



**Audit Report
CATS Bus Operations – Imprest Account
For Fiscal Year 2018
October 26, 2018**

**City Auditor's Office
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Purpose and Scope

The purpose of this audit was to determine whether the City has reimbursed the bus operations management company accurately and the funds have been disbursed properly. The City's outside auditor, Cherry Bekaert LLP (CB), performs agreed-upon procedures related to the Charlotte Area Transit System's Bus Operations Division (BOD). The work performed by Internal Audit is provided to CB for its review.

Auditors reviewed the operations and specific transactions for the fiscal year ended June 30, 2018. Tests were designed to determine whether:

- Internal controls over the transactions handled through the bus transit imprest fund, including payroll, are adequate,
- Wire transfers to the Charlotte Area Transit System (CATS) Bus Transit Payroll Imprest Account are accurately recorded;
- BOD's reimbursement requests are adequately supported, and
- Bus operations employees' wages comply with union agreement terms.

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.

This report is intended for the use of the City Manager's Office, City Council, CATS, and the City's external auditor Cherry Bekaert.

Conclusion

Controls are adequate to ensure that most reimbursements are adequately supported. However, neither CATS nor its contractor exercised proper oversight when new payroll software was installed, placing the City's finances at risk. System changes require a higher level of attention.

Summary Recommendations and Actions – 2018

The City reimbursed bus operation expenses of about \$66.8 million in FY 2018 and paid the bus operations management firm over \$600,000 in fees. The majority of these costs pay for bus drivers and bus maintenance, which have been adequately controlled – as audits concluded this year and historically. However, CATS and its contractor exercised insufficient review of new payroll software implementation in August 2017. As a result, errors occurred in deductions for the employees' 457 and pension plans.

The following recommendations are detailed, beginning on page 4:

1. TMC should refund the City \$57,756 for the incorrect calculation of the employer match of employees' 457 retirement contributions.
 - TMC returned \$53,546, but continues to owe the City \$4,210.
2. TMC should make a corrective contribution to the pension fund for the \$3,305 of missed deductions from employees' pay and refund the employee who was charged \$1,734 incorrectly subsequent to moving departments. In addition, TMC should hire an external audit firm to perform an audit of its retirement plan.
3. TMC should continue improving benefit election documentation and annually updating employee personnel files.
 - In the most recent enrollment period tested, the exception rate improved to 2% (down from 3%).

Background

McDonald Transit Associates, Inc. (McDonald) began providing transit management services for CATS' BOD in September 2003. Additional contract awards and extensions have resulted in McDonald providing continuous service to the City, with the current contract valid until February 2019.

McDonald is responsible for managing day-to-day operations and maintenance of CATS' largest bus fleet (other fleets include Special Transportation Services and Lynx Blue Line light rail). CATS engages a transit management firm in this capacity because North Carolina law prohibits governmental entities from managing and collectively bargaining with unions. The private company Transit Management of Charlotte, Inc. (TMC), which is managed by McDonald under its contract with the City, employs the bus drivers, maintenance staff, and parts room workers.

The City is fully responsible for the BOD's finances and is contractually required to pay all operating expenses. TMC is required to maintain an imprest account through which the following expenses are paid: wages and salaries of all TMC employees, the employer's share of payroll taxes and benefits, employer contributions to the pension plan, all payments made in settlement of claims or satisfaction of judgment incurred in the operation of the public

transportation system, all general and miscellaneous expenses for BOD, all expenses for liability insurance, workers' compensation and tort claims, and all expenses for materials and supplies (excluding bus parts, which the City pays directly to suppliers).

In August 2017, TMC implemented new payroll software, Paylocity. The individual payroll checks for the employees of TMC are prepared by this system. In addition, Paylocity calculates and deposits payroll withholding and the employer's share of taxes. Each week, the payroll administrative staff for TMC prepare a report based on printouts from Paylocity listing the amount and the account to be charged for payroll. This report is then forwarded to the Accounts Payable (AP) Administrator for inclusion in the request for payment from the City, along with any other miscellaneous payroll-related expenses.

Additionally each week, TMC requests to be reimbursed for itemized operating expenses and includes copies of invoices. CATS administration and the City's Finance staff review the request for funds. Upon approval, the City wire transfers the reimbursements into an imprest bank account in the name of TMC, from which checks are issued for operating expenses. TMC's AP Administrator writes the checks using Quicken software and they are forwarded to the general manager for his signature. The checks are then given to the General Administrative Assistant who prepares the envelopes and mails the checks. The payroll/finance administrator is responsible for reconciling the imprest account on a monthly basis.

Prior Year Update

For FY17, CATS and TMC satisfactorily addressed the findings and recommendations.

Recommendation #1: TMC should continue to annually update all employee benefit folders with signed authorization or acknowledgement forms. Employees that were incorrectly charged for unauthorized deductions should be refunded.

- Corrections have been made to the employee benefit deductions with refunds issued to the two affected employees. TMC updated employee benefit deduction folders with signed authorization and acknowledgement forms. Every employee that has benefits will be required to view and sign the required forms; the operating procedures were changed accordingly.

Recommendation #2: TMC should annually update all employee benefit folders with signed authorization forms, including union dues and waivers of coverage. TMC should enforce the contract language stating a certification of United Transportation Union (UTU) members is to be provided monthly.

- TMC and the UTU representative have developed an itemized report showing current UTU members and their respective deduction amounts. Delivery of this report was started in September of 2017. Signed authorization forms will be maintained and kept in the employee's personnel records.

Audit Findings and Recommendations – 2018

1. TMC incorrectly matched employees' 457 retirement contributions, resulting in a City overpayment of \$57,756.

The union agreements between TMC and the Bus Operators Union and the Maintenance Employees Union specify the amounts TMC will match for employees' retirement contributions for the 457 plan. TMC matches 50% of each employee's contribution, up to 3% of Bus Operators' gross income, and up to 4% for Maintenance Employees.

Auditors determined that 40 employees (of TMC's 936 bus and maintenance employees) had been incorrectly credited with 100% matches of their contributions. These 40 had transferred between departments. When the Paylocity system was implemented in August 2017, it matched and paid the employees as if each worked in both departments (50% match for each department, resulting in overall 100% match).

The aggregate overpayment to employees was \$57,756, which TMC obtained from the City as reimbursement, along with other expenses throughout the year.

Recommendation: TMC should correct the error and refund \$57,756 to the City.

TMC Response: During the implementation of Paylocity, historical data was dumped from the old system (Ceridian) into Paylocity. As a result, there were employees that were assigned the 457 deduction for two departments instead of one, thus overstating the 457 match for those employees. TMC has requested that Paylocity further investigate the error. The current benefits staff and director did not join TMC until the end of the implementation of Paylocity, so we cannot address inadequacies of review during the implementation and testing of the software.

Since the error has been identified, we submitted a request for the overpayment from Wells Fargo and received \$53,545.91, and have returned those funds to the city. Letters have been sent to those employees effected notifying them of the error. Two of those employees had been terminated and had utilized their full balance, so we were unable to recoup those funds.

Our Benefits Specialist has made the correction in Paylocity by deleting the extra department on those employees that had two departments assigned. Paylocity has created a custom report for us that identifies each employee contributing to 457, department, rate of contribution and amount of match. Our Benefits Specialist has been assigned the task of performing monthly reconciliations each month to verify each employee has one department assigned and that the match is correct to prevent these types of occurrences in the future. She will review her findings with the Finance Director each month.

CATS Response: The new Payroll System, Paylocity, has created an exception report that identifies each employee by department, rate, and the required match amount for the 457 contributions. If an employee falls outside of these established parameters they will

be identified and corrected. The monthly reconciliations are another means to cross check and verify the contributions for accuracy.

Audit Note: *The City remains owed \$4,310. This amount should be billed to TMC or deducted from the management fee.*

2. **TMC's insufficient review of system deductions contributed to undetected errors in pension fund deductions.**

Per the union agreements, all TMC employees contribute a percentage of their gross pay towards the company's pension plan. The rate is 7.35% and 4.50% for Bus Operators and Maintenance employees, respectively.

Insufficient review of system deductions allowed the following errors to occur:

- One employee had no pension deductions for seven months, resulting in a \$2,031 underpayment to the pension fund.
- One employee was not enrolled in the pension fund when eligible. Seven months of nonpayment totaled \$1,274.
- One employee had an inaccurate, higher percentage deducted during the Paylocity system change, with an impact totaling \$1,734.

Recommendation 2A: TMC should make a corrective contribution for the \$3,305 of missed deductions from the employees' pay.

TMC Response: Since the error was identified, we have solicited direction from Wells Fargo as to how to resolve. Once we have made a request for funds from the city, and that money is in our imprest account, we will initiate a deposit for funds to get placed into the employees' pension accounts by Wells Fargo. The Benefits Administrator has since made corrections in Paylocity to assign the correct pension contribution to those two employees affected.

Our Operations Analyst has created a report in Paylocity that the Benefits Administrator can generate each month, including each employee, department, age, date of hire, and pension contribution rate – to prevent the recurrence of errors. The Benefits Administrator will verify contribution rates and verify that each employee is contributing towards the pension plan if applicable. Findings will be reviewed with the Finance Director each month.

CATS Response: Paylocity experienced challenges during implementation. It is unfortunate that the transfer of data was not scrubbed for accuracy after the transferring process was completed from one system to the next. Lessons learned going forward: there needs to be a validation of data once the transmission is complete.

The identified amount due to the employee for no pension deposits will be rectified and deposited into the employee's pension account as required. The exception report developed by Paylocity will assist in ensuring proper contributions and contributing rates are accurate.

Audit Note: *The City fully reimbursed TMC for employee pension contributions which should have been deducted from paychecks and deposited into employees' pension accounts. TMC failed to deduct pension contributions for its employees.*

TMC stated its plan (above) to request additional funds from the City to correct its error. However, the City should not reimburse TMC a second time.

Recommendation 2B: TMC should refund the employee charged \$1,734 incorrectly subsequent to moving departments.

TMC Response: The employee in question had the correct contribution rate in our old system (Ceridian), however after implementation, the rate changed. Our records don't reflect the rate was changed by a user, so we believe it was a system error. The Benefits Administrator has since made the correction to the employee's record in Paylocity and assigned the correct contribution rate.

CATS Response: The identified amount due to the employee will be deposited into the employee's bank account. The exception report developed by Paylocity will assist in ensuring the proper contributions and contributing rates are accurate.

Recommendation 2C: TMC should hire an external audit firm to perform an audit of its retirement plan.

TMC Response: TMC will perform a search for an external audit firm that specializes in retirement plan benefits and submit an RFP for an external audit to be conducted.

CATS Response: To provide more oversight in the retirement and pension plan, CATS will assist TMC in obtaining a firm that has expertise in auditing pensions and retirement plans that will assist TMC with an added check and balance on the retirement plans.

3. **TMC should continue improving benefit election documentation and annually updating employee personnel files.**

Open enrollment for benefits such as medical, dental, life, short-term disability, and supplemental insurance occurs annually in March. Employees are strongly encouraged to attend open enrollment, but are not required. If employees fail to make elections during the open enrollment period, current elections are automatically rolled over into the new policy year. Whenever there is a change in the medical insurance carrier, attending open enrollment is mandatory in order to receive those benefits. The risks resulting from a non-mandatory

open enrollment have been outlined in prior years' audits. These risks are mitigated by TMC's substantial efforts to have every employee make yearly elections.

Auditors tested two FY18 pay periods – one from the prior open enrollment period March-April 2017 and one in the most recent election period in March 2018. Seven of the 435 deductions tested had exceptions (2%). Errors found are consistent with those seen in prior audits, the majority of which were due to manual entry errors and missing authorization forms.

Exception Error Rate			
Pay Period	Exceptions	Total Deductions	Error Rate
01/04/18	4	208	1.9%
06/28/18	3	227	1.3%
FY18 Totals	7	435	1.6%

The following exceptions were found during the current review:

- Two incorrect deductions (of 435 sampled) requiring reimbursements.
- The remaining five exceptions were due to missing or unsigned authorization forms, coverage selected but not deducted, or other recordkeeping errors.

Recommendation: TMC should continue to annually update all employee benefit folders with signed authorization or acknowledgement forms. Employees that were incorrectly charged for unauthorized deductions should be refunded.

TMC Response: New payroll software has the capability of automated benefit election processing. An automated open enrollment will be implemented for FY19 beginning with our administration staff. We have a kick off call scheduled with Paylocity in November 2018. By automating the open enrollment, we hope to minimize the amount of manual errors and missing forms. The current benefits staff has made great strides to improve in this area during the fiscal year. Our automated open enrollment initiative should help further minimize these types of errors.

CATS Response: The steps put into place over the past two years to avert errors during the benefit selection process have resulted in a reduction in discrepancies. Once the automation of the enrollment has been rolled out, it should diminish even further.