numbers for each batch of pay allotment documents submitted for data processing to prevent errors in social security numbers and dollar amounts. We found, however, that these controls are no longer used by the payroll office. As a result, errors in pay allotment data are not detected and corrected before data processing is begun.

Lack of adequate control to insure
timely processing of employment
termination data

In the Administration's payroll system, which is operated on an "exception" basis, each employee is paid for a normal 80 hours unless a special instruction is given to the computer to effect a pay change. Whenever a personnel action form showing a permanent pay change--or a time and attendance report showing a temporary change--is not received and taken into account by the payroll office before a payroll is processed, a paycheck will be issued in error.

Thus, the most effective way to prevent the issuance of paychecks to terminated employees under an "exception" type of payroll system is to follow procedures which will insure that the payroll office is promptly notified by the personnel office of the effective dates of all employment terminations. The necessity for these procedures was recognized and agreed on by GAO and Administration representatives before the Administration's payroll system was approved.

We found that personnel action forms for the termination of employment (termination documents) are not always received promptly by the payroll office from the personnel office and that delays in the receipt of these documents have resulted in the issuance of paychecks to terminated employees.

Lack of adequate control over the
transmission of source documents

The GAO Manual (6 GAO 15 1) provides that systematic control procedures shall be applied to all pertinent payroll documents--such as personnel action forms, time and attendance reports, and leave records--to provide assurance that the documents are properly taken into account in determining amounts payable and in processing payrolls. One of these essential control procedures is an effective method to insure that, when source documents are transferred from one department or location to another, all documents are accounted for.

Effective control over source documents is particularly important in payroll systems operated on an "exception" basis. In these systems, a paycheck will be issued in error whenever a time and attendance report showing a temporary pay change, or a personnel action form showing a permanent change, is not received and taken into account by payroll clerks before the payroll is processed. The erroneous issuance of paychecks is facilitated when, in the absence of adequate control over source documents, payroll clerks do not know whether they have received information concerning all pay changes.

The necessity for an effective control--such as transmittal slips describing a group or batch of documents--over personnel action forms and time and attendance reports received by the payroll office was recognized and agreed on by GAO and Administration representatives before the Administration's payroll system was approved. We found, however, that no controls over the transmission of these documents has been established.

As a result, the payroll office is without means to determine whether all documents are received intact or whether any documents may be missing or misplaced. Because of this lack of assurance regarding the accuracy and completeness of payroll input data, erroneous salary payments (including payments to terminated employees and employees on leave without pay) may be made.

Administration officials' comments
and GAO evaluation

We were told by Administration officials that the revised payroll procedures manual had not been issued because tentative plans had existed, during the months immediately following the approval of the Administration's accounting system, for a redesign of the payroll system. This tentatively planned action did not materialize, however, and the Administration continued to operate with its old (unapproved) payroll manual. The Administration officials expressed doubt whether the revised manual should be issued at this time in view of the planned implementation of a redesigned payroll system sometime in calendar year 1973.

The Administration officials were of the opinion that predetermined control totals are not necessary for verifying the accuracy of processed payroll data because verification of these data is accomplished by other means--primarily by checking payroll computer runs against source documents after the data processing has begun.

This subsequent checking of payroll data also was cited by the officials as a justification for discontinuing the use of dollar control totals and hash totals of social security numbers for pay allotment data. They noted, however, that the Administration has recently established a measure of control over these data by making sure that the correct number of pay allotment documents is accounted for in data processing operations.

With respect to the nonuse of transmittal slips to control the transmission of source documents to the payroll office, the Administration officials pointed out that control is achieved over some of these documents by having payroll clerks check payroll data for newly hired and terminated employees against a pending list of personnel actions furnished by the personnel office.

The Administration officials acknowledged that the delayed receipt of personnel action forms by the payroll office has been a problem. They stated that several steps recently have been taken to speed up the processing of these forms. They agreed, however, that further action is needed to accelerate the processing of these documents and said that the matter will be given further study.

In a draft report furnished to Administration officials for advance comment, we expressed the opinion that, to achieve the most effective results from its payroll system, the Administration should take all steps necessary to insure that its payroll procedures are complete and current. We concluded, therefore, that a revised payroll procedures manual should be issued and implemented immediately instead of being deferred until the proposed new payroll system becomes operational.

We questioned whether checking payroll data against source documents after processing has begun is a satisfactory substitute for the use of predetermined control totals. We pointed out that the use of predetermined control totals would permit errors to be corrected at an earlier processing point, thus avoiding the necessity for subsequent manual intervention and reprocessing to correct these errors.

Also, we questioned whether checking payroll data against source documents after processing has begun is a satisfactory substitute for document controls for pay allotment data. Although we recognized that the recently established procedure for accounting for the number of documents processed should help achieve better control over pay allotment data, we expressed the opinion that further controls are needed to insure the accuracy of these data. We concluded that the most practicable way of establishing these controls would be by following the procedures provided by the Administration's payroll manual for using predetermined dollar totals and hash totals of social security numbers.

We agreed that checking payroll data for new hires and terminations affords a type of control over the transmission of some source documents. We pointed out that this checking does not apply to many source documents, however, because it excludes all permanent pay changes other than new hires and terminations and all temporary pay changes as shown on time and attendance reports. We concluded, therefore, that simple controls (such as transmittal slips) should be established over the transmission of all source documents to the payroll office to permit the discovery and correction of errors before payroll processing is begun.

Finally, we concluded that the further action to be taken by the Administration to accelerate the processing of personnel action forms should include a definite procedural requirement that all employment termination documents be transmitted to the payroll office in time for them to be taken into account before payrolls are processed.

GAO proposals

In our draft report we proposed that the Administration's payroll procedures and internal controls be strengthened by

- issuing a revised payroll procedures manual incorporating changes agreed on between GAO and Administration representatives before the Administration's payroll system was approved,
- reinstating the requirement for using predetermined control totals to verify the accuracy of input data for regular payrolls,
- reinstating the requirement for using predetermined dollar totals and hash totals of social security numbers to verify the accuracy of payroll input data relating to employees' allotments of pay,
- establishing appropriate controls over the transmission of source documents from initiating organizations to the payroll office, and
- requiring that all employment termination documents be transmitted to the payroll office at dates sufficiently in advance of the effective dates of terminations to enable the timely removal of the names of terminated employees from the active payroll.

In a meeting with Administration officials on December 14, 1972, we pointed out that GAO's approval of the payroll segment of the Administration's accounting system could be withdrawn if the Administration's procedures were not revised to conform to the approved system or if the Administration could not demonstrate that other, alternative procedures used by the Administration were adequate to insure effective internal control over its payroll operations

Administration/GAO action to be taken

As a result of our discussions during the December 14 meeting, Administration officials agreed to issue a revised payroll procedures manual within the next few weeks. They said that, except as indicated below, the revised manual will incorporate all changes previously agreed to by GAO and Administration representatives

The Administration officials were of the opinion that existing internal controls are adequate to insure the accuracy of payrolls and to prevent the issuance and distribution of erroneous paychecks. They stated that, in all instances in which the existing controls deviate from those provided for in the Administration's approved payroll system, appropriate revisions will be incorporated in the revised payroll manual and submitted to the

Financial Management staff of the GAO Financial and General Management Studies Division for review. It was agreed that GAO will then determine whether the revised controls are adequate.

OTHER WEAKNESSES IN INTERNAL CONTROLS

Machine editing not used
for supplemental payrolls

Programmed controls (checks included in the internally stored instructions of a computer) can help provide assurance that data processing is reliable. One type of programmed control is machine editing, by which processed data are validated by comparing them with predetermined standards.

Although the Administration uses machine editing to verify the accuracy of its regular payroll data processing, it does not use this control to validate the processing of supplemental payroll data.

We discussed this matter with Administration officials who expressed the view that machine editing for supplemental payrolls is mostly unnecessary because the input data for these payrolls are independently controlled by predetermined control totals from a manually maintained payroll control register. These officials agreed, however, that some type of machine editing should be applied to supplemental payrolls to prevent the issuance of checks to ineligible payees. They said that, consequently, the Administration will revise its procedures to provide that supplemental payrolls will be machine edited by checking social security numbers against the master employee record file

We believe the proposed procedure should provide better control over the accuracy of supplemental payrolls and help minimize the erroneous issuance of paychecks.

Error listings not retained
and evaluated

We noted that listings of errors detected by machine edits in the processing of the Administration's regular payrolls were not retained and periodically evaluated to determine error patterns, causes, and trends

We found that, for three pay periods for which error listings were available (June 25 through August 5, 1972), the edit error rate for the permanent change input to the regular payroll averaged about 18 percent of the total input. In our opinion, this error rate is high

In our discussion of this matter, Administration officials expressed doubt concerning the desirability of retaining and evaluating error listings. They explained that, although written analyses are not prepared, some of the more significant types of errors are identified during the error correction process and are brought informally to the attention of responsible management officials so that action can be taken to correct the causes of the errors

We believe the evaluation of error experience on a more systematic basis could be useful to the Administration's management in identifying types of errors with high rates of incidence, investigating the underlying causes of these errors, and taking action to prevent or correct them at an earlier processing point.

Need for internal audits of
automatic data processing controls

In making our review we considered the Administration's Office of Audit's most recent internal audit of the Administration's payroll practices and procedures. We found that this audit was competently performed and reported on. However, we noted one important area of the Administration's operations (automatic data processing) which has not been given sufficient internal audit attention.

The GAO Manual (3 GAO 52) states that internal auditing should extend to all agency activities and related management controls. We were informed by an Administration official that internal audits have not been made of the effectiveness of internal controls over automatic data processing operations. In view of the importance of these controls in the effective operation of the Administration's financial management system, we believe this area should be given appropriate internal audit attention.

Recommendations

We recommend that the Administration further strengthen its internal controls over payroll activities and automatic data processing operations by

- requiring payroll error listings resulting from machine edits to be retained and periodically evaluated to determine error patterns, causes, and trends, and
- directing the Administration's Office of Audit to perform periodic reviews of the effectiveness of internal controls over automatic data processing operations

NEED FOR IMPROVEMENT IN THE
MAINTENANCE OF LEAVE RECORDS

Leave records must be maintained accurately to insure that employees are paid correct amounts and are credited and charged with correct amounts of leave earned and used. Our review indicated a need for improvement in the Administration's maintenance of leave records

In our review of the leave records of 72 selected employees (1-1/2-percent sample) for the leave year ended January 8, 1972, we noted 19 errors in the records of 12 employees. These errors resulted in overstatements of employees' leave balances totaling \$254, understatements of leave balances totaling \$143, and a salary overpayment of \$21. The 19 errors are summarized below.

<u>Type of error</u>	<u>Number of errors</u>	<u>Over- statements of leave balances</u>	<u>Under- statements of leave balances</u>	<u>Salary over- payment</u>
Errors in addition	5	\$ 64.41	\$ 7.48	
Errors in crediting employees with unused leave transferred from prior Government service	5	79.53	102 03	
Errors in computing and recording leave accruals	4	75.48	33.80	
Errors in leave category charged	2	-	-	
Other errors affecting employees' leave and pay	<u>3</u>	<u>34.83</u>	<u>-</u>	<u>\$21 28</u>
Totals	<u>19</u>	<u>\$254 25</u>	<u>\$143 31</u>	<u>\$21.28</u>

The errors noted were for the most part attributable to clerical inaccuracies in computing and recording leave charges, accruals, and balances. Some of the errors apparently were caused by insufficient knowledge by time clerks of applicable regulations. In our opinion, errors resulting from both of these causes could be reduced by more intensive training of time clerks and their supervisors. We were informed by a member of your staff that classroom training had not been provided to time and attendance personnel since the fall of 1971.

In a separate review of the leave records of 47 employees whose employment had terminated during the leave year ended January 8, 1972 (4-percent sample), we noted 10 errors in the records of two employees. These errors resulted in a failure to make lump-sum payments to the employees for \$150 of accrued annual leave and a failure to credit the employees with accrued sick leave valued at \$32.

Conclusion

Although Administration officials have taken action to correct the specific errors noted, we believe the number and nature of the errors indicate a need for greater emphasis on accuracy in leave computation and recording and on supervisory reviews of these operations.

Recommendations

- We recommend that responsible Administration officials be required to
- place increased emphasis on the need for accuracy in computing and recording employees' leave,
 - insure that supervisory reviews of timekeeping and leave recording operations will be more effective in detecting and preventing errors, and
 - provide classroom instruction in the maintenance of time, attendance, and leave records to time clerks and their alternates

Proposed agency action

In commenting on our draft report, an Administration official stated that increased emphasis will be placed on the need for accurate timekeeping and leave reporting at the clerical and supervisory levels. Actions proposed to be taken by the Administration include conducting a training program in time and attendance reporting, issuing special instructions emphasizing the responsibility of supervisors for the accuracy of time and attendance reports, analyzing leave errors to identify time and attendance reporting offices with high rates of errors, and taking appropriate corrective action to eliminate the causes of these errors.



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FEB 6 1973

Dear Mr. Coleman

Enclosed for your information is a copy of our letter with enclosure to the Administrator, Small Business Administration, on the results of our recent review of the Administration's payroll and leave operations.

Sincerely yours,

H. L. Krieger

H. L. Krieger
Regional Manager

Enclosure

Mr. Ronald G. Coleman
Assistant Administrator for Administration
Small Business Administration

LSI DO NOT RE-ARRANGE