

Detroit Public Schools

Office of the Auditor General



PAYROLL VERIFICATION AUDIT

**UNCLAIMED CHECKS AND ADVICES INVESTIGATED FOR
PAYROLL FRAUD**

REPORT NO: 09-196

REPORT DATE: June 30, 2009

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RESULTS IN BRIEF

Thirty-seven payroll checks and 220 payroll remittance advices totaling over \$208,000 have been turned over to the Inspector General's (IG) Office for further investigation of potential payroll fraud. The payroll checks and remittance advices were available to be claimed from June 9, 2009, the date they were issued through June 12, 2009. Most of the Detroit Public School (DPS) employees claimed their payroll check and/or payroll check remittance advice within the four-day process, however, those individuals who did not pick up or make arrangements to pick up their payroll checks and remittance advices are now the subject of internal investigations for payroll fraud.

Some employees avoided pending investigations by claiming their payroll checks and/or payroll remittance advices after the four-day process had concluded. Nearly 100 claims for payroll checks and or remittance advices by employees were made after the payroll verification process came to a close. Most of these claims were for remittance advices. Employees claiming their payroll checks and/or advices after the deadline were required to submit a notarized explanation of why they failed to comply with the payroll verification requirement to pick up their checks or advices within the allotted four-day period.

During the course of the payroll verification process we noted and took actions mitigate risk exposures that could result in improper payments and unnecessary expenses. In addition, one of the actions could help reduce safety risk for students and school-based employees. The District has been mailing payroll checks and/or payroll remittance advices to over 2,500 of its employees regardless to their work locations. This practice had been in place for several years and some of the employees had been receiving their checks in the mail since 1999 even though there was no assurance they were still working for the District. Human Resource officials could not justify why the practice was continued and agreed that only a small percent of employees such as substitute teachers and employees on medical or sick leave should receive their payroll checks and/or advices in the mail.

In addition, the District will save an estimated \$2,000 per month or \$24,000 per year by reducing the mailing of payroll checks and or advices to employees' residences. Also, at the direction of the Emergency Financial Manager, all DPS employees are now required to and have received a DPS-picture badge. Although students are required to have picture identification at the schools, school-based employees were not required to have or carry badges to gain access to the schools. Requiring all employees to have their DPS-issued picture badges should help facilitate security efforts and reduce safety risk at the schools.

The extent of noncompliance with payroll verification procedures may be due to several factors including misinformation, poor communication, apathy, inaccurate employee

information and fraud. We were informed by several employees that they did not have correct information or did not receive the letters sent to all employees. In at least one case, the audit team was told by an employee who claimed their payroll remittance advice after the June 12th deadline that they were not concerned about their employment status being investigated.

To the extent that fraudulent payroll activity is confirmed by the Inspector General's investigation, the cost of such fraud is greater than the lost dollars resulting from the fraudulent activity. The District like any governmental entity has been entrusted with public dollars. When taxpayer dollars are stolen, diverted for personal use, or spent irresponsibly it has a negative impact on the District's reputation, which, in turn, has an adverse impact on the perception the public has about Detroit Public Schools.

OBJECTIVE, SCOPE & METHODOLOGY

The objective of this audit was to determine the extent to which payroll (i.e., ghost employee) fraud may be occurring in the Detroit Public Schools payroll system. The Scope of our audit covered the payroll cycle of May-16 through May 29, 2009 for payroll checks and remittance advices issued on June 9, 2009.

To determine the extent to which payroll fraud may be occurring within the Detroit Public School (DPS) Payroll System we arranged for all DPS employees, not including contractors, to personally pick up their payroll checks and/or payroll remittance advices on June 9, 2009. Employees were required to present a DPS-issued picture badge and their 6-digit employee file number to obtain their payroll documents.

This process was carried out at ten designated DPS-facilities geographically located within the city of Detroit on June 9, 2009 (see attachment I.) The payroll verification process was continued at a centrally located DPS facility (New Center One Building) from Wednesday, June 10 through Friday June 12, 2009. In total, employees were given four days to personally pick up their payroll checks and/or remittance advices to verify their employment status. Those employees who could not personally pick up their payroll documents due to medical or other reasons were given the opportunity to submit a notarized affidavit with the requested information to pre-verify (i.e., come in prior to the June 9, 2009 date with the requested information) their employment status. During the period of June 9 – 12, 2009, thirty-one audit consultants and 5 internal audit team members were assigned to the designated locations to verify employment status of DPS employees.

DETAILED REPORT

BACKGROUND

The Detroit Public Schools (the District) employs more than 13,800 people not including contractors. These employees are housed at various facilities throughout the city including the Central Administration Offices and the District's 194 schools. The District relies on a manual time and reporting process to record and process payroll for its employees, which includes employees paid on an hourly and exception basis. The manual payroll process coupled with a lack of oversight and high turnover in leadership positions has increased the risk exposure for potential abuses within the payroll system.

According to a 2006 report by the Association of Certified Fraud Examiners, the average company loses 5 percent of its revenues annually to occupational frauds such as payroll fraud. The most prevalent type of payroll fraud is ghost employee schemes. Detroit Public School (DPS) Officials became increasingly concerned about the possibility of payroll-related fraud after two former DPS employees were indicted in May, 2009 for a payroll fraud scheme that involved over \$400,000 between 2001 and 2005. This occurred just two months after a DPS payroll supervisor was suspended for adding extra hours to his own check.

Given the recent incidents involving payroll abuses at DPS, the Emergency Financial Manager requested the Office of the Auditor General to conduct a payroll verification audit by handing out payroll checks and/or remittance advices to each of the District's active employees. As part of the payroll verification process, the Emergency Financial Manager required that all employees have a DPS-issued badge. The effort, which was led by the Human Resource department, required that over 9,000 DPS employees receive a DPS-picture badge. Employees were required to show their DPS-issued badges and provide their 6-digit employee number to claim their payroll check and/or remittance advice.

Checks and Remittance Advices Go Unclaimed

Nearly two weeks after the payroll verification process concluded for the Detroit Public School System, 37 checks for \$16,144 and 220 remittance advices for \$192,239 have not been claimed. Employees of the Detroit Public Schools (DPS) were required to personally pick up their payroll check and/or payroll remittance advices on the pay day of June 9, 2009.

Employees who failed to pick up their payroll checks and/or remittance advices have been referred to the Inspector General's Office for investigation into possible payroll fraud. The rightful owner of the 37 checks and 220 remittance advices failed to contact the Office of the Auditor General and are not currently on any approved medical or sick leave. As such, each owner of the checks and/or remittance advices remaining will be investigated to determine whether or not they are a current District employee who has earned the compensation.

Most Employees Claimed
Payroll Checks/Advices

Most of the DPS employees showed up to claim their payroll check and/or payroll check remittance advice during the four-day payroll verification event. Of the 4,731 checks and 9,141 remittance advices to be handed out, 4,674 checks or about 99 percent and 8,806 or about 96 percent were claimed over the four day process.

Table 1.1: Daily Count of Check/Advice Claims

	June 9 th	June 10 th	June 11 th	June 12 th	Advices/ Checks
Start	15,303*	4,725	2,901	1,609	9141 / 4731
End	4,725	1,824	1,292	1,217	335 / 57
Claimed	10,578	2,901	1,609	392	8806 / 4674

*Includes 1431 employees who receive both check and advice

As shown in the table, most of the checks and advices were claimed in the first day. The table indicates that the number of people who came in to personally claim their payroll check and/or advice declined each day.

Late Claims Avoid
Pending Investigations

Nearly 100 employees claimed their payroll checks and/or payroll advices after the June 12, 2009 cutoff date. Employees who claimed their payroll check or remittance advice were required to provide written notarized explanations as to why they failed to claim their payroll documents in the allotted timeframe, which released them from pending investigations. In most cases, the employee either forgot or had schedule conflicts that caused them to miss claiming their payroll check and/or advice during the scheduled timeframes. However, a few employees stated that they thought they had more time to claim their payroll check and/or advice.

In total, 18 checks for \$12,925 and 78 remittance advices for \$148,402 were claimed during this period. According to DPS payroll officials, it is not unusual for a small number of remittance advices to go unclaimed as employees have already received a direct deposit of their earnings and may not feel compelled to obtain the remittance advice.

Payroll Verification Process
Helps Identify & Address
Risk Exposures

During the course of the payroll verification process, the audit team identified and addressed several significant risk exposures that could adversely impact district operations. These risks include improper payroll payments, improper access to personnel records, unnecessary operational expenses and safety risks for students and school-based employees.

According to Human Resource (HR) officials, over 2500 DPS employees were receiving their payroll check and/or remittance advice through the mail at their residence. When the audit team inquired about why these employees were receiving their payroll check and/or advice through the mail, we were told that some of the employees did not have permanent work locations and others were on approved medical or sick leave. However, HR officials did acknowledge that a number of these employees had been receiving their payroll checks and or advices in the mail because when the PeopleSoft system was implemented in 1999 these employees were “hard coded” in the program language and thus their work locations could not be updated even if they now had a permanent work location or were no longer on sick or medical leave.

When the audit team reviewed the list of over 2500 employees, we determined that fewer than 400 employees had reasonable justification to continue to receive their payroll check and/or payroll remittance advice in the mail. Specifically, we determined that 23 of the employees were on some form of approved leave (i.e., medical, family medical leave or leave without pay) another 369 such as substitute teachers work at different schools and did not have permanent work locations.

Based on the results of our analysis, the audit team requested that the payroll department send checks and/or remittance advices for these employees to their work locations. This change mitigates the risk of former employees receiving paychecks at their residence. Human Resource officials felt that it was unlikely that any former employees were included in the group of 2500 whom received their payroll information at their residence, but agreed that it was no longer necessary to treat this group any different than other employees who receive their payroll checks and/or advices at their work location.

According to DPS information, we determined more than 30 payroll employees have access to change the work locations for DPS employees in PeopleSoft which determines where payroll checks and/or remittance advices are sent. To address this issue, we have requested that this access be restricted to appropriate human resource employees. According to the Payroll Supervisor, this access is not required and should be restricted. At the time of our report, this change had not been made.

In addition to addressing the risk of improper payments and inappropriate access to personnel records, these changes will eliminate the cost of mailing 2500 payroll checks and/or remittance advices to employees’ residence every other week. According to an official in payroll distribution, the cost was estimated to be over \$1,000 per pay period or over \$24,000 per year because the payroll department did not use bulk mailing.

Requiring all DPS employees to have a DPS-issued badge will help enhance safety measures at DPS schools for students and school-based employees. In the past, only employees assigned to the central office were required to have a DPS-issued badge. However, given the risk that students and school-based employees face with a number of visitors entering schools on a daily basis, the ability to identify DPS employees and students (whom are required to have a badge) helps to enhance safety measures.

Various Reasons Could Explain Noncompliance

The extent of noncompliance with the payroll verification procedures may be due to several factors including misinformation, poor communication, apathy, inaccurate employee information and fraud. Some employees may not have been fully informed about the requirements or their responsibility to comply with the payroll verification procedures. Based on input from some of the employees who came in to verify their employment status after the deadline, they claimed that they were unaware that the process ended June 12 and thought that they had additional time to meet the requirements. Other employees stated that they did not receive the letter or directive informing them about the procedures even though the information was sent to all DPS work locations and communicated through a District-wide announcement. In at least one case, the audit team was told by an employee that they had other commitments and were not concerned because they knew they could verify their employment if investigated.

Another possible reason for the unclaimed payroll documents could be inaccurate information on employees. In planning the payroll verification audit, audit team members found that in some cases human resource information was not always updated timely to reflect the most current status of employees. According to Human Resource (HR) Officials, this is because HR is not always informed timely when an employee quits, goes on medical leave or retires. Although employees are required to inform HR of actions that could impact their employment status such as medical leaves, resignations and retirement, some employees fail to notify HR in a timely manner of their decisions. As such, HR does not always have the most recent data on all employees' status.

Ultimately, there is a real possibility that some of the checks and remittance advices turned over to the Inspector General's Office may in fact be due to fraud. The thought that so many employees would forgo picking up a check they rightfully earned or claiming a remittance advice that would preclude them from being investigated raises sufficient suspicion for further investigation

Preliminary Analysis Raise Some Concern

Prior to turning over 37 payroll checks and 220 remittance advices to the Inspector General's Office, the OAG conducted some preliminary analysis on the respective employees to determine whether their employment status could be confirmed using an alternate approach.

Specifically, the audit team considered possible duplicate entries, reviewed human resource records to confirm the employees' active status and contacted work locations to confirm the status of those employees with unclaimed payroll documents.

We found that of the 26 cases where duplicate or multiple names were identical or similar, none were confirmed as duplicate entries on the payroll register. The OAG also

worked closely with HR on obtaining information on the original 57¹ payroll checks not claimed by employees during the four-day verification process. Based on information obtained from HR, it appears that two employees were not active. One employee had just retired on June 1, 2009 and was rightfully due a check and the other employee retired in April, 2009, but according to a payroll representative he received a check for vacation pay. We questioned why an employee whom retired nearly 6 weeks prior would still be on the payroll. According to HR officials, this was due to their office not receiving timely information about the change in the employees' status.

In addition, prior to turning over the remaining payroll checks and payroll check remittance advices, the audit team attempted to call the work locations of the employees associated with the remaining 37 payroll checks (as of June 22). In all but one case no one was available to answer the inquiry. In that case, the secretary told one of the audit team members the employee we inquired about was on medical leave since May 7, 2009, which is why she couldn't pick up her check. However, no medical paperwork for this individual was ever filed. As a result, the employee was still receiving her regular pay check without coming to work or even drawing down her sick leave bank as there was no record of her being on approved medical leave.

CONCLUSION

Detroit Public Schools is in the midst of a financial crisis. The District has a deficit for current year and the amount is forecasted to be even higher in the coming fiscal year. At the same time, the number of students attending Detroit Public Schools has declined significantly in recent years reducing the primary source of funding for the District. Faced with these challenging conditions, the Emergency Financial Manager has sought out wasteful spending and abusive practices that can siphon off needed funds and cost the District thousands of dollars.

In support of this effort, nearly all of the DPS employees on the payroll for June 9, 2009 pay date provided the required evidence they were in fact the rightful owners to make claims for their payroll checks and/or remittance advices. However, those employees who failed to verify their employment status within the allotted timeframe have now been turned over to the DPS Inspector General's Office for investigation.

Although the likelihood is that many of the 257 payroll documents turned over to the Inspector General for investigation will be rightful claims of DPS employees, the possibility that even a few of these cases are not legitimate claims warrants the attention of investigation because this sends a strong message to any employee who has considered or is involved in fraudulent activity and such behavior is unacceptable and will eventually be identified, investigated and pursued legally if substantiated. The cost of payroll theft is not totally quantifiable by the dollars taken away from the students, but also the cost to the District's reputation and how it is perceived by the public.

¹ Two of 57 unclaimed checks were for individuals who came in to pre-verify their employment.

RECOMMENDATIONS

To help ensure the accuracy of personnel records that are used to determine payroll, we recommend that DPS management (i.e., Emergency Financial Manager and Superintendent) to:

- Establish a policy that would require all department heads (e.g., school principals, assistant superintendents and directors) to report any employment changes for staff under their jurisdiction to Human Resources within 48 hours. This will provide for timely updates on personnel related actions including medical and sick leave.

To mitigate the risk of unauthorized changes to personnel records, we recommend that the Payroll Division Director (or their designee) request Information Technology to:

- Restrict the payroll department's access to the location code under the pay location option in PeopleSoft.

MATTER FOR CONSIDERATION

In addition to our recommendations, we believe that the Payroll Division Director may want to consider the cost and benefits of:

- Creating edit reports for payroll based on reported changes in employee status to be sent to department heads (i.e., principals, executive directors, etc.) to verify reported changes to employee status. This will help ensure the accuracy and completeness of the changes to payroll.