

Performance Audit 24-03: Payroll Deductions

April 2025

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

April 11, 2025

To: Mayor Kelly
City Councilmembers

RE: Payroll Deductions Audit (#24-03)

Dear Mayor Kelly and City Councilmembers:

The attached report contains the results of our Payroll Deductions audit. Based on our findings, we determined the City's internal controls governing payroll deductions provide reasonable assurance that payroll deductions are accurate, timely and supported by appropriate documentation. However, our audit identified opportunities to strengthen internal controls, improve operational efficiency, and minimize the risk of noncompliance with citywide policies and procedures.

To address the opportunities for improvement, we recommended updates and amendments to existing payroll deduction policies and procedures and changes to the City's process for maintaining employee health coverage during an approved leave of absence.

We would like to thank the Payroll Division and Human Resources leadership and staff for their courtesy, cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Jermaine Freeman, Chief of Staff
Mande Green, Chief Operating Officer
Steven Wilson, Deputy Chief Operating Officer
Javid Majid, Chief Finance Officer
Melody Wingfield, Chief Human Resources Officer
Gail Duffey, Manager Payroll
Starla Benjamin, Director Total Rewards
Jim Arnette, Tennessee Local Government Audit

TABLE OF CONTENTS

AUDIT PURPOSE	2
BACKGROUND	2
Financial Information	4
FINDINGS AND RECOMMENDATIONS.....	4
Internal control effectiveness.....	4
Audit Test: FIT, Social Security and Medicare deductions	5
Audit Test: Voluntary deductions	5
Audit Test: Involuntary deductions.....	5
Audit Test: Element (Payroll) Registers	6
Maintaining employee health coverage during an approved leave of absence	6
APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS.....	7
APPENDIX B: PRIORITY LEVEL DEFINITIONS	8

AUDIT PURPOSE

This audit was performed in accordance with the Office of Internal Audit's 2024 Audit Agenda. The objective of the audit was to examine the payroll deduction process for City of Chattanooga (hereinafter referred to as the "City") and determine if the internal controls governing payroll deductions provide reasonable assurance that payroll deductions are accurate, timely and supported by sufficient documentation.

BACKGROUND

The City is required to deduct, where applicable, Federal Income tax (FIT), Social Security tax (except sworn employees), Medicare tax, garnishments, and other court-ordered wage assignments from employee paychecks.¹



FIT withholding is determined based on the employee's earnings and the number of W-4 allowances claimed. Employees are required to file a W-4 form with the City. In the event of changes in the employee's exemption status, a revised W-4 form must be filed before payroll deduction adjustments are made.

Social Security and Medicare withholding amounts are determined in accordance with the Federal Insurance and Compensation Act (FICA).

For garnishments, Federal and State law limit the amount of earnings that may be withheld in any workweek or pay period to the lesser of 25 percent of disposable earnings or the amount by which disposable earnings are greater than 30 times the Federal minimum hourly wage

¹ Section 9.6 of the Employee Information Guide.

(\$7.25/hr.).² The limit applies regardless of how many garnishment orders an employer receives. A wage garnishment order is valid for six (6) months, or until the debt is paid, whichever comes first. After six (6) months, a new garnishment can be issued.³

State law governs wage assignments for child and/or spousal support.⁴ In Tennessee, the amount withheld for child/spousal support cannot exceed fifty percent (50%) of the employee's income after FICA, withholding taxes, and a health insurance premium that covers the child(ren) are deducted. The order may also include an amount necessary to cover fees owed to the clerk of the court, if applicable.

Each year, the City offers open enrollment to employees to enroll in voluntary employee benefit plans, including medical/dental/vision insurance, Health Savings Accounts (HSAs), Flexible Spending Accounts (FSAs), life and disability insurance, and Worksite Benefits (critical illness, accident, and hospital indemnity insurance). The cost of coverage is deducted from the employee's paycheck each pay period. Employees are required to complete their benefit enrollment electronically using the Oracle system. Once completed, the employee receives a printable confirmation of coverage and deduction amount for each pay period.

Other voluntary deductions, including membership/club dues, deferred compensation, small loan repayments, and charitable contributions require signed consent by the employee.⁵

The City's Payroll Division is responsible for administering payroll deductions and distributions, including verifying deductions are appropriately authorized by the employee, and updating the City's payroll system. The City's Human Resource (HR) Department is responsible for coordinating the voluntary benefit enrollment process, providing benefit information to third parties, and reconciling FSA and HSA contributions.

² See 15 U.S.C. § 1671, *et seq.* and T.C.A. § 26-2-106. Federal regulations define disposable earnings as the amount of money an employee has left after required deductions have been deducted from gross pay. These deductions include Federal, state, and local taxes, Social Security, Medicare, unemployment insurance taxes, and withholdings for employee retirement systems.

³ T.C.A. § 26-2-214(b)(1)

⁴ T.C.A. § 36-5-501.

⁵ The City's Finance Department maintains employee signed consent and other supporting documentation authorizing these deductions.

Financial Information

	CY2023	CY2024
Federal Tax		
○ FIT	\$12,443,112	\$12,070,352
○ Social Security	\$5,202,134	\$5,553,323
○ Medicare	\$2,008,803	\$2,100,985
Voluntary Deductions		
○ Medical	\$5,204,165	\$5,393,111
○ Vision	\$206,671	\$213,101
○ Dental	\$1,099,590	\$1,255,002
○ Worksite Benefits	\$1,384,881	\$1,400,949
○ HSA	\$338,227	\$373,788
○ FSA	\$353,605	\$428,288
○ Union Dues	\$547,916	\$564,990
○ Deferred Comp.	\$471,058	\$581,610
○ Membership/Clubs	\$117,839	\$75,696
Involuntary Deductions		
○ Garnishments/Assigns.	\$66,165	\$81,091
○ Bankruptcy	\$353,365	\$278,069
○ Spousal/Child Support	\$572,731	\$564,723
○ General Pension Plan	\$1,600,024	\$1,719,634
○ Fire & Police Pension	\$5,712,767	\$5,683,876

Source: Oracle

FINDINGS AND RECOMMENDATIONS

Internal control effectiveness

Tennessee law requires municipal governments to establish and maintain effective internal controls.⁶ Internal controls help organizations maintain efficient operations, comply with laws and regulations, and prevent fraud, errors, and mismanagement. To ensure compliance with Tennessee law, the City developed and implemented an internal control manual based on guidance issued by the United States Government Accountability Office and the Tennessee Comptroller of the Treasury. The City's internal control manual requires each city department to develop and maintain effective internal controls through policies and procedures that provide reasonable assurance that each department's objectives will be achieved.

Based on the results of our audit tests and procedures (described below), we determined the City's internal controls governing payroll deductions provide reasonable assurance that payroll deductions are accurate, timely and supported by appropriate documentation.

⁶ T.C.A. § 9-18-102(a)

However, to strengthen existing internal controls and improve operational efficiency, the Payroll Division should update and amend its operating procedures to provide guidance/instruction on how to customize the pre-built reporting tools developed by Oracle AST. The current procedures are outdated and have not been updated since the Oracle system change.

Audit Test: FIT, Social Security and Medicare deductions

Requirement(s): For manual payroll systems using Forms W-4 from 2020 or later, the Internal Revenue Service recommends employers follow the standard withholding rate tables in Publication 15-T (*Federal Income Tax Withholding Methods*). The current tax rate for Social Security is 6.2% for the employer and 6.2% for the employee, or 12.4% total. The current rate for Medicare is 1.45% for the employer and 1.45% for the employee, or 2.9% total.

Results: The amounts deducted for FIT, Social Security and Medicare taxes for the employees and pay periods we examined were accurately calculated and processed timely. **We found no errors or deficiencies.**

Audit Test: Voluntary deductions

Requirement(s): Employees can authorize deductions for voluntary benefits, including medical/dental/vision insurance, HSAs, FSAs, life and disability insurance, and Worksite Benefits by completing an online enrollment using the Oracle system. Other voluntary deductions, including membership/club dues, deferred compensation, small loan repayments, and charitable contributions require signed consent by the employee.

Results: The voluntary payroll deductions for the employees and pay periods we examined were authorized by the employees with sufficient supporting documentation. **We found no errors or deficiencies.**

Audit Test: Involuntary deductions

Requirement(s): The amount of earnings that may be garnished in any workweek or pay period is limited to the lesser of twenty-five percent (25%) of disposable earnings or the amount by which disposable earnings are greater than thirty (30) times the Federal minimum hourly wage (\$7.25/hr.). Amounts withheld for child/spousal support cannot exceed fifty percent (50%) of the employee's income after deducting FICA withholding taxes and health insurance premiums covering the child(ren).

Results: The involuntary payroll deductions for the employees and pay periods we examined were computed and processed timely in accordance with applicable Federal and State requirements. **We found no exceptions or deficiencies.**

Audit Test: Element (Payroll) Registers

Requirement(s): The Payroll Division and HR utilize Element Register Reports to track/reconcile payroll deductions for each pay period. Element Register Reports extract information from Oracle regarding all payroll deductions.

Results: The payroll deductions identified in the Element Register Reports for the pay periods we examined matched the transactions/amounts recorded to the City's General Ledger. **We found no errors or deficiencies.**

Recommendation 1: We recommend the Payroll Division continue to update its policies and procedures to align with current systems, strengthen internal controls and improve operational efficiency.

Auditee Response: We agree with the audit finding and recommendation.

Estimated Implementation Date: July 1, 2025

Priority Level: 3

Maintaining employee health coverage during an approved leave of absence

Section 12.9 of the Employee Information Guide permits an employee on an approved leave of absence to continue health coverage through the City's group plan, provided the employee maintains coverage for the duration of the leave by making premium payments to the City.

However, during the audit period (July 1, 2023 to June 30, 2024), we found instances where the City's process for maintaining an employee's health coverage during a leave of absence did not align with the Employee Information Guide. Our audit disclosed that, during a leave of absence, the City covered the employee's cost of health coverage and pursued reimbursement through payroll deduction when/if the employee returned to active employment.

Recommendation 2: We recommend the City require employees who wish to continue their health coverage during a leave of absence to make their premium payments to the City.

Auditee Response: We agree with the audit finding and recommendation.

Estimated Implementation Date: July 1, 2025

Priority Level: 1

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and our assessment of risk, this audit covers the City's payroll deduction process from July 1, 2023 through June 30, 2024. When appropriate, we expanded the scope to meet our audit objectives. We obtained source documentation from archived records in the Payroll Division, HR Department and the Oracle system. Original records and digital copies used as evidence were verified through physical examination.

We examined evidence on a test basis and applied other audit procedures to meet our audit objectives. The procedures included:

- Reviewing applicable laws and regulations governing payroll deductions;
- Reviewing internal controls, policies, procedures and performance standards;
- Reviewing IRS guidelines for payroll deductions;
- Conducting a risk assessment to identify high-risk activities and potential fraud risks;
- Interviewing key personnel; and
- Examining payroll records and reports.

We used non-statistical sampling to determine the sample size and selection of the records we tested for compliance. Non-statistical sampling is the selection of a test group based on the auditor's judgment, rather than a formal statistical method. We did not extrapolate the results of our testing to draw conclusions on the population as a whole.

To achieve the audit objectives, we relied on data maintained in the Oracle system. We assessed the reliability of the data and conducted sufficient tests of the data. Based on these assessments, we concluded the data was sufficiently reliable to achieve the audit objectives.

We conducted this performance audit from May 2024 to March 2025 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence we obtained provides a reasonable basis to support the findings and conclusions expressed herein.

APPENDIX B: PRIORITY LEVEL DEFINITIONS

Priority 1: Critical control weakness exists that exposes the Auditee to a high degree of risk. Noncompliance with federal, state or local law, regulation, statute, charter or ordinance will always be considered a priority 1.

Priority 2: Control weakness exists that exposes the Auditee to a moderate degree of risk.

Priority 3: The opportunity for improved efficiency or reduced exposure to risk exists.

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To make a report, call 1-877-338-4452 or visit our website:

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