Audit Report
Fictitious (Ghost) Employees
February 28, 2019

City Auditor's Office
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Purpose and Scope

This report addresses a narrow scope issue regarding the City's internal controls related to the detection and prevention of fictitious (ghost) employees – someone recorded on the payroll system, who does not work for the City, i.e., was never employed, or has separated. The review consisted of an assessment of the City's employee separation procedures as well as pay period testing for any abnormal payroll transactions (pay periods ended 3/31/2017 and 9/28/2018).

We conducted this performance audit 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Government Auditing Standards (§7.11) require disclosure of the following:

> The scope of our audit was significantly limited by auditors' inability to test employee bank account numbers and social security numbers. While the Internal Audit Charter grants audit personnel "full access to all of the City's activities, records, property and employees, as necessary to the performance of their audit activities," auditors have been prevented from using the requested data. The City's Human Resources and City Attorney's Offices reached the opinion that auditors could not use this type of information for audit purposes because City employees have not been made aware of that possibility. While our findings are adequately supported, additional findings and conclusions may have been determined if we had been able to review all relevant data.

This report is intended for the use of the City Manager's Office, City Council, and all City Departments.

Conclusion

The City's controls are not adequate to prevent the occurrence of fraud which could be accomplished by compromising payroll records, resulting in payments to fictitious persons.

Summary of Findings and Recommendations

The following findings are detailed, beginning on page 3:

1. *The City should disclose to employees that personal information may be used for audit purposes.*

   - Due to data access restrictions, Auditors did not perform common tests using personal identifying information (e.g., social security numbers, bank accounts). Internal Auditors who follow best practices regularly perform such tests to detect potential fraudulent activity and ensure effective controls are in place.

2. *Additional controls are needed to reduce the City's exposure to payroll fraud schemes.*

   - City Policy HR20, Employee Separation from the Workplace, provides a framework for Departments to follow when an employee leaves the City. This checklist should be required to be used by departments.

   - Human Resources should conduct periodic personnel audits to monitor for potential fraudulent activity.

Background

The City employs approximately 7,700. There are 21 Departments, each having multiple divisions (406 city-wide). Employee hires and separations (terminations and retirements) create administrative opportunities for fictitious employees to be created. The following details FY 2018 employment activities.

Employee Census Analysis – FY18	
Type	Amount
Beginning Employee Count, 7/1/17	7,497
Additions	1,046
(Separations)	(656)
(Retirements)	(192)
Ending Employee Count, 6/30/18	7,695

Fictitious, or ghost employees, are individuals listed on the payroll register that receive a paycheck, but do not provide any services to an organization. There are two main types of ghost employees:

   - a fictitious employee added to payroll either intentionally or inadvertently
   - a former employee that was never removed from payroll

Audit Findings and Recommendations

1. *The City should disclose to employees that personal information may be used for audit purposes.*

   As the scope limitation paragraph above notes, audit effectiveness has been impacted by data access restrictions imposed upon Internal Audit. The Internal Audit Charter (signed by the City Auditor and four City Managers plus one interim Manager over the past 20 years, and periodically shared with City Council) states that the primary objective of Internal Audit is to provide reasonable assurance that the City has an operating and effective system of internal controls. To accomplish this objective, the charter grants auditors full access to all City activities, records, property and employees as necessary to perform their audit activities. Auditors are strictly accountable for the safekeeping of records and property examined, and for maintaining the confidentiality of information obtained and reviewed during audits.

   Using this authority, auditors regularly access sensitive documents and data when called upon by management to conduct special reviews, including personnel investigations.

   Auditors did not perform common tests using personal identifying information (e.g., social security numbers, bank accounts) during this audit. Internal Auditors who follow best practices regularly perform such tests to detect potential fraudulent activity and ensure effective controls are in place. Prior to Audit's access restriction (many years ago), an employee was found to be using a false social security number. When addressed by the employee's management, the employee resigned without explanation. No follow-up occurred.

   Auditors can use access to personal identifying information to detect fraud and help ensure that employees comply with City purchasing, ethics and program policies. For example, comparison of employee and vendor addresses might identify an employee who is also a vendor – which is prohibited by City policy. Audit tests using such data could also identify employees processing, deleting or modifying their own transactions in the City's utility billing system.

   According to the City Attorney's Office and Human Resources, employees have not been given notification that their personal identifying information will be utilized for audit purposes, including the verification of compliance with City policy. Employees are provided a form entitled "How Human Resources Uses Your Personal Information" at time of hire. While audit activities fall under the "assist in the administration of government" item included on the form, the form does not specifically note that employees' personal information will be used for audit purposes. That issue can be easily resolved by specifically adding such notification to the existing list.

Recommendation: Human Resources should add language to the "How Human Resources Uses Your Personal Information" notice given to employees that discloses personal information may be used for audit purposes, as part of the administration of government.

2. ***Additional controls are needed to reduce the City's exposure to payroll fraud schemes.***

According to the Association of Certified Fraud Examiners' (ACFE) 2016 Report to the Nations on Occupational Fraud and Abuse, payroll fraud accounts for 8.5% of fraud cases that occur in organizations with over 100 employees, and that rate increases to 13.5% in a Government and Public Administration setting. The median loss of these schemes is $90,000 and the median duration before detection is two years. Ghost employee frauds are generally successful because of organizational weaknesses in internal control.

The City has established controls to mitigate the risk of payroll fraud. When an employee joins the City, a new hire process is completed by the Department. All required documents are sent to City Human Resources for verification and approval, and then added to the employee's personnel file. This reduces the initial risk that a fictitious person can be added to the payroll. Additionally, the payroll time approval process requires that no employee shall approve his or her own time.

City Policy HR20, Employee Separation from the Workplace, provides a framework for Departments to follow when an employee leaves the City. Included in the policy is a checklist that is recommended for Departments to use as part of the employee separation procedure. A department can choose to use its own checklist and include additional separation procedures as necessary to complete the process.

Departments were surveyed and asked if they used the checklist in the policy, or an alternate. Responses are provided in the appendix.

For the two pay periods tested, payroll data was analyzed and compared to an employee master file. From this sample, the following issues were identified – which indicate potential fraud risk:

- Missing employee ID numbers
- Duplicate addresses
- Paychecks with no deductions
- Terminated employees remained on payroll registers

Each of these was reviewed and resolved. Explanations were obtained, including data entry errors, lack of updated addresses, special payments which did not require deductions, and tax-related actions.

Recommendation 2A: All Departments should use a Human Resources-mandated employee separation checklist to document the employee separation process. Departments would be able to add additional separation procedures as necessary. A copy of the completed checklist would be retained in the Department's employee file.

Recommendation 2B: Human Resources should conduct periodic personnel audits to monitor for potential fraudulent activity. This audit would include the following procedures:

- Review employee master file for employees with duplicate addresses, PO Box addresses, similar names, or missing information
- Compare direct deposit accounts for employees using the same account
- Confirm social security numbers are valid
- Verify terminated employees have a completed separation checklist on file

Appendix

Department	Follow HR20 Checklist (or similar)	Checklist in Employee File
Aviation	Yes	Yes
CATS	Yes	Yes
CDOT	Did not respond	Did not respond
Charlotte Communications & Marketing	Yes	Yes
Charlotte Water	Yes	Yes
City Attorney's Office	Yes	No
City Clerk	No	No
City Manager's Office	Yes	Yes
Economic Development	No	No
Engineering & Property Management	No	No
Fire	Yes	Yes
Housing & Neighborhood Services	No	No
Human Resources	Yes	No
Innovation & Technology	Sometimes	Yes
Internal Audit	No	No
Management & Financial Services*	Yes	Yes
Planning	Yes	Yes
Police	Yes	Yes
Solid Waste	Yes	No
Strategy & Budget	Yes	Yes

Management & Financial Services was in place until August 2018, when the department transitioned to Finance.