

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

AUDIT OF
FSM PAYROLL OPERATING CONTROLS
FISCAL YEARS 2010, 2011 and 2012 Through May
REPORT NO. 2012-04



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August 9, 2012

His Excellency Manny Mori, President
Honorable Members of the FSM Congress

Executive Summary: Audit of FSM Payroll Operating Controls

The Office of the National Public Auditor (ONPA) announces the release of Audit Report No. 2012-04, Audit of the FSM Payroll (PR) Operating Controls. A digital copy of the report is available for public review online at www.fsmopa.fm and printed copies are available at the ONPA's offices in Palikir, Pohnpei and in Weno, Chuuk. The audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States.

The objectives of the audit were to determine:

1. If management is adequately monitoring the internal control activities over PR operations.
2. If there is reasonable assurance that pay checks are issued:
 - a. Only to current, authorized employees,
 - b. At the authorized pay rates, and
 - c. Only for time authorized.
3. If the PR Function is generally operating in compliance with laws and regulations

The audit scope covered fiscal years 2010 through 2012 May. During each of these years approximately 25,000 checks totaling more than \$15 Million were issued. Included were approximately 201 employees of the State Governments (SG) of Chuuk and Kosrae that are funded by the US discretionary funds. The SG employees are entered to the computer and are processed the same as FSM employees. The FSM Departments are submitting hours for SG employees, for example the States Health Department employee hours are submitted by the FSM Department of Health.

Based on the audit testing, the auditors found:

- Significant over payments were made to active employees for hours not authorized and not requested. The over payments were not detected or corrected by Department of Finance & Administration (DF&A).
- Significant wrongful payments were made to terminated employees. The wrongful payments were not detected by DF&A.

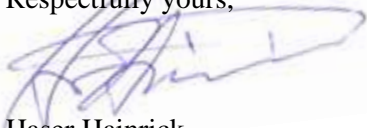
- Changes to pay rates in the computer were not verified by Personnel or DF&A. The pay rates entered by the hands-on operators were not verified by anyone else to ensure that only legitimate pay rates were entered as authorized by management. Changes to pay rates were performed by both DF&A and Personnel. Some of the pay rates tested could not be verified to Personnel Action Forms (PAFs) on file in Personnel.
- Not all key duties are segregated and thus the system is vulnerable to mistakes and improper acts. For example, the persons who print the paychecks (none are pre-numbered) are system experts having administrative privileges. In other words, the DF&A employees who are printing checks, could modify their own check and then delete or modify all record of wrongdoing.
- Lack of monitoring of changes to employee payroll master records may have resulted in illegitimate pay increases and premiums.
- The operating departments, agencies, offices who submit their time summary reports - signed by the allottee, to DF&A for payroll processing are not ensuring the integrity of the information. Hours not worked were approved by the allottee. Also, the summary of hours approved does not always agree with the detail hours (regular, vacation, sick, other) reported.
- A plan for payroll continuity in the event of a computer failure has not been formalized or documented by DF&A.

Ultimately, the significance of the findings and the nature of the findings should be adequately alarming to motivate the implementation of strong controls. The gravity of the findings if not corrected, will eventually erode the integrity of the payroll system, if such has not already occurred.

On July 13, 2012 we discussed the report during an exit conference with the Acting Secretary of Finance and Administration and the Personnel Administrator, both of whom expressed general agreement with the findings and recommendations.

The DF&A and Office of Personnel management responses indicate that they concurred with the findings and agreed to the recommendations. They also indicate some corrective action plans that they would implement at their offices.

Respectfully yours,



Haser Hainrick
National Public Auditor

XC: Vice President
Chief of Staff
Department of Finance and Administration
Office of Personnel

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INTRODUCTION

Background

The payment of salaries and wages in a timely and accurate manner is key to the effective functioning of FSM National Government. While the processing of paychecks is performed by the Department of Finance & Administration (DF&A), the Office of Personnel (Personnel) is responsible for authorizing all employee master information, and each operating unit (see appendix 2 for list of 25) is responsible for maintaining attendance records, authorizing and providing to DF&A a summary of hours to be paid to each employee. The employee master information includes such information as employee status (active, leave, terminated), pay rate, pay rate changes, employee number, department and location.

Table¹ of FSM DF&A Payroll (PR) Activity for CY 2011 and 2010
(Approximate total dollar amount and total checks processed)

Government Entities	Calendar Year 2011	Checks Processed	Calendar Year 2010	Checks Processed
FSM National				
• Executive Branch	\$10,854,976	16,703	\$11,122,151	16,419
• Congress	\$1,112,927	1,584	\$1,080,407	1,537
• Supreme Court	\$673,531	795	\$595,020	727
• Agencies & Others	\$780,304	1,513	\$738,732	1,524
Chuuk State*	\$1,194,208	3,405	\$1,047,272	3,254
Kosrae State*	\$527,125	1,822	\$477,702	1,680
Totals	\$15,143,071	25,822	\$15,061,284	25,141

Source: DF&A Statistics, produced by the Automated Data Processing (ADP) of DF&A. *For the States of Chuuk and Kosrae, this payroll was funded by the US discretionary grants, and is expected to be transferred to Chuuk and Kosrae States - Department of Finance for payroll processing. The transfer will occur in incremental stages as the new discretionary grants become effective.

Salaries, wages and benefits are generally the largest expense of every government. Due to its complexity and its direct impact on cash and personal benefit, the processing of PR is vulnerable to significant amounts of waste, abuse and fraud. Hence, it is critical that the internal control framework be monitored regularly to give assurance that the controls are operating effectively and that controls are not being overridden or bypassed.

The DF&A PR function is responsible for accurately processing the hours submitted by the allottees, at the pay rate authorized by Personnel, to employees authorized by Personnel. DF&A is also ultimately responsible for ensuring that payroll controls are functioning properly and to provide leadership when controls are not functioning properly.

¹ See Appendix 2 for a list of organizations, departments, offices and agencies paid.

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Section 4.1 of the Financial Management Regulations requires that time and attendance records be maintained for all employees, both exempt and non-exempt. The PR process requires the reporting of hours for all employees, and pay checks are issued based on the hours submitted. If no hours were submitted for the employee, then no paycheck should be issued.

PR is staffed by only one position, the PR Manager, who reports to the Assistant Secretary of Finance for Treasury. As noted in the table on page 1, more than 25,000 paychecks totaling over \$15 million annually were processed during each of CY 2010, and CY 2011. The software used, Fundware (FW) PR Module, was implemented in August 2008 and automated much of the payroll function. All of the FSM State Governments also implemented the FW software package.

At the present, approximately 1,000 paychecks are issued for each bi-weekly pay period, or an average of more than 2,000 checks per month. There are 26 pay-periods annually. This activity includes NG employees located not only in Palikir and throughout the four FSM States, but also at the FSM embassies located in Tokyo, Suva (Fiji), Beijing, Washington DC, the consulate offices in Guam and Honolulu, and the mission at the United Nations in New York.

About 201 of the approximately 1,000 paychecks issued per pay period are to employees of the States of Chuuk and Kosrae who are funded by US discretionary grants. This arrangement made in April 2007 was at the request of the respective state governors. A Memorandum of Understanding (MOU) was executed and signed by the previous FSM President and the respective governors. The States of Chuuk and Kosrae employees were set-up in the Fundware (FW) PR Module the same as FSM employees with no separate identification, except for the general ledger where the particular fund account is separate. President Mori declared in December 2011 that this arrangement is to terminate and transfer back to the States of Chuuk and Kosrae.

To process this many paychecks accurately, timely and in a controlled manner requires careful planning and precise execution. A strong system of internal control is key and necessary to ensure accuracy and to prevent theft. Control weaknesses can result in significant waste, abuse or fraud given the high degree of automation and the large number of checks issued. Management must continually assess and evaluate its internal controls to assure that the control activities are effective and updated when necessary.

Objective, Scope and Methodology

Objective – The objectives of our audit were as follows:

1. Determine if management is adequately monitoring the internal control activities over PR operations.
2. Determine if there is reasonable assurance that pay checks are issued:
 - a. Only to current, authorized employees;
 - b. At the authorized pay rates; and
 - c. Only for time authorized.

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3. Determine if the PR Function is generally operating in compliance with laws and regulations.

Scope – The scope of the audit covered fiscal years 2010, 2011 and 2012 (through May 2012). The audit was conducted pursuant to Title 55 FSM Code, Chapter 5, which states in part:

“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.”

The audit was performed in accordance with the *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States, 2007 revision, and accordingly included such tests of records, transactions and other audit procedures that were necessary to achieve the audit objectives.

The audit fieldwork was conducted at the DF&A Main Office in Palikir, the field offices in Chuuk, Kosrae and Yap, and the FSM Office of Personnel in Palikir.

Methodology

To determine if management is adequately monitoring the internal control activities over PR operations the audit team:

- performed a risk and control assessment
 - interviewed management,
 - performed an operational walkthrough
 - observed operations
- identified and evaluated unmitigated risks, and
- performed detail testing for each key, unmitigated risk identified.

To determine if there was reasonable assurance that pay checks were issued only to current, authorized employees and to determine whether the hours paid were authorized, a pay period was selected from CY 2011 [pay period (PP) #13] and the hours paid for each pay check were compared to the hours authorized on the Timesheet Summary Reports (TSRs) signed by the allottees. To determine if paychecks were issued to employees after the date of termination, a special report was requested of all employees terminated during FY 2010 and 2011. However, the data in the computer was not reliable since most terminations were not actual terminations. Additionally, there was no listing of terminated employees in both DF&A (PR Function) and the Office of Personnel. Therefore, we were not able to test the continuing of paychecks after employment. However, some instances came to our attention during the performance of other tests. Additionally, interviews and inquiries were performed directly with all 25 operating units that submit a summary of hours worked for each employee, all of whom were required to account for their time and attendance. A list of all 25 operating units is included as appendix 2.

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To determine if there was reasonable assurance that pay checks were issued only at the authorized pay rates, the auditors randomly selected a test sample of 50 pay checks from PP#13 CY 2011 and pay rates were compared to the documentation available at the Office of Personnel. Also, to determine if pay rates representing a pay increase were authorized, a special report of all pay increases during FY 2010 through FY 2011 was requested. Using the special report, a test sample of 54 pay increases was judgmentally selected and the pay increases were compared to the documentation available at the Office of Personnel.

To determine if the PR function is operating in compliance with laws and regulations, we reviewed the Public Service System Regulation (PSSR) and the Financial Management Regulations (FMR) for regulations that directly apply to the PR functions performed by DF&A or the Office of Personnel, and then performed interviews and observations regarding compliance.

Prior Audit Coverage & Compliance Investigation Division (CID) Referral

This was the first performance audit by ONPA of the PR Operating Controls. We reviewed the prior years' FY 2010 and 2009 Single Audit reports issued by the external audits, Deloitte and Touch, LLP in regards to the PR functions, and found 3 findings:

- Finding 2010-09 Condition 3: "For 10 (or 26%) of 39 payroll samples tested, the employee personnel action form, which documents the authorization of employment and pay rate, was not available."
- Finding 2009-08 Condition 3: "For 7 (or 23%) of 30 payroll samples tested, we noted that (1) pay rates per the system and PAFs differed, or (2) either partial or no financial records (i.e., PAF, approved timesheet, etc.)"
- Finding 2009-14 Condition 3: "For 3 (or 20%) of 20 payroll samples tested, pay rates per the system and Personnel Action Forms differed resulting in a net underpayment."

We also identified a finding and have been referred to the National Public Auditor's Compliance Investigation Division (CID) for further review.

Conclusion

Based on our audit, we conclude that management is not adequately monitoring internal control.

The auditors found:

- Significant over payments were made to active employees for hours not authorized and not requested. The over payments were not detected or corrected by DF&A.
- Significant wrongful payments were made to terminated employees. The wrongful payments were not detected by DF&A.
- Changes to pay rates in the computer were not verified by Personnel or DF&A. The pay rates entered by the hands-on operators were not verified by anyone else to ensure that only

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legitimate pay rates were entered as authorized by management. Changes to pay rates were performed by both DF&A and Personnel. Some of the pay rates tested could not be verified to PAFs on file in Personnel.

- Not all key duties are segregated and thus the system is vulnerable to mistakes and improper acts. For example, the persons who print the paychecks (none are pre-numbered) are system experts having administrative privileges. In other words, the DF&A employees who are printing checks, could modify their own check and then delete or modify all record of wrongdoing.
- Lack of monitoring of changes to employee payroll master records may have resulted in illegitimate pay increases and premiums.
- The operating departments, agencies, offices that submit their time summary reports - signed by the allottee, to DF&A for payroll processing are not ensuring the integrity of the information. Hours were approved by the allottee that were not worked. Also, the summary of hours approved did not always agree with the detail hours (regular, vacation, sick, other) reported.
- A plan for payroll continuity in the event of a computer failure has not been formalized or documented by DF&A.

Ultimately, the significance of the findings and the nature of the findings should be adequately alarming to motivate the implementation of strong controls. The gravity of the findings if not corrected, will eventually erode the integrity of the payroll system, if such has not already occurred.

The findings and recommendations are discussed in detail in the following pages.

FINDINGS AND RECOMMENDATIONS

Finding 1: Significant overpayments to active employees were made automatically without detection / correction

Financial Management Regulation: 4.1

No government funds shall be disbursed to liquidate an obligation for the service of any employee unless the following documentary evidence has been filed: Time/Attendance Documentation – Signed by the allottee or his designee, verifying days/hours worked...

Prudent Practice:

Internal controls must be adequate to prevent overpayments.

The auditors selected a pay period preceding announcement of the audit to help ensure an unbiased, representative pay cycle. Pay Period (PP) #13 for CY 2011 was selected. In total, approximately 89,000 hours were processed for payment during this period.

The auditors found the following examples:

- Paychecks for 15 employees were overpaid by a total of 459.25 hours. The wrongful payments were not detected by DF&A. This resulted in overpayments of \$2,352.35.
- Additionally, paychecks for 2 employees, each for 80 hours, were issued despite the fact that zero (0) hours were submitted to PR; no paychecks were requested or expected. The wrongful payments were not detected by DF&A. This resulted in additional overpayments of \$496.90.
- Additionally, paychecks for 2 employees were overpaid 17 hours of overtime which was not requested and not authorized. The wrongful payments were not detected by DF&A. This resulted in additional overpayments of \$68.50.

As a result, significant waste, abuse and possibly fraud are occurring without correction. If these results are representative of all 26 pay periods per year, times multiple years, this represents a lot of waste and abuse and potential fraud.

Cause:

- The FW PR Module is set-up to automatically pay all active employees a regular 80 hours, unless manual intervention occurs.
- DF&A management is not monitoring/reviewing the detail activities of the PR function to ensure that only the hours authorized are processed for payment, i.e. the hours authorized as compared to the hours set-up for payment. DF&A may not be performing this control because of the poor condition in which the TSRs are received from the operating organizations.

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- Examples of paychecks that were issued and picked up by the operating units were brought to DF&A leadership attention in the past; however, effective corrective actions were not implemented.

Recommendations:

We recommend the Secretary of DF&A (or designee) should:

- A. Ensure that only the hours authorized by the allottees are processed for payment.
- B. Prepare a policy and procedure statement, to be distributed to the operating departments, agencies, and offices, requiring each TSR to be fully complete, summed and totaled, grand totaled (overall total) and balanced (totals agree and cross-foot) before it can be received by PR.
- C. Ensure that PR does not accept, and must reject, all TSRs that are not fully completed. To be complete, each page must foot and cross-foot (columns and rows must total properly and sum to page totals), and the sum of all page totals must agree to the grand totals. This should be verified before acceptance by PR.
- D. Ensure that the final PR hours (e.g. verification report prior to printing checks), absolutely agree with the TSR total hours. As a key control, any differences must be reconciled to avoid wrongful payments.
- E. Following issuance of the print-checks-report but prior to actual printing, the total hours should be verified again to the TSR totals (e.g. hours authorized).

Finding 2: Significant wrongful payments to terminated employees were processed

Financial Management Regulation: 4.1

No government funds shall be disbursed to liquidate an obligation for the service of any employee unless the following documentary evidence has been filed: Time/Attendance Documentation – Signed by the allottee or his designee, verifying days/hours worked...

Title 52 FSM Code Ch.1.II.123

The Personnel Officer shall establish and maintain a current roster of all officers and employees in the public services, indicating for each the class of position held, the salary and any other appropriate data.

Prudent Practice:

Internal controls must be adequate to prevent overpayments.

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DF&A and the Office of Personnel were not able to provide a list of employees terminated and therefore, the auditors were not able to perform tests of terminated employees, except where instances came to our attention while conducting other tests as noted in other findings. The auditors found the following examples of wrongful payments, and other conditions as described below:

- PR continued for an employee who died in May of 2011, yet PR continued for another 5 months. Much of the paycheck was allotted to a personal bank account and one or more vendors as credit against personal debt. Amount wrongfully paid: \$2,730.24; approximately \$1,920.33 likely is not recoverable due to direct deposit for personal use. The allottee had approved the hours for payment.
- PR continued for an employee who resigned in June of 2011, yet PR continued for another 4 months. Amount wrongfully paid: \$1,460.00; approximately \$569.88 likely is not recoverable due to direct deposit for personal use. The allottee had approved the hours for payment.
- Other instances of payments to terminated employees were reported by the departments, agencies, offices being paid by DF&A PR and formal letters were issued to DF&A. However, corrective action was not effective because the root causes were not corrected. For 2 examples, see Appendix 3A and 3B at pages 18 and 19.
- The TSRs for PP#13 from CY 2011 (selected for other audit tests described in findings 1 and 6) indicated 61 employees as inactive while still in the FW PR Module as active. These were not followed up by management as to potential terminations. Each of the 61 required manual intervention to prevent overpayments, and 2 of the 61 were wrongfully issued paychecks for a full 80 hours each.
- The list of active employees is not maintained by Personnel.

As a result, significant overpayments to terminated employees are occurring.

Cause:

Terminated employees remain as active until a personnel action form (PAF) effecting such termination is received by the Office of Personnel. PAFs for terminated employees many times are not received or, not received timely - not until months after the effective date and sometimes only when requested by Personnel. Also, known instances of termination - for example, the employee died, are not updated to the FW PR Module until the PAFs are processed. Control weaknesses discussed in the other findings also contribute to continued payment to terminated employees. For example - accidental inclusion of hours due to the default setting for an automatic 80 regular hours, which, in the absence of manual intervention and the absence of DF&A management monitoring, results in wrongful checks.

In some instances the PR function received TSRs with hours authorized by the allottees who were likely careless in approving hours for the terminated employees. (Also, see finding 6 regarding lack of attendance records).

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Management was not able to provide a listing of terminated employees. The FW system is not used as designed and the status of "terminated" no longer means the employee was terminated. In most instances, employees indicated as terminated were recreated under the same name but different employee number and the 2 master records do not relate (do not correlate). In other words, there is no indicator in the terminated employee record that it was recreated as an active employee. In one instance, four employees exist for the same person - 2 were terminated "employees," one was an inactive "employee" and another was active, even though all 4 are the same employee.

The Office of Personnel has a list of "active" employees but it is not maintained. If the active list of employees were timely maintained, then as employees are terminated and removed from the active list, a list of terminated employees would therefore be facilitated. As soon as an employee resigns, dies, or is otherwise inactive, the Fundware status should be edited to "inactive." By updating to "inactive" status, accidental payments can be avoided. Updating to "inactive" status should be done prior to the processing of PR.

Many of the allottees are not requiring detail attendance records be maintained within their organizations (see finding 6). As a result, some allottees are approving hours wrongfully.

Recommendations:

We recommend that the Personnel Administrator (or designee) should:

- A. Use an alternative method of identifying terminated employees. An alternative method could be to perform follow-up on employees indicated on the TSR as having -0- hours. A list of employees having -0- hours on the TSRs would need to be obtained from the DF&A PR. Call the operating unit and inquire; if the employee (with -0- hours) is terminated, then edit the employee status in FW to inactive until the PAF is received - then edit the status to terminated.
- B. Maintain manually a list of terminated employees including all related information.

Note: The recommendations to DF&A in finding 1 of comparing the total hours authorized to the total hours set for payment and then reconciling any differences will also help control accidental payments to employees for whom no hours were authorized (that is, terminated employees). And the recommendations in finding 6 (attendance records) will help correct the issue of allottees signing for hours that were not worked.

Finding 3: Wrongful payments to newly hired employees prior to their first day of work were made automatically without detection

Financial Management Regulation: 4.1

No government funds shall be disbursed to liquidate an obligation for the service of any employee unless the following documentary evidence has been filed: Time/Attendance Documentation – Signed by the allottee or his designee, verifying days/hours worked...

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Prudent Practice:

Internal controls must be adequate to prevent overpayments.

The auditors found that paychecks were generated and distributed for employees newly hired for whom hours were not authorized by the allottees. For example, in April 2011 a paycheck was generated and distributed for a new employee of the Office of the FSM Public Defender (PD), without hours ever being authorized by the allottee. The administration of the PD was alert and returned the check to DF&A. In the Office of the National Public Auditor (ONPA), in February 2012 a new employee's start date was delayed, *and no hours were authorized by the allottee*. However, a paycheck was still generated and distributed. The administration of ONPA was alert and the paycheck was voided and returned to DF&A. See Appendix 3C.

This control weakness (see cause below) will likely persist until corrective actions are implemented to prevent such situations.

As a result of the control weakness, overpayments to newly hired employees occurred without detection by DF&A. The above examples were identified because the departments were being alert and recognized the payments were unauthorized and thus the departments returned the wrongful checks to DF&A.

Cause:

Since the FW PR Module automatically pays all employees in the active status, the moment the Office of Personnel enters the newly hired employee to FW - is the same moment the employee is set for payment for 80 regular hours. If this occurs at any time prior to generating the print-check-report it will be included in the regular printing of checks despite no hours having been authorized. This potential waste and abuse of taxpayer money is not detected because DF&A is not verifying (not monitoring) whether the hours-set-for-payment actually agree (were in balance) with the hours-authorized by the allottees.

Recommendation:

The recommendations made in finding 1, if properly and fully implemented, will help prevent the early payment to newly hired employees for hours not authorized.

Finding 4: Lack of segregation of key duties (SOD) and user privileges

Standards for Internal Control in the Federal Government

"Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets..." US GAO publication GAO/AIMD-00-21.3.1, p.14.

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The auditors found:

- There are 3 ADP employees in DF&A, each having full administrator privileges, which means that each employee has full access privileges to FW. It is also part of their regular, assigned duties to print the paychecks every pay period. A large number of blank check stock (not pre-numbered) is kept on an open ADP shelf on a regular, on-going basis.

As a result of the above condition, paychecks could be illegitimately created and the records modified or deleted and go undetected until the bank account is reconciled.

- The PR manager (who regularly processes PR) performed over 400 edits to employee master files during fiscal year 2011. The changes performed were for various reasons, however, a significant number of the edits performed by PR were for pay rate increases. The capacity to perform edits to employee master files, i.e. addition of new employees, changes to pay rates, is the responsibility of the Office of Personnel. This responsibility is documented in a letter dated February 7, 2011 from the Secretary of DF&A to the Personnel Officer. Additionally, the changes / edits to the employee master files *were not reviewed by the management of either the DF&A or the Office of Personnel*. In other words, the DF&A PR person performed the edits and no one else (for example, her supervisor) verified whether all the changes were performed accurately and only according to an existing PAF.

It should also be noted (see finding 5) that significant changes were performed to master files for which the PAF either was not performed, or was lost and not filed.

As a result, allowing the PR function to perform the Personnel function to gain greater efficiency also increases the risk that unauthorized changes may be performed to the master files and not be detected.

- There is a high-level administrator account still active with no name indicated, *having top level privileges*. During FY 2011, 21 edits to employee master files were performed by the user of the “no name” account.

As a result, significant changes to master information (i.e. pay rates) or even acts of intentional destruction (disgruntled employee) could be performed without traceability, since there is no name associated with the administrator account.

Cause:

- The Office of Personnel may not be performing personnel actions timely and consequently PR is performing the action. If not performed timely, additional work is created unnecessarily for the PR function.
- Management does not periodically review user privileges to ensure incompatible duties are properly segregated.
- The PR Manager (user-access) workgroup set of privileges includes employee master file edit capability which has not yet been segregated or disallowed.

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Recommendations:

We recommend the Secretary of DF&A (or designee) should require:

- A. DF&A employees to no longer have access to edit the employee master information (for example changes to pay rates), nor access to add new employees.
- B. DF&A personnel who have FW user privileges, especially those with high level access privileges (Administrators and System Administrators), to not have access to the blank check stock. The administrators potentially could generate their own checks and then delete the records. The employee who prints checks should not have access to other PR responsibilities.
- C. Blank check stock be kept in a locked cabinet or locking safe at all times except during printing, and all check stock used and stock remaining should be specifically accounted and reconciled to the original count of blank checks (running total).
- D. All user accounts must indicate the name of the user. No account having edit capability, especially administrator capability, should ever have no name. This is due to the lack of traceability as to who the user is.
- E. Development of a policy to govern user access privileges, also stipulating the frequency that user access is to be reviewed by management, and the frequency of review.

We recommend the Personnel Administrator (or designee) should:

- A. Emphasize to each staff the importance of timely keying each PAF and to personally monitor the timeliness as recommended in B below.
- B. Set-up a system of accountability to ensure all authorized changes to employee master files in the FW PR Module are processed within 24 hours. This may require:
 - 1. Designing a manual log to track - time of receipt of PAFs, and then time of processing.
 - 2. Requesting a report from ADP of all changes entered to the PR master files.
 - 3. Sign-off on the change report and filed for the record in the event of challenge.

Finding 5: Lack of monitoring of changes to employee payroll master records may have resulted in illegitimate pay increases and premiums

Public Service System Regulation

Part 7: (paraphrase): ... employment terms must be documented using a personnel action form (PAF), and must be signed and approved by the appropriate officials...

Part 8.8b (25% of base pay) "...the personnel office is responsible for review and approval for all requests for payment of Hazardous Work Differential."

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Part 8.9 (15% of base pay) "...to receive night differential pay ... a request for Personnel Action shall be initiated ... The Personnel Officer will review the propriety of, and act on each request ...

The auditors selected a random sample of 50 employee pay rates from the 2011 PP#13, added another sample of 54 of the largest pay rate increases during fiscal years 2010 and 2011, and added all 74 pay premiums paid to recipients during the 2011 PP#13, to determine whether the pay rates, increases and premiums had been authorized as required by law.

The auditors found:

- Of the 50 employee pay rates tested, 10 pay rates were not verifiable as being authorized (PAF not on file in Personnel Office).
- Additionally, 54 pay rate increases were tested and 9 pay increases were not verifiable as being authorized (PAF not on file in Personnel Office).
- Additionally, 74 instances of premium pay rates (night-time differential, hazard pay) were tested and 69 could not be verified as being authorized (PAF not on file in Personnel Office).

As a result:

- Significant amounts of PR based on pay rate increases, and payment of premiums cannot be verified by Personnel as having been approved and authorized. Either PAFs were not done, or they are not on file.
- Employees were added, pay rates entered, and increases to pay rates were input to the computer system without assurance or management verification that the actual changes made to the computer were authorized and documented.
- The ultimate effect of unauthorized changes is potential waste, abuse or fraud.

Cause:

Management is not monitoring changes to the PR master data in the FW PR Module. The FW PR Module may not have pre-designed reports to facilitate effective monitoring, and special reports have not been developed.

As to the pay premiums, the Office of Personnel stated that they allow the Dept. of Justice (DOJ) to determine who should be eligible for the pay premiums based on their work assignments and scheduling. The process was that DOJ would provide the premium to the employee and the allottee authorizes the premium on the summary time sheet reports to DF&A bi-weekly along with the hours.

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Recommendations:

We recommend that the Personnel Administrator (or designee) should monitor changes to employee master records to prevent illegitimate pay increases and premiums. One way to accomplish this is as follows:

- A. Design and implement a control log to document all PAFs when they are received, and when they are processed. MS Excel could be used for this purpose, and thus could be sorted in various ways for inquiry purposes. Or a manual log, the advantage being that it is unalterable.
- B. Request DF&A to design and produce a special report² that will capture *all* changes to the employee master files. The report should be standardized and put into production on a regular, recurring frequent basis to be determined by management. The frequency of the report should be based on how much time gap Management is willing to allow from the time a potentially illegitimate change *or accidental error* was keyed, for example an illegitimate *or accidental* pay increase, and the time management actually detects the change. The purpose of the report, of course, is for management to monitor all changes entered to the employee master files. The report should be reviewed by management, verified for legitimacy (to PAFs), signed and filed for reference.
- C. Pay premiums, per the law, require Personnel Administrator approval, to be documented using the PAF. The Office of Personnel should provide to DF&A a list of employees authorized to receive pay premiums and only employees authorized should receive the particular premium.
- D. Perform a cost to benefit analyses to determine whether correcting the lack of available documentation can be corrected at a reasonable cost. Consider identifying all current employees for which primary elements of employment (for example, rate of pay) are missing documentation, and then prepare or locate the PAFs. Or, if not cost beneficial to recreate PAFs that are missing, identify another method of obtaining / documenting the proper authorization.

We recommend the Secretary of DF&A (or designee) should only process pay premiums to the employees that were authorized by the Office of Personnel.

Finding 6: Attendance records in the operating departments, agencies and offices are minimal and many times non-existent

Financial Management Regulation: 4.1 *No government funds shall be disbursed to liquidate an obligation for the service of any employee unless the following documentary evidence has been filed: Time/Attendance Documentation – Signed by the allottee or his designee...verifying days/hours worked*

²A report could easily be designed for use by the Office of Personnel using MS Access, a user friendly software that is part of MS Office. For example, DF&A ADP generated special reports using MS Access for purposes of this audit.

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The auditors interviewed the preparers of the TSRs at each organization³ submitting attendance hours to the DF&A PR function. The preparers were generally the administrative officers of each organization.

The auditors found that attendance record-keeping was generally poor, with few organizations maintaining detail records and nearly all were not using the time clock, or there was no timekeeping device available, and alternative methods were not used to record attendance. In some departments, paychecks were issued to employees who had *consistently not submitted* attendance records.

In some departments, allottees signed the TSRs without knowledge of whether each employee had worked.

The result of paying employees for more hours than they actually worked or employees who minimally attended work are waste, abuse and potential fraud. Ultimately, the abuse negatively affects the morale of the honest people. For example, employees who are required to maintain attendance records many times use their annual leave in small increments throughout the year to make up for lateness or other circumstances, versus having it available at the end of the year; while other employees (who are not required to maintain attendance records) who work less than 8 hours in a day, still have their annual leave available at year-end *because of the poor record keeping for attendance*.

Cause:

In some of the departments and agencies, employees are located in distant areas away from the main office and detail records were not requested of the employees. In other instances, large offices that do not require detail record keeping allow employees to self report directly to the administrative personnel without records being maintained. The allottees may not realize that in some cases they are actually signing for terminated employees, or active employees who have not worked the hours indicated.

Recommendation:

We recommend that the Secretary of DF&A (or designee) should prepare a policy that lists the detail responsibilities regarding attendance records that each organization should be keeping to ensure that the hours reported to the PR function are accurate and have supporting documentation. The policy should be well communicated to all organizations whose employees are paid by DF&A. We recommend that the DF&A Secretary request the FSM President to sign and distribute the policy with a cover letter requiring all organizations whose PR is processed by DF&A to comply with the policy.

Finding 7: Lack of planning documentation for payroll continuity and disaster recovery.

International Monetary Fund Publication on Operational Risk Management (ORM) and Business Continuity Planning for Modern State Treasuries (TNM 11/05 November 2011):

³ See Appendix 2 for a list of all organizations submitting time reports and receiving PR through the DF&A PR function.

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"Business continuity planning should be an integral part of the ORM framework for treasury ... Treasury should have in place a business continuity and disaster recovery plan to ensure its ability to operate on an ongoing basis and limit losses in the event of any business disruption."

Potential events that could incapacitate the PR system are many; for example, *a long term power outage*, or failure of any of many individual hardware components, loss of programming or data. Failure of hardware components could be caused by simple events such as the spilling of a beverage over electronic components, a leaky roof over the computer, *or just normal wear and tear leading up to equipment failure.*

The auditors found that there is no documented plan to assure continuity of the payroll function following a computer failure. Management indicates the PR data is backed up to an external drive by an ADP employee in whose possession it stays off-site. In the event of a disaster, management indicates the PR could be performed on the Fundware system at Pohnpei State. However, no formal arrangements with Pohnpei State have been undertaken and the actual capacity to act as a back-up site, and the protocols and necessary procedures have not been specified, confirmed, authorized or documented.

In the absence of a formal, detail, workable plan, when the FW PR Module fails DF&A may not have an actual mechanism to facilitate PR. This situation would be very significant considering the high degree of automation and the large number of employees depending on the regularity of PR payments for personal finances and daily living.

Cause:

Management has not taken the time to prepare a back-up plan.

Recommendations:

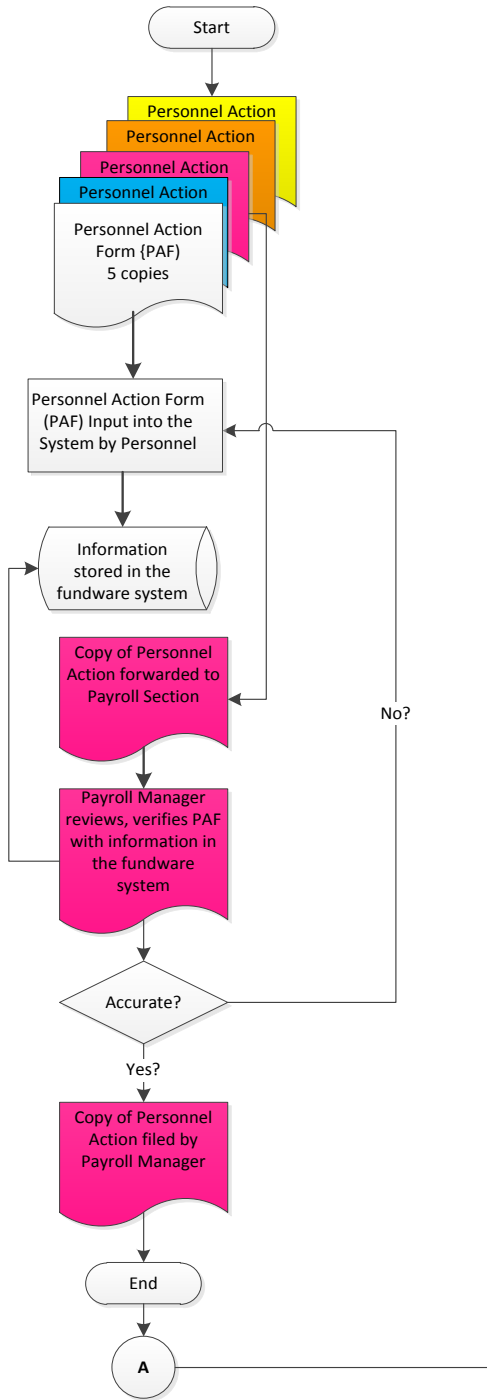
We recommend the Secretary of DF&A (or designee) should prepare a documented, detailed plan of PR Continuity and Recovery that, in addition to backing up of data, includes:

- Detailed procedures of how the PR would be prepared if FW, or the computer becomes unavailable.
- Arrangement of protocols, for example - if Pohnpei State is the desired back up location then a specific understanding and arrangement should be formally agreed between both governments.
- The actual plan should be practiced and periodically tested.

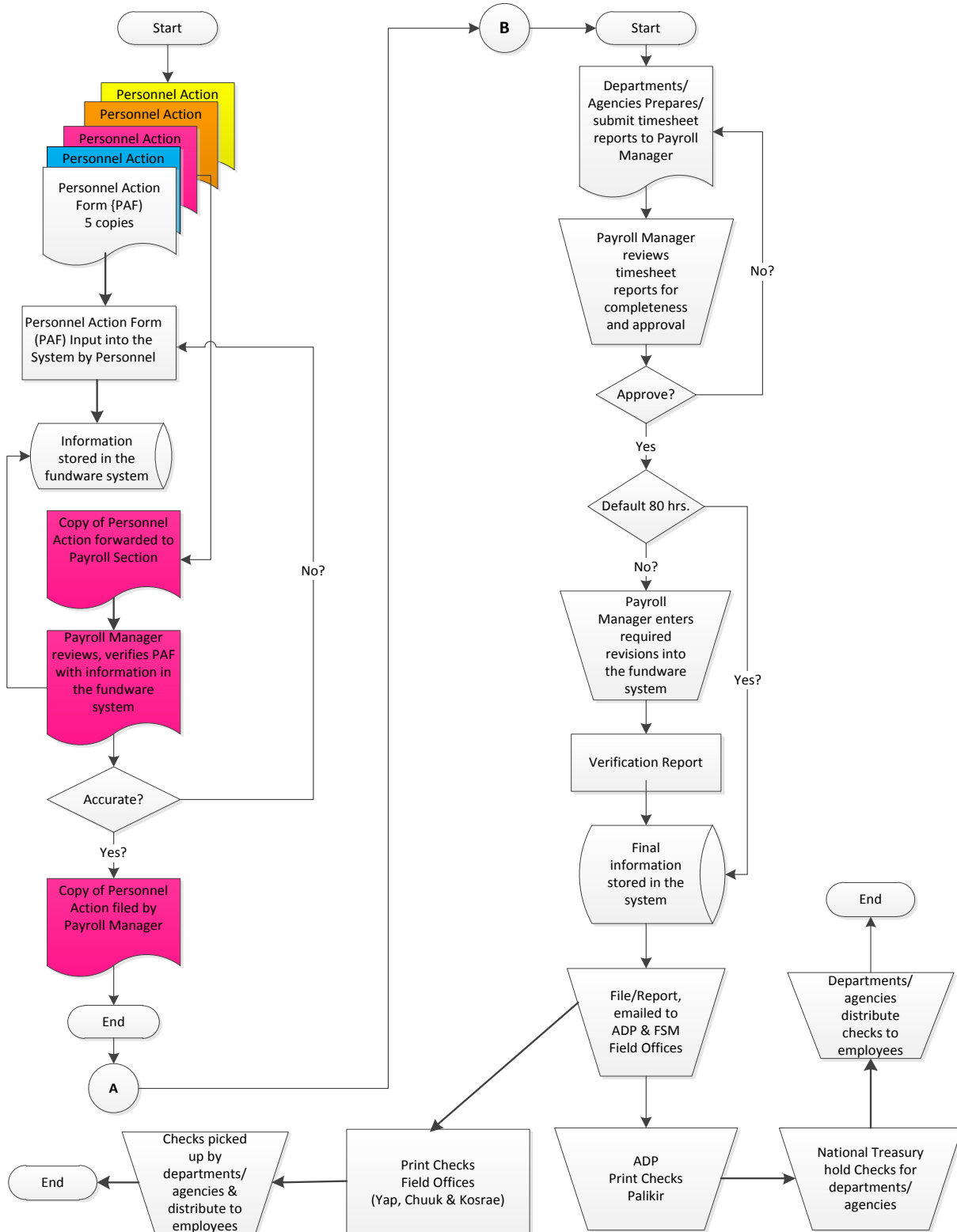
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APPENDIX 1: PROCESS FLOW CHART

A. Personnel Action Processing Flow



B. Bi-Weekly Payroll Processing Flow



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**APPENDIX 2: LIST OF ORGANIZAITONS PAID BY THE FSM DF&A PAYROLL FUNCTION
AND AUDIT COMMENTS**

(All these organizations submit time sheet reports to DF&A)

Ref	Branch of FSM, Agencies, Offices, or Others	Department , Agencies, Offices, Others
1	<i>Supreme Court</i>	Supreme Court
2	<i>Congress</i>	Congress
3	<i>Executive</i>	President's Office
4		Finance & Administration
5		Health & Social Affairs
6		Justice
7		Personnel
8		Project Management Unit
9		Education
10		Transportation, Communication & Infrastructure
11		Foreign Affairs
12		Resource & Development
13	<i>Offices</i>	National Archives, Culture & Historic Preservation
14		Public Defender
15		Statistic, Budget, Operation, Compact Management
16		Postal Services
17		Office of Environment and Emergency Management
18	<i>Agencies</i>	Banking Board
19		Coconut Development Authority (CDA)
20		Insurance Board
21		National Election Office
22		National Oceanic Resource Management Authority
23	<i>Independent Agency</i>	National Public Auditor
24	<i>Others</i>	MiCare Health Insurance Plan
25		Weather Services

Source: DF&A PR Records, www.fsmpio.fm/agencies.html; <http://www.fsmgov.org/ngovt.html>

*The Assistant Secretary of DF&A states that the funding for MiCare Health Insurance Plan and for Weather are both reimbursed into the National Treasury.

The FSM Departments of: 1. Education, 2. Health & Social Affairs, have a total of approximately 201 employees in Chuuk and Kosrae States which are funded by the US Discretionary Grants. Per the President's declaration in December 2011, the PR administration for the state employees is expected to be transferred to the States on an incremental basis starting in July 2012.

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APPENDIX 3: A. Letter from FSM Supreme Court to DF&A



SUPREME COURT
of the
FEDERATED STATES OF MICRONESIA

MARTIN G. YINUG
Chief Justice

DENNIS K. YAMASE
Associate Justice

READY E. JOHNNY
Associate Justice

BEAULIEA CARL WOODSWICK
Associate Justice

1056583

CHUUK STATE
P.O. Box 601
Chuuk, FM 96942
Ph: (691) 330-2908
FAX: (691) 330-4126

KOSRAE STATE
P.O. Box J
Koror, FM 96944
Ph: (691) 370-3185
FAX: (691) 370-2080

POHNPEI STATE
P.O. Box PS-J Palikir Station
Pohnpei, FM 96941
Ph: (691) 320-2351/2763/2764
FAX: (691) 320-2766

YAP STATE
P.O. Box 546
Yap, FM 96943
Ph: (691) 350-2159
FAX: (691) 350-2336

04/25/12


The Honorable Rose Nakanaga
Acting Secretary
Department of Finance and Administration
FSM National Government
Palikir, Pohnpei
FSM 96941



Dear Hon. Nakanaga:

I am returning a payroll check for _____ processed by your payroll staff more than a month after his contract was expired and had left the Court. This oversight could not be a mistake for the following reasons: 1) the clearance and termination action was acknowledged and signed by Personnel on March 05, 2012 and the payroll system reflected that and 2) the time sheet submitted for that pay period (#8) had 0 hours reported for _____. Please check if there were payroll checks processed prior to and after that pay period, (#8). This is a test case that gave proof that timesheets approved and submitted to payroll from departments and agencies have nothing to do with who gets paid. There is a serious flaw either in the system or in the people that run the system. Either way correction is needed.

Thank you very much for your continuing assistance.


Kapilly Capelle
Director, FSM Supreme Court

cc. Assistant Secretary Juliet Jimmy
FSM PA
FSMSC General Counsel
File



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APPENDIX 3 B. Letter from TC&I to DF&A



Federated States of Micronesia

Department of Transportation, Communication & Infrastructure
Palikir, Pohnpei State FM 96941

Office of the Secretary

March 08, 2010

MEMORANDUM

TO: Assistant Secretary, National Treasury

FROM: Secretary

SUBJECT: Request for Check Cancellation

This is to request your office to cancel a payroll check number 35707 payable to _____ dated March 02, 2010 as it was mistakenly printed on pay period number 05. We have attached the canceled check for your review and appropriate action.

Please let me know if any clarification is needed.

Thank you,

A handwritten signature in black ink, appearing to read "Francis I. Itimai".

Francis I. Itimai

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APPENDIX 3 C. Letter from ONPA to DF&A



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

P.O. Box PS-05, Palikir, Pohnpei FSM 96941

Tel: (691) 320-2862/2863 Fax: (691) 320-5482

CID Hotline: (691) 320-6768; E-mail: hhainrick@fsmopa.fm

Wednesday, February 22, 2012

Juliet Jimmy
Assistant Secretary
National Treasury Division
Department of Finance & Administration
Palikir, Pohnpei FM 96941

Subject: Check No. 123928



Dear Ms. Jimmy:

The purpose of this letter is the return the check reference above due to a newly hired staff that hasn't started working but has a check printed out for him. We have gone through each payroll check for PP#4 and found that one check shouldn't be printed out until PP#5. The check is printed out for which was an error so we would like to return the check to your Department to make any necessary corrections.

If you have any questions or need further clarification, please contact our office.

We appreciate your assistance. Thank you

Sincerely,

A handwritten signature in black ink, appearing to read "Haser Hainrick".

Haser Hainrick
National Public Auditor

SN

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MANAGEMENT RESPONSE: OFFICE OF FSM PERSONNEL

Personnel Office, FSM Government
Palikir, Pohnpei, FSM 96941

Responses to findings of Audit of FSM Payroll Controls
(Report No. 2012-04)
July 26, 2012

This report depicts the responses and corrective actions that Office of Personnel perceives to be taken into consideration to minimize or eliminate the findings reflected in the Audit of the FSM Payroll Controls as known to be called Report No. 2012-04. This report responses only to findings that are relevant to the Office of Personnel, FSM National Government.

Finding 2: Significant wrongful payments to terminate employees were processed.

Response: The Office of Personnel agrees to this finding, however, Personnel Office cannot just terminate any employee until the personnel action form to terminate the employee is received from the concerned department or office. The Personnel Office has a computerized personnel listing as "active" employees, but again this listing is updated based on the personnel actions received; even though this computerized listing is updated, it cannot be updated properly until all terminated personnel action forms are received. There is no way this computerized personnel listing can be updated if other departments or office do not initiate the termination action form on a timely manner. These departments or offices know when their employees are dislocated, while Personnel Office has no idea when they are dislocated. At some instances, employees of the other departments or offices would leave and never come back, or die, thus personnel actions are not prepared from the departments or office to be processed and documented.

Corrective Action:

- (a) Payroll should work closely with the Personnel Office by informing our office whether time is submitted or not;
- (b) The best way to illuminate this problem is to have Payroll unit to do inputting of personnel actions and time so that they would know whether or not time is submitted. If not, Payroll unit should terminate or inactivate the employee until the personnel action form is received.
- (c) At the moment Payroll unit and Personnel Office are situated in different building, thus routine internal control is not executed. Perhaps personnel responsible for inputting personnel action forms should be hired to work with the payroll unit.

Finding 3: Wrongful payments to newly hired employees prior to their first day of work were automatically without detection.

Response: Personnel Office also agrees with this finding, however, it was due to changes made by the two Offices cited in the report to experience this finding. In one instance, one Office initiated the action to be effective on a certain date and later changed it when the initial personnel action form was already inputted into the Fund Ware System. The personnel action form was already processed when the changed date was received by the Personnel Office. In the other instance, the personnel action form was processed when the prospective employee decided not to begin employment. The concerned office did not process the termination action form in time when the initial personnel action form was already processed.

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Corrective Action:

- (a) Concerned offices or departments should make sure prospective employees/new hires begin on the exact date as reflected in the initial personnel action form. If not, it should inform on a timely manner to the Personnel Office to delay the inputting.
- (b) It is a system issue because as a personnel action form is inputted time is automatically kicked in.
- (c) Change the Fund Ware Payroll System

Finding 4: Lack of segregation of key duties (SOD) and user privileges.

Response: Personnel Office agrees to bullet number 2 that master files were not reviewed by the management of either the DFA or the Office of Personnel.

Corrective Action:

- (a) Personnel Office also agrees to follow your recommendation to review the master file change report from payroll on monthly basis to reconcile changes made to employees files.
- (b) Personnel Administrator will also sign-off on all transmittals to the Payroll.

Finding 5: Lack of monitoring of changes to employee payroll master records may have resulted in illegitimate pay increases and premiums.

Response: Personnel Office also agrees with this finding, however, it has no knowledge that rates are inputted without the personnel action forms being authorized. The procedure as stated in the Public Service System Regulations is not followed by the concerned offices or departments. Personnel Office has the authority to approve employees who are entitled for the 25% of the hazardous differential, but without the personnel action form being authorized, the concerned office by its initiative submitted the time to Payroll without the knowledge of the Personnel Office. At this stage time is inputted without consulting the Personnel Office.

Personnel Office further agrees that personnel action forms (PAF) were not performed, lost or not filed, however, it is prudent to state that all the citations are related to the State Government employees whose payroll are processed by the FSM Government. In the mean time, Personnel Office is in the process of collecting all the missing PAFs from the State Governments.

Corrective Action:

- (a) Personnel Office has transmitted a memo on July 16, 2012 requesting Department of Justice to initiate personnel action forms to reflect the 25% hazardous premium. The memo also assured DOJ to make sure that 25% hazardous premium is only applied when the employees' health and safety are in danger.
- (b) Payroll unit to consult Personnel Office when time is submitted by any concerned department or offices.
- (c) Personnel Office is collecting the missing PAFs.

Submitted by:


Salpasr Tilfas
Administrator, Personnel Administration

**Office of the National Public Auditor
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MANAGEMENT RESPONSE: DEPARTMENT OF FINANCE & ADMINISTRATION



Secretary of Finance
&
Administration

August 6, 2012

Mr. Haser Hainrick
National Public Auditor
FSM Public Auditors Office
Palikir, Pohnpei
FM 96941

Dear Mr. Hainrick:

We appreciate the opportunity given to us to review and comment on the recently concluded review of the *Audit of Payroll Operation control FY2010, 2011 and 2012* through May. Below is our response to the citations relevant to the Department.

Finding 1: Significant overpayments to active employees were made automatically without detection/correction.

Response: Currently there is only one staff, the payroll manager who is responsible for the processing of payroll. Timesheets are due on Saturday, the ending of each pay period, leaving only two days for the payroll manager to review, verify and enter hours for time submitted for processing. We are in the process of assigning an additional staff to assist the payroll manager during payroll processing week to ensure that hours entered into the financial system reflect hours submitted on the authorized timesheets submitted by each Department, Office, and Agency.

Finding 2: Significant wrongful payments to terminated employees were processed.

Response: We depend on the timely reporting of the Departments, Agencies and Offices to inform the Department of Finance to terminate an employee in the financial system in the form of a completed Personnel Action. The Department of Finance will work closely with the Departments, Offices, Agencies and the office of personnel to identify employees that are deemed inactive but are still showing as active on the financial system.



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Finding 3: Wrongful payments to newly hired employees prior to their first day of work were made automatically without detection.

Response: We concur with the finding. (See response to finding 1)

Finding 4: Lack of Segregation of key duties (SOD) and user privileges

Response: In regards, to accessibility to the blank check stock, all check stock will be placed and locked in treasury. During a check run, the payroll manager will request for release of blank check stock from treasury to be used to print checks. After the check printing is completed, all excess blank check stock will be returned to treasury until the next check run. The plan is to transition the function of printing checks to the treasury manager so all checks are printed in treasury.

Restricted Access to pay rate

The payroll manager is responsible for calculating retroactive payments, which require access to the employee master file, especially pay rate increases. Taking away the privileges for this function will have an adverse effect in ensuring that employees are receiving appropriate amount due them. A memo will be issued to the Payroll manager to implement a new procedure to print a system report (PYLPYM) for verification against the PAF to be submitted to the operations manager for verification and filed in the employee file which is to be maintained by the payroll manager. An additional memo will be issued to the ADP staff to remove the payroll manager's access to set up new employees.

Finding 7: Lack of planning documentation for payroll continuity and disaster recovery

Response: During the selection of the financial management system, it was decided that all of the states would have one uniform system. One reason being that it will be easier if and when there is a technical issue or in case of emergencies that the states can utilize the closest states financial system to ensure that operations is not halted or affected. There have been various discussions between the IT Staff and State Finance Directors for such set up. The Department will work on documenting in writing what is currently in place.

**Office of the National Public Auditor
Audit of FSM Payroll Controls
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Thank you,



Rose N. Nakanaga
Acting Secretary

**Office of the National Public Auditor
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ONPA EVALUATION OF MANAGEMENT RESPONSE

Both the DF&A and the Office of Personnel generally expressed their agreement to the findings and recommendation provided in this report. They also indicated some corrective action plans that they would implement at their offices.

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NATIONAL PUBLIC AUDITOR'S COMMENT

We would like to thank management and staff of the DF&A and the Office of Personnel and the other Departments, Offices and Agencies for their assistance and cooperation during the course of our audit.

The ONPA may perform a follow-up review within the next 6-9 months to ensure that DF&A and the Office of Personnel have taken corrective measures to address the findings and recommendations provided in this report.

In conformance with government auditing standards, we provided a copy of the draft report to the Acting Secretary of DF&A and Office of Personnel to provide their response to the audit.

We have provided copies of the final report to the President and Members of the Congress for their use and information. Other recipients include the Vice President and the Chief of Staff. We will make copies available to other interested parties upon request. An electronic copy will also be posted on the office website at www.fsmopa.fm.

If there are any questions or concerns regarding this report, please do not hesitate in contacting the Office. Contact information for the office is listed on the last page of the report, along with ONPA and staff who made major contribution to this audit.



Haser H. Hainrick
National Public Auditor

August 9, 2012

**Office of the National Public Auditor
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ONPA CONTACT AND STAFF ACKNOWLEDGEMENT

ONPA CONTACT: Haser H. Hainrick, National Public Auditor
Email: hhainrick@fsmopa.fm

ACKNOWLEDGEMENT: In addition to the contact named above, the following staff made key contributions to this report:

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⁴ Part of the audit team for only a short period of time

⁵ Part of the audit team for only a short period of time

⁶ Part of the audit team for only a short period of time