CITY AUDITOR'S OFFICE

To: Mayor and Council Members

From: Andrea R. Russell, City Auditor

Date: December 6, 2019

Subject: Financial Services - Payroll Inquiry 4/1/2018- 9/30/2019

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

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.

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 through out 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.

SCOPE and METHODOLOGY

The scope of our inquiry included IRS Form 941's and supporting documentation filed between 4/1/2018 through 9/30/2019. 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 and Form 941's and supporting documentation submitted to the IRS for the City, Charter School and CRA.

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.

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

We also documented a timeline of events concerning the former Payroll Supervisor's notification of supervisory Financial Services staff, as well as when information was communicated to the Financial Services Director and the City Manager's Office.

RESULTS

Based on our review we determined the following:

- **Bi-Weekly Review Results**
    - Three of 153 were paid late for the City.

- Two of 153 where documentation was incomplete so EIN couldn't be verified.
- One of 153 instance where the Charter School EIN was used for City deposit.
- Five of 153 were lacking supporting documentation to demonstrate deposit was made.
    - Of these five deposits; two were confirmed late and incurred $46,475.86 in penalties.
- Preparer and approver signatures were inconsistent and, in some instances, not present.
    - 133 of 153 of the wire transfer forms were prepared by payroll staff.
    - There were four wire transfer forms where there is no evidence of deputy finance director and/ or finance director approval.
- Five of 153 instances where the EFTPS deposit was made to the incorrect the tax period resulting in penalties for failure to file and failure to make proper deposit totaling $128,487.05 for the City.

➢ **Quarterly 941 Results**

- Three of six Schedule B amounts for the City did not agree to the biweekly submissions and/or the general ledger amounts.
    - One Schedule B for the quarter ended 9/30/2018 was incomplete. Schedule B was missing the bi-weekly submission for pay date 9/27/2018 which resulted in $156,092.39 penalties.
    - One Schedule B for the quarter ended 3/31/2019 was filed late and resulted in $44,299.99 in penalties.
- Form 941's are due by the end of the month following the last month of the quarter.
    - Eight of 18 (44%) were not filed by the end of the month following quarter end.
    - Eight of 18 (44%) were unable to determine if filed timely as the certified mail receipts were not available.
    - Two of 18 were filed by the deadline.
    - Four of 18 were mailed to the incorrect location
        - Of the four, three were not filed by the end of the following month (see above).
- Form 941's are accompanied by a coversheet indicating preparation and Senior Accounting Manager approval for final signature by the Financial Services director.
    - 12 of the 18 (66%) were prepared by the former Payroll Supervisor.
    - Four of the 18 showed no evidence of approval by the Senior Accounting Manager or designee.
    - All 18 were signed by the Financial Services Director.

- A Schedule B must be filed with the Form 941. This schedule shows totals for the monthly deposits made.
  - Three of six Schedule B total amounts filed for the City did not agree to general ledger total amounts.
  - The number of employees on the Form 941 didn't agree to supporting reports for six City and six Charter School submissions ..
  - Three of six Schedule B's were not reviewed in a timely manner and were filed late
- We noted variances in general ledger amounts due to the inclusion of Form 945 amounts that must be reported separately from Form 941.

➢ **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**

- According to IRS notices, the City incurred penalties and interest totaling $402,369 due to:
  - Failure to make a proper federal tax deposit
  - Failure to file
  - Failure to pay
- Certain penalties and interest were decreased according to IRS notices totaling $56,169.78. Adjustments were due to reconciliations performed by the IRS and communicated to the City.
- Amounts considered overpayment by the IRS totaled $2,527,196.21. It is important to note that the $2.5 million didn't represent true overpayments, but rather what the IRS considered overpayments due to incorrect or incomplete filing by the City.

CONCLUSION

Although, required deposits and reports were inaccurate, incomplete or not filed or made in accordance with IRS deadlines, all payroll taxes due were remitted for the period included in the scope of the review. A lack of proper review and approval of the former Payroll Supervisor's work contributed greatly to the inaccuracies noted. Based on our review, there is no need for a criminal investigation at this time. It was determined that, although not made in a timely manner, all funds associated with Form 941 payroll taxes were remitted to the IRS.

C: John Szerlag, City Manager
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Kimberly Bruns, City Clerk

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