



CHARLOTTESM

INTERNAL AUDIT

**Audit Report
CATS Bus Operations – Imprest Account
For Fiscal Year 2016
October 20, 2016**

**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 Bus Operations Division (BOD). The work performed by Internal Audit is provided to CB for its review.

The City contracts with a management company, McDonald Transit Associates, Inc. (McDonald) to manage bus operations, known as Transit Management of Charlotte, Inc. (TMC). TMC sends reimbursement requests to the Charlotte Area Transit System (CATS) for operating expenses, except bus parts for which the City pays directly to suppliers. The City wire transfers the reimbursements into an imprest bank account in the name of TMC, from which BOD issues checks for operating expenses.

Auditors reviewed the operations and specific transactions for the fiscal year ended June 30, 2016. 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 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

CATS has established adequate internal controls to ensure expenditures from the imprest fund are timely and accurate. CATS plans to require annual updates to benefit elections, which should reduce the risks associated with a non-mandatory open enrollment.

Summary Recommendations and Actions – 2016

The following findings are detailed, beginning on page 4:

1. Procedures should be followed to ensure approvals occur before payments are made.
 - CATS has designated a backup
 - Approval guidelines have been established to ensure consistency and accuracy within the approval process.
2. TMC should correct benefit elections documentation and annually update employee personnel files.
 - TMC is working with the Union to ensure proper documentation is provided for all deductions. For future enrollment periods, TMC will obtain a signed authorization form from every employee regardless of whether the employee is electing to change his or her benefits.
 - TMC has refunded ten employees (\$1,141) identified in this audit. In addition, CATS and TMC will test a 3% sample of benefit forms monthly and verify the deducted amounts are correct.
 - A new HR/Payroll software system will be implemented in the summer of 2017 and will allow direct input of employee benefits into the HR/Payroll system as employees are making these elections. Prior to the initiation of that system, TMC will seek to obtain forms from all employees during the enrollment period.

Background

McDonald began providing transit management services for CATS' Bus Operations Division (BOD) on September 1, 2003. The City awarded McDonald another contract for three years plus two additional optional years effective August 1, 2008. The City has exercised its right to extend the contract terms. On March 25, 2013, the City Council approved an additional six month extension of the contract (through January 31, 2014) to enable McDonald to complete negotiations with United Transportation Union (UTU). On January 31, 2014, a new contract was signed between McDonald Transit Associates, Inc. and the City of Charlotte for three years plus two additional optional years effective February 1, 2014.

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. Bus drivers, maintenance and parts room workers are employed by the private company Transit Management of Charlotte, Inc. (TMC), which is managed by McDonald under its contract with the City. McDonald and TMC employees work at the Davidson Street and the Tryon Street facilities.

The City is fully responsible for the finances of the BOD and is required by agreement 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.

The individual payroll checks for the employees of TMC are prepared by Ceridian. In addition, Ceridian calculates and deposits payroll withholding and the employer's share of the taxes. Each week the payroll administration staff for TMC prepares a report based on printouts from Ceridian listing the amount and the account to be charged for payroll. This report is then forwarded to the accounting specialist for inclusion in the request for payment from the City. Also included in the request are any other miscellaneous payroll-related expenses to be paid.

Each week, TMC requests payment for itemized expenses and documents the request by providing copies of invoices. The request for funds is reviewed by CATS administration and the City's Finance staff. Upon approval, a wire transfer of the funds is made by the City, and TMC issues the checks the following day. TMC's accounting specialist writes the checks using Quicken software, and they are forwarded to the general manager for his signature. The checks are then given to the financial support clerk 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 FY15, CATS and TMC addressed findings and recommendations satisfactorily, as discussed below.

Recommendation #1: CATS should update its approval process to include the following procedures: (1) Improve controls by removing Accounts Payable (AP) from the weekly summary emails to ensure CATS has approved the expenses before AP can process the invoices and Treasury can initiate the wire transfers; (2) Designate a backup to approve expenses when the CATS Chief Operations Planning Officer (COPO) is unavailable.

- AP has been removed from the weekly summary email distribution list to prevent processing invoices in advance of CATS' approval. CATS has designated a backup to approve expenses in the COPO's absence. It was noted during FY16 testing that in the COPO's absence, the alternate signatories did not include the date of their review along with their signature.

Recommendation #2: TMC should ensure that employees' payroll deductions match their benefits elections. While open enrollment provides an opportunity for all employees to confirm or change existing benefit elections, it has not been practical to obtain full participation. Therefore, CATS and TMC should consider alternate methods to ensure that employees are

regularly updated regarding their existing coverage, allowing discrepancies to be resolved in a timely manner.

- For its March 2016 benefits period, TMC conducted a comprehensive enrollment process through the use of an outside firm that specializes in benefit enrollment. Employees were given two weeks to sign up in person at the Company's two facilities, and anyone who missed that window was able to sign up via telephone for an additional week. Approximately 80% of employees signed up through this process. The employees who did not attend or call had their benefits roll over. No one was cancelled from his or her policy for missing the enrollment window. All participants received a printout of the benefits selected.

Audit Findings and Recommendations – 2016

1. Procedures should be followed to ensure approvals occur before payments are made.

In order to receive payment for payroll and operational expenses, TMC emails a summary of expenses (signed by TMC management) to CATS, usually every Thursday. The next day TMC hand-delivers the originals and one copy to CATS who now have a representative in the same building. CATS conducts a review of the detailed invoices, indicates approval with a dated signature, and forwards the documentation to Accounts Payable (AP). AP then inputs the dollar amounts to correspond with account numbers in Munis and attaches the backup documentation received from CATS. An employee with City Finance's Treasury Division will then log into the City's bank account to schedule the wire transfer of funds to TMC.

In FY16, based on recommendations presented in FY15, CATS amended the procedures used when submitting TMC invoices for reimbursement by AP. Under the old methodology, the Chief Operations Planning Officer (COPO) dated his/her signature before sending to AP. Under the new method, proof of the transmittal date to AP is obtained by CATS including a printed copy of the email to AP showing the date and timestamp with the invoice backup uploaded to Munis. This approach prevents payment prior to approval.

For the past several years, late and missing signatures have been a recurring issue. Internal Audit noted the following exceptions in FY16:

- Four of the 101 wire transfers (4%) lacked a date of CATS approval before the wire transfer date. The result was \$2.42 million of expenses reimbursed without proper CATS approval.
- Four instances (4%) of missing signatures occurred. The lack of TMC management approval allowed \$919,150 of payroll and operational expenses to be wired to TMC's account without adequate authorization.

While the errors above indicate a weakness in the approval process, all expenses were found to be appropriate. The missing dated signatures from CATS all occurred during the COPO's

absence. This indicates the designated backup(s) need to be aware of the review and approval process.

Recommendation: CATS should update its approval process to include the following procedures:

- Ensure the designated backup(s) are aware of the procedures to approve expenses when the COPO is unavailable.
- Print a copy of the email sent to AP to include with the detailed backup file. The purpose of this email would be to confirm, via the timestamp, that the CATS approval occurred prior to the wire transfer.

CATS Response: A new position, General Manager of Bus Operations (GM), has been created and filled as of August 2016. The GM has replaced the COPO as the primary approver for all payment requests as of late August 2016. The COPO will be the designated back-up for the GM. Approval guidelines have been established to ensure consistency and accuracy within the approval process.

2. **TMC should correct benefit elections documentation and annually update employee personnel files.**

Recordkeeping

Open enrollment for benefits such as medical, dental, life, short-term disability, and supplemental insurance occurs annually in March. Employees are required to attend open enrollment only if they are making changes to their benefits; otherwise their current elections are automatically rolled over into the new policy year. There are several risks resulting from a non-mandatory open enrollment:

- *Unrecorded Benefit Elections* – Additional coverage elected but the change isn't properly recorded. This could result in the employee filing a claim that is denied.
- *Unrecorded Cancellations* – Canceling a benefit but the cancellation isn't properly recorded. This could result in a continuation of deductions from their paycheck. TMC would be liable for reimbursing the difference.
- *Outdated Elections* – An employee could have elected a deduction at a specific rate several years ago. Over time, that rate would likely have increased. With no recent authorization form on file at the new rate, it cannot be verified that the employee would elect the benefit in question at the new rate.

For FY16, nine percent (9%) of the tested deductions (97 out of 1,063) had exceptions. Auditors tested two pay periods prior to the most recent open enrollment date and one subsequent date. The majority of exceptions were due to manual entry errors, missing authorization forms, and/or continuation of coverages after cancellation. The following exceptions were found during the current review:

- Ten employees (of 44 sampled) with incorrect deductions taken from their paycheck requiring reimbursements totaling \$1,141
- Two additional errors which cannot be corrected by TMC; rather, an outside party must reimburse the employee directly.
- The remaining exceptions were due to missing authorization forms, unsigned forms, coverage selected but not deducted, or other recordkeeping errors.

Contract Compliance

Auditors did not test deductions for FY16 related to union dues and supplemental insurance (AFLAC). TMC staff noted they no longer receive the authorization forms, and the Union emails the list of changes. Therefore, auditors were unable to verify whether deductions were authorized. As noted in both labor agreements (Article III-B of the Operations Agreement and Article III-A of the Maintenance Agreement), TMC is required to have written consent on file for each employee who chooses to participate in the Union. In prior years, these consent forms have been kept in personnel folders and auditors were able to confirm the deductions.

Recommendation 2A: TMC should annually update all employee benefit folders with signed authorization forms, including waivers of coverage, union dues, and AFLAC elections. For the years following FY17 open enrollment, a signed acknowledgement form should be obtained even if an employee elects to roll forward coverage from a prior year.

CATS/TMC Response: For future enrollment periods, TMC will ensure that a signed authorization form is requested from every employee regardless of whether the employee is electing to change his or her benefits. TMC will obtain a signed verification of employee benefit elections from every employee actively at work and will request the same through written correspondence from inactive employees during the open enrollment period.

Recommendation 2B: A sample test resulted in 10 of 44 employees (about 23%) with at least one error related to benefit elections or rates. The associated risks must be addressed by a thorough review of all employee records. At the earliest possible date, TMC should research all BOD employees' benefit elections and resolve any incorrect deductions by either refunding the employees or obtaining a signed election form indicating the deductions are correct.

Actions Taken: TMC refunded the ten employees (a total of \$1,141) identified in this review. Corrections have been made to the incorrect employee benefit deductions with refunds issued to the affected employees.

CATS/TMC Response: CATS in conjunction with TMC is performing a 3% random sampling of its benefit forms each month to check against submitted invoices for accuracy in medical plan declarations. This process will continue each month to ensure that errors are identified and corrected in a timely manner. TMC will also perform its own internal audit of all current benefit deductions with the next regular billing cycle to ensure that the correct deductions are being made for each employee.

Recommendation 2C: TMC should consider an online open enrollment process that could reduce the occurrence of manual entry errors.

Actions Planned: TMC is in the process of procuring a new HR/Payroll software system that will allow web-based access to outside contractors during the enrollment process. This, in conjunction with WIFI access that is being added at both S. Tryon and Davidson garages, will allow for real time enrollment of employees into requested benefit programs during the annual enrollment process when this software is implemented. This implementation is anticipated in the summer of 2017.

The real time entry process enabled by the new system will allow benefits changes to be entered on the spot and verified by employees directly at time of enrollment.