



Office of the Superintendent of
Financial Institutions Canada

Bureau du surintendant des
institutions financières Canada

Report on
**Office of the Superintendent of Financial
Institutions**

**Corporate Services Sector
Human Resources
Payroll**

April 2010



OSFI
BSIF

Canada 

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1. Background

Human Resources – Payroll An audit of OSFI’s Human Resources - Payroll was approved by the Audit Committee and the Superintendent for inclusion in A&CS 2009/10 audit plan.

The Human Resources (HR) Payroll group is responsible for the calculation and disbursement of pay and pay related compensation for all OSFI employees.

The headcount for OSFI was 501 employees as at March 31, 2009. Payroll total costs were \$68.6 million in FY 2008/09. This amount represents about 74% of OSFI total operating expenses.

OSFI operates under a bi-weekly pay period system. The processing of payroll has been outsourced to a third party agency, Public Works and Government Services Canada (“PWGSC”). PWGSC is responsible to maintain the payroll master file data, including all tables for the calculation of tax withholdings and some benefits. PWGSC is responsible for identifying legislative changes and ensuring that all taxable updates used to compute required deductions at source remain current and operate effectively. PWGSC processes the payroll, disburses payroll directly into employee bank accounts, and directly remits employee tax withholding and employer’s payroll taxes owed to the government on behalf of OSFI.

Payroll is processed using the PWGSC payroll application software – Regional Pay System (“RPS”). The application is used by the HR Pay Advisors to input employee payroll data, which is submitted for processing through the PWGSC web-site. Payroll financial information is transmitted to OSFI via the website, and is uploaded on to the Free Balance/Corporate Reporting system.

In addition to RPS, there are three other internal systems used in the Payroll process:

- The Human Resources Manager System (HRMS), which holds basic employee data such as personal information, position, division, salary level and status.
 - The Performance Pay System (PPS), which is used to assist with the annual employees’ performance pay process.
 - The Automated Leave (ALS), which was internally developed to track leave and overtime.
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2. Audit Objectives, Scope and Approach

Audit

Objectives

The purpose of this audit was to provide assurance on the design and effectiveness of the internal controls over OSFI's Payroll Process.

The objectives were to determine:

- Whether internal controls were adequately designed and functioning as intended.
- Whether payroll information was properly authorized, complete and accurate.
- Whether payroll activities properly comply with applicable agreements, government acts and regulations and HR policies/procedures.
- Potential areas for improvement, as appropriate.

Audit

Scope

The audit focused on payroll transactions from January through September 2009.

The areas covered in this audit included a review of the Payroll process from its initiation (i.e. employee set up, salary base, benefits entitlement, performance pay, salary increases) to changes to payroll data (i.e. terminations, other) to recording of payroll costs and liabilities in the general ledger. In addition, we reviewed management oversight controls around the processing of the payroll.

Specifically excluded from the scope of the audit were:

- Payroll data processing performed by PWGSC.

Audit

Approach

Our audit approach included:

- A review of HR policies and procedures, existing agreements, government acts and regulations related to the areas being assessed, as appropriate.
- "Walkthroughs" of the payroll process in order to understand current payroll systems (RPS, HRMS, PPS, ALS) and documentation.
- We examined, on a random test basis, evidence supporting a sample of payroll transactions (i.e. routine and non-routine transactions) that occurred from Jan 1, 2009 until Sept 30, 2009.
- Interviews with HR and Finance management and staff responsible for processing and authorizing pay transactions, receiving and transferring pay data from PWGSC-RPS system to OSFI's Corporate Reporting System, and preparing and recording payroll financial information in the general ledger.

**Audit
Criteria**

The Criteria for this audit was derived from the *COSO Framework*. The criteria was used to help us ascertain the extent to which existing management internal controls ensure that Payroll key risks in the areas of “*Process, Systems, People*” are properly mitigated and monitored.

The audit was conducted in accordance with *The Institute of Internal Auditors’ International Standards for the Professional Practice of Internal Auditing*, consistent with the Treasury Board Policy on Internal Audit.

3. Overall Audit Conclusion

Based on our assessment of the Payroll process and underlying processes and systems, our view is that the existing management internal control framework requires significant improvement in the following areas:

- Payroll policies and procedures;
- Payroll systems and security controls, incl. information reporting;
- Payroll process internal controls; and
- People skills risk and adequacy of resources.

All of the above represent core control elements that need to be properly designed and incorporated into current practices in the HR Payroll process in order to be able to provide reasonable assurance that processing of the payroll information and associated risks are effectively managed.

Resolution of key control gaps identified in our audit will require OSFI management’s attention in implementing action plans to address the audit report recommendations, including revisiting the planned timeframe to implement a new HR Payroll / Finance information system.

Our observations and recommendations are detailed in Section 5 of this report.

A&CS would like to thank all members of the Payroll Group, Finance and IT for their assistance during this audit. Their cooperation and contributions were invaluable in the conducting of this audit.

Senior Director, A&CS

Date

4. Management Response

We thank the audit team for their collaborative approach in conducting the payroll audit. We are in agreement with the findings of the audit. Accordingly, we have already started the review of our policy framework, have been successful in prioritizing an HR/Payroll system within the context of the IM/IT strategy, and have been in regular contact with PWGSC, the service providers of the government pay system, to receive the requisite reports needed for reconciliation purposes.

We are committed to addressing the recommendations outlined in the audit, and in ensuring adequate internal controls are in place within the payroll process to ensure risks are addressed in a balanced way. As noted, a number of initiatives have already been undertaken to address some of the findings, others will be addressed shortly, while others will require senior management intervention (improved timeframe for an HR/Finance system) and working with PWGSC to strengthen reporting and reconciliation practices.

Finally, it is important to note that we have instituted manual checks and balances to ensure the integrity of our processes. These are carried out by an experienced and knowledgeable Payroll team that ensures pay processes are completed in a timely and efficient manner.

5. A&CS Audit Observations and Recommendations

Overview A discussion of each key risk area is organized as follows:

- *What we looked for, during the audit (“Criteria”)*
- *What we noted during the audit (“Observation”)*
- *Recommendation(s)*

5.1. Payroll Policies and Procedures

Criteria

- *Policies and/or standard operating procedures needed for payroll administration exist, are appropriate, are regularly assessed for their relevance and are updated.*
- *Mechanisms are in place to identify, comprehend, enforce and monitor adherence to federal/provincial laws and regulations, HR policies and collective agreements on a regular basis and take appropriate action, as required.*

Observation Although we found a few payroll guides, Payroll does not have a set of comprehensive policies, guidance, procedures for payroll administration. We noted that the work done by the HR Payroll staff relies on factors such as their individual knowledge and interpretation of informal rules. This gap in formal policies, guidance and procedures was likely a contributing factor leading to the inconsistent practices observed during the audit.

We also noted that there are limited procedural directives assigning clear roles and responsibilities among the stakeholders involved in the payroll process. We found there was no formal information-sharing process between stakeholders, which is needed to support the targeted dissemination of relevant information to those that need it.

A key concern is that core knowledge of payroll administration and processing of transactions resides with a few experienced, dedicated HR Payroll staff, who if absent would create a significant void in knowledge about policy requirements and past practices. Thus, there is an urgent need to review current policies and procedures to assess the comprehensiveness of current payroll practices and management oversight, and formalize them, as required.

Without a set of complete policies, guidance and procedures for payroll administration, there could be inconsistencies in payroll decisions, and insufficient information and support for payroll transactions. In addition, in the absence of such clearly established *reference documentation*, HR staff may not be able to identify and raise concerns related to payroll policy and gaps in controls.

Recommendation *We recommend that:*

- *A comprehensive set of Payroll policies, guidance, procedures including definition of respective roles and responsibilities be developed and implemented to emphasize key activities of the internal control framework and critical roles, as well as to promote uniformity in the process.*
- *A communication protocol be developed to ensure effective sharing of information and coordination of activities between stakeholders.*
- *Management conduct periodic reviews of payroll policies, procedures and tools to assess their relevance and identify control gaps.*

5.2. Payroll Systems and Security Controls

Criteria

- *Employees have access to payroll standard operating guidance and procedures and related tools.*
- *Appropriate system application and logical controls exist to ensure the reliability of financial reporting and safeguarding of assets.*
- *System controls are designed to reduce need for manual controls.*
- *Responsibility for monitoring the management of information is clearly assigned.*
- *Access to payroll records and information is limited to authorized individuals, provided on a “need-to-know” basis and ensures segregation of duties.*

Observation

We noted that most systems supporting HR Payroll are “standalone” resulting in multiple databases making it difficult to manage payroll on a consolidated basis. As a result, duplicate data entries are required to process payroll information that could result in inconsistencies in practices and input / processing errors. We also noted that not all payroll information requirements/parameters are incorporated into some of these payroll systems (i.e. PPS, ALS) due to system limitations. This could lead to potential non-compliance issues. HR Payroll staff is aware of the conditions, hence manual time-consuming work around procedures have been put in place to review pay information and identify and correct any errors found. HR Payroll staff should be commended for their effort and skill to prepare calculations for a high volume of non-routine transactions, some of which can be complex, in a timely manner.

Except for RPS, system controls over access to payroll records and information, data input and processing need to be reviewed and formalized. We noted that access to employees’ payroll information is broadened to all HR staff, as this information is stored in a central area. Further, HR staff access privileges to the HRMS, PPS and ALS systems need to be reviewed to ensure they are limited to a need-to-know basis only.

A&CS was informed that, as part of its IM/IT strategy, OSFI intends to replace current HR / Finance system with an integrated / automated one in the next few years.

The risk is that existing systems may not be adequate to support the Payroll process. The risk of error is high due to the high degree of manual procedures, non-automated controls and system limitations, including information reporting. Further, inappropriate access to payroll information and records could result in data corruption and/or non-compliance with privacy rules.

Recommendation

We recommend that:

- *Management assess the timeline for implementation of a new HR/Finance system.*
- *Management commence identification and documentation of payroll processing and reporting requirements to support the existing and the new payroll systems.*
- *For the existing RPS, management requires increased awareness and access to reporting tools to assist them in fulfilling their review and reconciliation requirements of payroll information.*
- *Formal policy and procedures for access and safeguarding of payroll information be put in place, are adhered to by those involved in managing and maintaining payroll information and ensure that there is appropriate segregation of duties.*

5.3. Payroll Process: Internal Controls

Criteria

- *System information is adequate, complete, relevant and timely to enable people to discharge their responsibilities effectively.*
- *Management oversight activities are built into the process, and performed in the ordinary course of running the business (i.e. reconciliations, management review and approval of financial and non-financial reporting, unreconciled items, etc).*
- *Management identifies key payroll related risks and periodically assesses whether current controls appropriately mitigate those risks.*

Observation

We noted that existing payroll systems have significant reporting limitations. This lack of automated reports to monitor, track, review and report on payroll information entered (i.e. payroll actions initiated) by HR Payroll staff in RPS is a significant internal control weakness. For example, some key reports such as the payroll register and the batch summary contain information that needs to be properly reviewed and reconciled in order to ensure the completeness and accuracy of payroll input and processing. We confirmed that PWGSC does not provide such reports to OSFI. As a result, the absence of adequate information reporting will significantly impair HR Payroll staff's ability to discharge their responsibilities with respect to review and reconciliation of financial information.

We also noted that HR Payroll staff write-up various "brought forward" notes as reminders to process specific payroll transactions and to verify if previous payroll transactions were properly processed by RPS. Overall, we noted that there are an excessive number of manual controls (i.e. work around procedures, inconsistent checks and cross-checks by staff) that lack substance and rigor, and miss key control steps such as reconciling data input to information reported as processed on the payroll register and to control accounts and resulting general ledger accounts.

Regarding the HRMS system in Payroll, HR staff cited it is outdated and inefficient. Changes to payroll data are inputted to both RPS and HRMS. As a result, there could be timing and information discrepancies between the two systems. Periodically, HR Payroll staff complete work around procedures to ensure both systems have the same information. This is done prior to HRMS information being reconciled to budget/planning information. However, supporting documentation is not retained as evidence of completion of the process and review by HR management. In addition, we found no evidence that divisional/RC managers verify and confirm their staff levels and payroll budgets to actual information that is provided to them on a regular basis, as part of this process.

Moreover, HRMS does not keep employees' historical data. Hence, in order to produce payroll management reports, HR staff need to gather/compare information from/to various payroll sources (i.e. pay cards, files) to ensure HRMS information is complete and accurate. This work around procedure is also manual, time consuming, and prone to human error. The quality of the work greatly depends on the knowledge and experience of the individual performing the task, as there are no procedural guidance/directives for HRMS.

Once PWGSC-RPS has processed the payroll information, there is an automatic upload of the information to Free Balance (“FB”). Finance maintains a manual logbook, which identifies the last payroll files retrieved from PWGSC web site. Information from FB is used to record OSFI payroll costs (salaries and benefits) and related liabilities in the general ledger (G/L).

We noted that there is no post verification of the accuracy and completeness of the payroll information uploaded to the G/L. We were unable to confirm if PWGSC, as an application service entity, is required to provide an annual CICA 5970 audit report on the adequacy and effectiveness of their controls for the Regional Pay System (RPS), as part of OSFI internal controls for financial reporting purposes.

Outstanding payroll processing items we identified revealed concerns about the soundness of current procedures to monthly reconcile and monitor G/L and sub-ledgers accounts. Current procedures rely on a master list of balance sheet control accounts. However, reconciliation of employee benefits deductions and other payroll accounts such as vacation pay, garnishments, payroll advances to ensure its accuracy is not being done and/or responsibility is not clearly assigned. These key payroll internal controls should be performed on a regular basis.

We noted that there is minimal review by management to ensure that payroll information and transactions were properly inputted and processed. Current internal control assurance mechanism in HR Payroll is at the basic data entry level where Pay Advisors perform peer reviews. This control lacks independence and may be subject to conflicts of interest as a “reviewer” could be verifying their own data and transaction input.

The regular review of payroll reports and reconciliation of pay information by management is essential to confirm that payroll costs and related liabilities were accurately and completely processed in a timely manner, and aids in identifying input and processing errors.

The risk is that initiation and processing controls are not adequate to identify payroll transaction errors prior to funds being disbursed, and errors in recording of payroll costs and related liabilities in the general ledger accounts.

We recommend that:

Recommendation

- *Management develop, or obtain from PWGSC, reports for reconciliation purposes and implement procedures to reconcile payroll input /output.*
- *Management develop reports designed for review purposes and institute a manual review structure that separates data entry from review responsibilities to ensure there is proper management oversight of payroll activities.*
- *G/L and sub-ledger payroll related accounts be fully reconciled going forward to ensure its completeness, integrity and accuracy.*
- *Mechanisms be put in place to help management periodically assess whether existing controls appropriately mitigate payroll related risks.*

5.4. People Skills Risk and Adequacy of Resources

- Criteria**
- *The entity provides employees with the necessary tools, training, resources and information to support the discharge of their responsibilities.*
 - *Adequacy of staff's knowledge and skills needed to perform assigned tasks in light of their responsibilities and accountabilities.*
 - *Key positions and activities have been identified, knowledge transfer practices are adequate, and sufficient back-up exists.*

Observation We noted that, on a broad perspective, the quality of the work is heavily reliant on the knowledge and experience of the HR Pay Advisors. While this in itself is valid, it is important to note that individual knowledge and interpretation of informal rules can be difficult to maintain because of increased complexity and pace of change of legislative policy and regulatory requirements. Further, it may be difficult for HR Supervisory and Pay Advisors to keep up with changes that may impact Payroll activities, if training is not provided. We noted that development and training needs for Payroll staff have not been formally identified.

Existing cross-training and back-up plans need to be strengthened, as OSFI exposure to the risk of loss of corporate knowledge may be high. Based on discussion with HR management, it would take two years, at a minimum, to bring a new Payroll employee up-to-speed. Further, due to the current lack of formal administrative payroll policy, guidance and procedures, and the high degree of manual work around procedures in current systems, training a replacement would require significant resources and be time consuming.

We also noted that, due to current system reporting limitations, there is heavy reliance on a specialized person to run numerous payroll reports and queries from the multiple payroll databases to support HR Payroll and Finance processes. We believe the impact to ongoing payroll operations would be significant, in the event the person is unable to carry out the work, as there is no trained back up in place for this key position. The risk of exposure increases with the fact that underlying practices, procedures, and reporting parameters are not documented.

OSFI's exposure to risk of corporate memory/knowledge loss could significantly impact the processing of OSFI's payroll.

- Recommendation** *We recommend that:*
- *Development needs for HR Payroll staff should be identified and formal training plans be put in place including specialized training in payroll.*
 - *Employees in supervisory positions should receive training to ensure they understand the scope of their work and responsibilities.*
 - *On an urgent basis, management revisits existing practices around transfer of knowledge, cross-training, back-up plans, and ensure that underlying operating procedures for payroll activities are adequately documented.*
 - *Adequate operational back-up plans should be put in place for resources identified as key.*