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November 29, 2007

HONORABLE CITY COUNCIL
OAKLAND, CALIFORNIA

RE: Performance Audit of the City's Payroll and Compensation Practices

Dear President De La Fuente and Members of the Council:

I am pleased to present a performance audit of the City's Payroll and Compensation Practices. This is the first comprehensive, citywide performance audit conducted of the City of Oakland in recent memory. Unlike a financial audit, the intention of a performance audit is to address whether the City is effectively and efficiently spending taxpayer dollars and also complying with relevant rules and regulations.

I engaged the independent audit firm of Sjoberg Evashenk Consulting to conduct this audit. The firm's partners' credentials are exemplary and their reputation is impeccable. Kurt Sjoberg was the California State Auditor for 11 years and brings more than 35 years of experience conducting performance audits and financial analysis at all levels of government. His partner, Marianne Evashenk, who also worked on this engagement, was the Chief Deputy State Auditor of California for 18 years before co-founding Sjoberg Evashenk Consulting.

Over 55% of the City's budget goes to personnel expenses. As the independently elected City Auditor, I wanted to audit a function of the City that cuts across all departments and represents a substantial portion of the City's financial resources. The good news is that the we found the standard payroll system appears to work as intended and the roles and responsibilities for standard payroll cycles appear to afford the appropriate separation of potentially conflicting duties, thus, minimizing the risk of inappropriate access to payroll records and improper payroll expenditures. However, the audit identified over three million dollars in City funds that were paid out in error, prematurely, or in violation of City rules and collective bargaining agreements. Specific findings from the audit include:

- Managers received more leave than allowed under collective bargaining agreements, costing the City an additional \$341,000 in 2006.

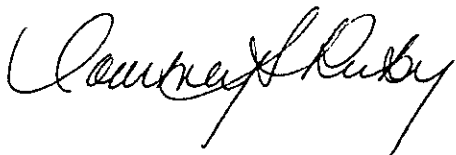
- City employees sold back at least \$3 million more in leave than allowed--\$2.5 million of vacation leave, \$500,000 of Management Leave, and \$113,000 of sick leave. For instance, one employee was allowed to sell back 480 hours of sick leave or five times the amount allowed in the collective bargaining agreement.
- City employees received 294 salary advances valued at over \$560,000 that were in effect interest free loans. The City has yet to collect on \$68,000 in outstanding salary advances including \$24,000 from employees no longer working for the City.
- One employee was awarded 22 extra vacation days and was paid \$17,000 for this additional leave that should not have been received. The error went undetected even when the employee left City employment.

The report concludes that these instances of overpayment to individuals occurred either because of the lack of policies and procedures in place to prevent such unauthorized disbursements, or because the staff did not follow the policies and procedures that were in place. Accordingly, the audit report includes 14 recommendations to address the problems identified. We have noted that the Administration has taken corrective action to address some of the issues identified in the report.

The report includes both a response from the City Administration and my response to the City Administration's response. I would have preferred a response that provided my Office and the citizenry with a constructive plan to address the well-evidenced findings in my report. Unfortunately, this was not the case. I do, however, appreciate the time the Administration dedicated to the audit and in the future, it is my hope that my Office is met with a greater level of cooperation and the public is afforded a greater level of accountability. My office will perform a follow-up audit to ensure our findings have been addressed and this will be reported to the Council and the public.

As Oakland's independent elected City Auditor, it is my Office's job to provide unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, help the City ensure accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. This report is just the beginning of my Office's commitment to shine a light on significant issues throughout the City. With the Administration's cooperation it is my hope that we may address these issues together and operate our City government more effectively, efficiently, and in the best interest of the public.

Respectfully submitted,



Courtney A. Ruby, CPA
CITY AUDITOR

City of Oakland
Office of the City Auditor

Performance Audit of the City's Payroll and
Compensation Practices

November 29, 2007



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Executive Summary

This is the first comprehensive, citywide performance audit conducted of the City of Oakland in recent memory. Unlike the financial audit performed annually by outside auditors, a performance audit does not focus on whether the City's financial statements fairly present its overall fiscal condition. Rather, a performance audit is intended to address whether the City is effectively and efficiently spending taxpayer dollars and also complying with relevant rules and regulations. If areas needing change are identified, recommendations for improving operations are provided. Thus, in this performance audit of the City's payroll and compensation practices, we identified a number of areas where the City needs to improve its business processes to strengthen controls and protect the public interest.

The City of Oakland is California's 8th largest city, with approximately 5,900 full and part-time employees providing public services to nearly half a million bay area residents. As in most municipalities, employee compensation and benefits comprise a significant portion of the City's expenses—the City of Oakland is no different with payroll-related expenditures totaling over 55.5 percent of its \$1 billion operating budget.

While we found that the City lacks a formal set of comprehensive written payroll policies and procedures, it has established the basic financial and administrative controls expected for the preparation and processing of standard, regular payroll cycles. Our review reveals that the processes for standard payroll generated through bi-weekly submission of timesheets from departments appear to work as intended and that the roles and responsibilities for standard payroll cycles seem to afford the appropriate separation of potentially conflicting duties, thus, minimizing the risk of inappropriate access to payroll records and improper payroll expenditures.

However, we found that the City needs to strengthen oversight, ensure validity of transactions, and improve controls over supplemental or off-cycle payroll transactions such as retroactive payments, leave buyouts, and bonuses. Specifically, we found that City employees conducting payroll activities have little formal guidance or written policies and procedures stipulating the roles and responsibilities for executing these varied and sensitive transactions. In fact, it is unclear as to the role and responsibilities of the central Payroll Group—whether it acts as a key control agency to oversee and monitor all pay-related expenditures or if it serves simply as a service center with administrative controls and accountability residing at individual departments. As a result, our assessment of internal controls and payroll operations reveals the following:

- ***The majority of off-cycle payroll transactions sampled lacked appropriate support and justification.***
- ***Past practices related to salary advances resulted in some payments that could be considered interest free loans and likely to result in losses to the City.***
- ***Inactive seasonal employee files remain active within the Oracle HR/Payroll system year-round creating opportunities for unauthorized transactions to occur.***

To ensure the integrity of City expenditures and the consistent treatment of all employees, the City needs to improve internal controls relative to off-cycle business processes. In addition to internal control matters, we found inconsistencies relating to additional compensatory benefits awarded to employees. Specifically, under administrative directives and certain provisions of labor agreements, the City has recognized some employees over the years with additional compensatory awards such as Management Leave, Executive Leave, cash bonuses, and employee recognition payments. The justification for these benefits, some recommended by departments and most approved by the City Administrator, includes recognition of overtime worked, superior performance, and meritorious conduct. Certain administrative and contract provisions generally address the granting of these benefits, but in actuality, City administration retains control over the majority of these awards. These awards are not inconsequential—in total, for the years 2004 through 2006, the City awarded nearly \$388,000 in cash awards for employee recognition or job bonuses alone. Additionally, during the calendar years 2005 and 2006, the City granted Management Leave awards valued at \$1.4 million and \$1.6 million, respectively. Our review found that approximately 30 percent of Management Leave awards were required by provisions included in MOUs. Further, some managers were awarded Executive Leave totaling more than \$97,900 over the three-year period. Finally, the City pays nearly \$700,000 annually for automobile allowances to 238 employees.

With full employee compensation including pay premiums, employer tax costs, and retirement contributions totaling in excess of \$589 million for the 2006-2007 fiscal year, the City's employees are afforded a variety of benefits such as health and other insurance, retirement, and paid sick, vacation, and holiday leave. In relation to employee compensation, during the period of our review we found:

- *Management leave awards averaged \$1.5 million annually and a significant number of these awards clearly exceeded collective bargaining agreement provisions or City rules by \$341,000. Moreover, the City granted Executive Leave awards to at least 10 executive managers valued at \$97,900 over the three years of our review.*
- *City practices afford liberal leave buyback options and do not enforce limitations stipulated within bargaining agreements and City provisions. As a result, employees sold-back at least \$3 million more in leave than allowed—\$2.5 million in vacation leave, \$113,500 of sick leave, and \$500,300 of Management Leave. Further, the City has few limitations on the buyback of other leave and existing processes allowed an abnormality to go undetected.*
- *Payment of separate cash employee recognition awards and bonuses to 324 employees citywide ranged from \$75 to \$10,000 per individual award and totaled \$388,000 over the period of our review. We determined that little criteria exists for the award of these cash payments and central guidance is insufficient to ensure fair, uniform, and transparent award of these benefits.*
- *Monthly automobile allowances ranging from \$137.55 to \$750 per month were paid to an estimated 238 employees nearing a total of about \$700,000 per year or an average of almost \$3,000 per employee.*

Further, as our audit reveals, the existing practices in conducting off-cycle payroll transactions increase the risk that inappropriate or inaccurate payments could be, or have been, issued. While some improvements have been recently implemented, other improvements and further action is warranted to ensure City funds are appropriately safeguarded. Specifically, we recommend the following:

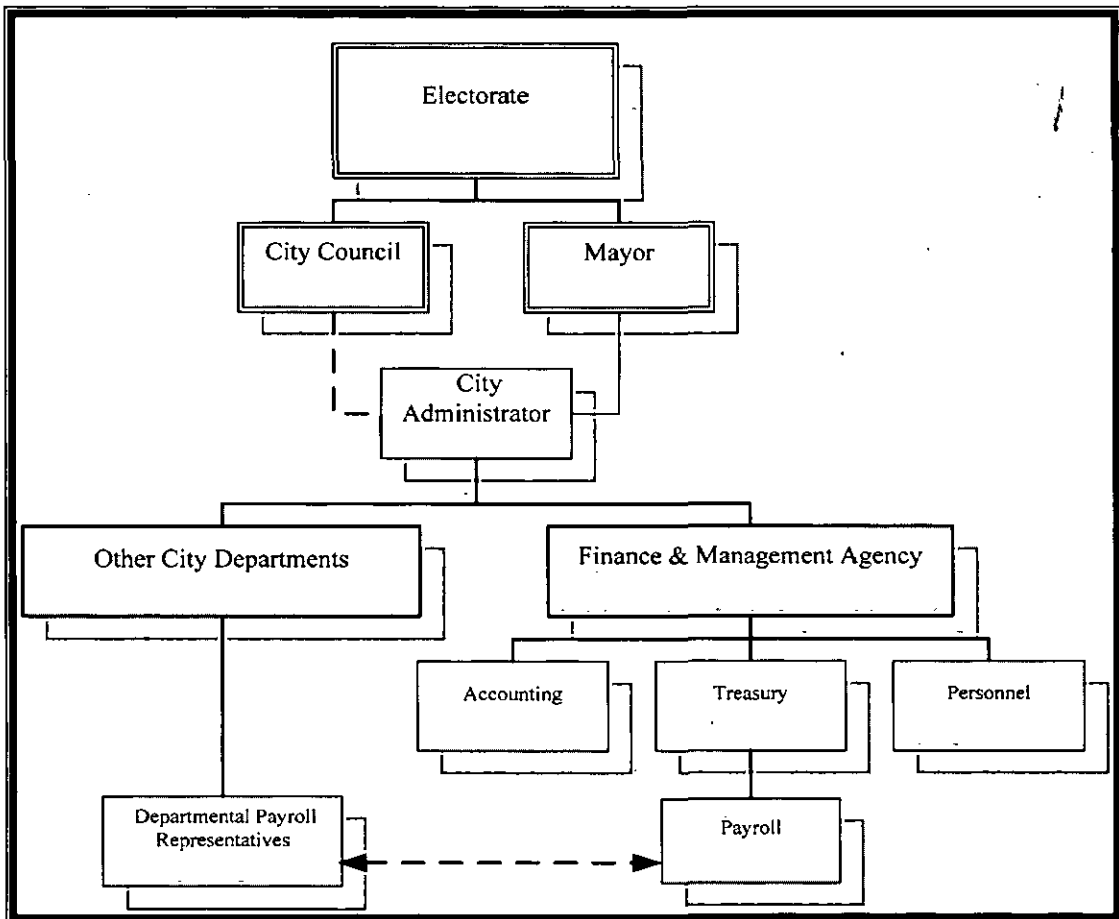
- ☑ The City needs to develop, disseminate, and follow a citywide set of comprehensive policies, procedures and protocols for administering all compensation-related activities.
- ☑ The City needs to clearly establish the central Payroll Group as the primary control entity responsible for the accuracy, validity, and completeness of every payroll transaction. Additionally, the City needs to clearly define and communicate the specific roles, responsibilities, and duties of departmental and central Payroll Group staff involved in the various timekeeping and payroll activities.
- ☑ The Finance and Management Agency should establish and follow a timekeeping and payroll processing manual that sets out the roles and responsibilities of departmental and payroll staff involved in the various timekeeping and payroll activities. This manual should clearly provide the processes, procedures, and protocols for conducting and monitoring all types of payroll transactions and retention of the supporting documentation.
- ☑ Salary advance or “early release of pay checks” policies and procedures should be revisited to determine the purpose and related criteria for this benefit, including provisions for ensuring that the employee has worked the time that is being “released early” or has sufficient vacation accrual to cover the payment. The central Payroll Group should continue its efforts to obtain repayment on outstanding balances and its efforts to improve tracking and immediate repayment of amounts advanced.
- ☑ The City must ensure that Administrative Instructions (AIs) and other administrative directives comply with terms of the MOUs and that these provisions do not conflict. Further, the City should ensure that all MOU and City rules and protocols are consistently and uniformly followed.
- ☑ During the collective bargaining process, the City should focus special attention on ensuring that provisions included in MOUs are aligned with administrative policies and that MOUs are complete and accurate. Any matters identified subsequent to the execution of these agreements should follow a formal process for City adoption and not be implemented by informal understanding.
- ☑ All payroll, benefit, and other related AIs need to be revisited and refreshed. In particular, City leadership should consider the various benefits afforded City employees, both represented and non-represented, and establish administrative guidelines and protocols for the fair, transparent, and deliberate award of such benefits.
- ☑ The City Council should approve and budget for all forms of compensation such as Executive Leave, Management Leave, and employee recognition and bonus awards. For each type of award of leave or cash payment, criteria and formal processes should be established and followed to ensure transparency, fairness, and integrity of benefits.

- The City Council, Mayor, City Administrator, and other appropriate City officials need to be provided on a pre-determined interval, detailed financial management reports providing information relative to current standard and off-cycle payroll costs including overtime, premium payments, and auto allowances; personnel levels; award of Management, Executive, and Special Recognition Leave; bonus and employee recognition cash awards; and, buybacks of leave time.

Introduction and Background

As the 8th largest city in California, the City of Oakland employs over 5,900 full-time and part-time employees at more than 10 departments to provide a multitude of public services ranging from law enforcement and public safety, streets and road maintenance, and city redevelopment and recreational services. With payroll and compensation-related costs for these employees comprising a large portion of the City's annual expenditures, the payroll process is a cross-cutting function and key element of City operations. Employee compensation is administered using a combination of automated and manual systems and is conducted by departmental payroll representatives and the central Payroll Group, housed within the Finance and Management Agency. As depicted in Figure 1, other partners directly or indirectly involved in the payroll process include departmental payroll representatives, the City Administrator, and the City Council.

Figure 1: City Payroll Structure



In early 2006, the Treasury Division was restructured to encompass the central Payroll Group under its umbrella of responsibility. Prior to that time, payroll had been overseen by the City Controller who is responsible for the Accounting Division—both divisions are part of the Finance and Management Agency. While departmental payroll representatives

are responsible for timekeeping and reporting, staff in the central Payroll Group perform primary functions for processing payroll, entering payroll adjustments, generating or printing payroll reports, printing and distributing checks, and administering the Oracle HR/Payroll application.

MOUs and Administrative Instructions

Guiding the terms of employment and compensation for City employees, Memorandums of Understanding (MOUs) are binding contractual arrangements negotiated and executed between the City of Oakland and each labor union or association. Currently, there are eight MOUs in place:

- Local 21, AFL-CIO—Professional & Technical Engineers
- Local 21, IFPTE—Deputy City Attorney Unit
- Local 55—International Association of Firefighters
- Local 790—Service Employees International Union
- Local 790—Service Employees International Union—Part-time Unit
- Oakland Police Officers’ Association
- Oakland Park Rangers’ Association
- Local 1245—International Brotherhood of Electrical Workers

In general, the MOUs establish certain employment provisions for employees represented by the particular labor union. As is often the case, executive, management, and some supervisory and professional staff are not represented by labor organizations and considered “non-represented” and deemed “exempt” under the federal Fair Labor Standards Act (FLSA). Such employees are governed by City rules and policies, including *Administrative Instructions (AIs)* issued by the City Administrator. Appendix A provides a listing of these represented and unrepresented units.

The MOUs cover a wide range of topics such as direct pay (salary), premium pay, overtime, shift differential, allowances such as for uniforms and shoes, leave, working conditions, personnel provisions, and grievance procedures. The specifics of these provisions vary between the MOU agreements and are specifically structured for the units represented—for instance, one MOU may provide \$100 for a uniform allowance, while another MOU will not include provisions related to uniform allowances at all.

Throughout the years, the City Administrator has issued some AIs that relate to payroll and compensation-related activities. For example, topics include “Payroll Procedures Policy” (AI 555), setting forth some guidelines and practices related to submission of payroll adjustments to the central Payroll Group, “Floating Holiday” (AI 520), providing guidance for the floating holiday benefit, and “Termination of Employment” (AI 570), including steps related to individuals leaving City employ. The AIs provide policy statements related to specific matters, but do not comprise a comprehensive set of policies and procedures for administering and monitoring the multitude of pay-related activities conducted by departments and the central Payroll Group.

In addition to the binding labor agreements and City policies, the Personnel Division issued an Employee Orientation Handbook in 2002 that reflects some payroll and personnel related areas such as paid time off, vacation sell-back conditions, and sick leave conversion. The City also issued in 1997 *We've Got You Covered*, the handbook setting out provisions related to non-represented management employees—recently, the City updated this handbook.

City Employee Compensation

Agreements negotiated with various labor unions as well as administrative instructions memorialize general provisions of payroll and compensation-related benefits. Combined with general practice and protocols, employee compensation is comprised of many discrete components. Generally, these components include, but are not limited to, the following:

- Base Salary—sworn and civilian
- *Holiday and Floating Holiday* pay
- Incentive and premium pay such as bilingual and shift differential
- Overtime
- Compensatory time
- Sick and vacation time
- Automobile Allowances
- Bonuses and Employee Recognition
- Extra Vacation Day
- Management Leave
- Executive Leave

Additionally, employees may earn retroactive pay, working above grade increments, or premiums for special assignments. Overall, the components of payroll are complex and detailed.

Payroll and Compensation Processes

To assist in administering payroll and benefit plans, the City utilizes specific modules within an Oracle enterprise application—the critical modules used include: HR/Payroll, General Ledger, and Oracle Time and Labor system. This automated system generates bi-weekly payroll checks, advices, and year-end tax reporting forms.

Prior to each of the 26 scheduled regular pay dates per year, department payroll representatives input time into the timekeeping module based on timesheets provided by employees and signed by their supervisors. After a scheduled cut-off period, the central Payroll Group accesses the Oracle HR/Payroll system and runs a simulated payroll; department payroll representatives receive payroll registers for the simulated runs and are tasked to review and verify the run for accuracy. Changes identified relating to the regular payroll runs can be made only during a limited time period after simulation and prior to executing the final payroll. Any changes, payroll adjustments, augmentations, or omissions identified after a regular payroll run must be made as part of a supplemental or

off-cycle run. Other actions often processed through the supplemental runs include leave buy-outs, retroactive payments, position upgrades, working above class, overtime payments, and termination payments.

Audit Objectives, Scope, and Methodology

In March 2007, the City Auditor of Oakland contracted with Sjoberg Evashenk Consulting, Inc. to conduct an independent performance audit of citywide activities related to the payroll and compensation practices in accordance with Generally Accepted Government Auditing Standards. The Oakland City Charter §403 states that the City Auditor “shall have the power and it shall be his or her duty to audit the books, accounts, money and securities of all departments and agencies of the City and such other matters as the Council may request.”

Audit Objectives

In light of the City Auditor’s mandate, our performance audit of the City’s payroll and compensation practices set out to achieve the following objectives:

- To determine whether the City’s control practices, policies, and environment related to payroll activities adequately and appropriately operate to assure that personnel, timekeeping, and payroll systems are in compliance with established rules and regulations.
- To ascertain whether the policies, procedures, rules, regulations, and protocols are uniformly and consistently applied throughout the City and ensure that pay and benefits are accurate, appropriate, earned, and paid to its employees.
- To assess whether the City’s administrative and departmental activities assure that amounts spent for employee compensation are prudent and in the best interest of the City, its employees, and residents to ensure the fair and appropriate use of city funds.
- To evaluate whether the City has established appropriate and sufficient rules, regulations, policies, procedures, and practices to safeguard city assets, provide appropriate checks and balances, and ensure the transparency and accountability of government.

Audit Scope

The period of our audit is focused on calendar years 2004, 2005, and 2006. However, where appropriate, we also reviewed subsequent timeframes (in 2007) to include in our overall evaluation of the current state of the business operations related to timekeeping, payroll, and compensation practices. In addition, particularly in relation to salary advances, we expanded our timeframe back to 2000 to ensure that the data under evaluation was viewed in full and in the proper context.

Our review encompassed related operations within the Finance and Management Agency, including central Payroll Group, Personnel, Accounting, and Treasury. Further we also included relevant procedures and practices at the following seven City agencies or offices:

- Police Services Agency
- Library Services
- Public Works Agency
- Fire Services Agency
- Office of Parks and Recreation
- Finance and Management Agency
- Community and Economic Development Agency

While our audit included timekeeping, pay, and compensation, we did not conduct an in-depth review of overtime practices as this area is slated for future audit.

Audit Methodology

To accomplish these objectives, we employed a variety of audit tests, analytical processes, evaluative techniques, interviews, research, other methods to obtain appropriate, data, evidence, and context information to support our work.

To gain an understanding of the payroll and compensation processes and practices employed by the City of Oakland and to understand the history of the payroll and timekeeping systems, we conducted interviews with the Finance and Management Agency Director, City Treasury Manager, Acting City Controller, City Personnel Director, staff and supervisors from the central Payroll Group and the personnel areas, as well as payroll representatives at seven City agencies or departments. Additionally, we conducted physical observations of timekeeping and payroll processing and identified the controls and oversight practices in place over the timekeeping and payroll processing for both regular and off-cycle runs.

In addition, we requested from City staff and independently gathered any available written rules, policies, procedures, and protocols related to timekeeping, payroll, benefits, leave, personnel, and related accounting activities. As such, we studied agreements struck through collective bargaining “Memorandums of Understanding” (MOUs), City Administrative Instructions (AI), local ordinances and rules, employee and management handbooks, and other documents.

As part of assessing the integrity of the payroll automated system and manual business processes, we performed a review of the control environment. Specifically, we reviewed the roles, responsibilities, and access over payroll and compensation-related activities to determine whether an appropriate level of segregation of duties existed with separate individuals performing tasks such as timesheet approval and input, processing of payroll, creation and review of payroll register, issuance and distribution of checks, and reconciliation of bank accounts. Further, we assessed and documented processes and practices to evaluate the strength of the controls in place to protect cash assets and ensure integrity of the system for accuracy and appropriateness—including reviews and approvals of timesheets, support, approval and review for changes to compensation, independent verification of payroll registers, performance of general ledger and bank reconciliations, appropriate controls and processes for voided and manual checks, security of check and remuneration statement stock, proper distribution of checks, and appropriate access controls related to automated systems.

To reduce redundancy of our audit effort, we met with the City's external auditors responsible for conducting the City's annual financial statement audit—Macias, Gini, and O'Connell—and reviewed their work relative to internal controls and payroll testing.

Because the external auditors reviewed certain payroll processes and tested the controls in place over payroll transactions to ensure the accuracy of pay, approval of timesheets, and compliance with some MOU provisions, we did not recalculate and test standard payroll transactions. According to the external auditors, detailed tests of the HR/Payroll module are planned for the current audit in process and will address areas such as user access and system edits; as such, we were unable to review the outcome of their work.

We also assessed the strength of the control environments, process weaknesses, and opportunities to improve compliance, consistency, efficiency and/or effectiveness of the operations at the seven City agencies or offices we visited. We sought to ascertain the department-specific formal and informal policies, procedures, and processes in place related to entering a new employee into the payroll system; preparing, documenting, and approving leave and overtime requests; preparing, signing, and approving timesheets; maintaining documentation of forms and support related to payroll and timekeeping actions; bi-weekly timekeeping processes, verification of simulated payroll; and distribution of paychecks and/or remittance advices. We also compared and contrasted the activities among and between the various departments as well as their interaction with the central Payroll Group.

Our audit tests included selecting a representative sample of payroll transactions to determine whether the action was adequately justified, supported, accurate, approved, consistent with rules and regulations, and complete. The resulting sample covered various city departments, representation units, time periods, dollar amounts, and types of transactions (such as retroactive pay, bonus, or leave buy-out). Additionally, we requested and tested underlying transactional support from the central Payroll Group for the entire batch of payroll activities and actions related to pay periods ending 7/16/04, 7/01/05, 6/30/06, and 12/29/06 to verify and validate justifications, approvals, completeness of records and support, uniformity, consistency, and accountability of payroll documentation.

To the extent data were made available, we attempted to identify trends related to supplemental compensation during off-cycle transactions as well as leave award and usage by reviewing reports from the Oracle HR/Payroll system showing data by department, representation unit, and organization code. Specifically, we analyzed statistical data related to bonuses, Management Leave awarded and cashed-out, executive awarded and cashed-out, sick leave and vacation buybacks, retroactive pay, salary advances, and automobile allowances. We used actual payroll data when available and, in some instances, we took actual hours and applied mid-range base salary amounts for the individual positions as reflected on the City of Oakland's salary ordinances.

While we attempted to independently verify the completeness and reliability of reports generated from the Oracle HR/Payroll system provided by central Payroll Group staff, this could not be accomplished in some cases due to the system design and functionality.

As a result, we could only spot-check individual and ad-hoc report transactions on a random basis to employee records and history files.

Nonetheless, we remained vigilant of any potential unusual activities, trends, or errors that would affect the accuracy and usefulness of the reports. Further, when we noted unusual activities or transactions, we requested and reviewed relevant history or reports for those individuals.

We conducted this audit in accordance with generally accepted government auditing standards. Our audit tests, analyses and evaluations were limited to those areas described as above in the Objectives, Scope and Methodology section of this report.

Chapter 1. While Standard Payroll Processes Appear to Operate as Intended, the City Needs to Improve Off-Cycle Practices

While the City of Oakland lacks a formal set of comprehensive written payroll policies and procedures, it has established the basic financial and administrative controls expected for the preparation and processing of standard, regular payroll cycles. Our review reveals that the processes for standard payroll generated through bi-weekly submission of timesheets from departments appear to work as intended and that the roles and responsibilities for standard payroll cycles seem to afford the appropriate separation of potentially conflicting duties, thus, minimizing the risk of inappropriate access to payroll records and improper payroll expenditures.

However, we found that the City needs to strengthen oversight, ensure validity of transactions, and improve controls over supplemental or off-cycle payroll transactions such as retroactive payments, leave buyouts, and bonuses. Specifically, we found that City employees conducting payroll activities have little formal guidance or written policies and procedures stipulating the roles and responsibilities for executing these varied and sensitive transactions. In fact, it is unclear as to the role and responsibilities of the central Payroll Group—whether it acts as a key control agency to oversee and monitor all pay-related expenditures or if it serves simply as a service center with administrative controls and accountability residing at individual departments. As a result, our assessment of internal controls and payroll operations reveals the following:

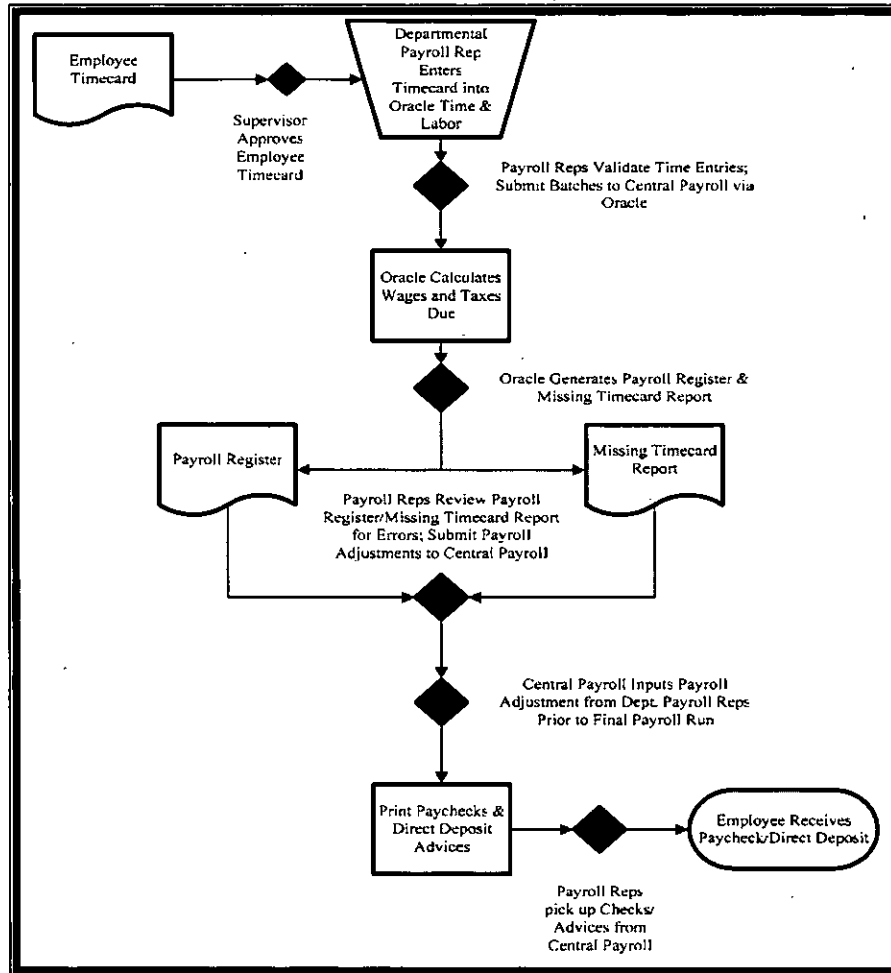
- The majority of off-cycle payroll transactions sampled lacked appropriate support and justification.
- Past practices related to salary advances resulted in some payments that could be considered interest free loans and likely to result in losses to the City.
- Inactive seasonal employee files remained active within the Oracle HR/Payroll system year-round creating opportunities for unauthorized transactions to occur.

To ensure the integrity of City expenditures and the consistent treatment of all employees, the City needs to improve internal controls relative to off-cycle business processes. To strengthen controls over off-cycle transactions, the City needs to clearly define and communicate the roles, responsibilities, and duties of the central Payroll Group and the department staff involved in timekeeping and payroll activities. In addition, all policies and procedures related to salary advances or “early release of paychecks” need to be revisited and processes improved over monitoring and collecting of the advances. Also, the City needs to establish formal processes to monitor the status of temporary, intermittent, and seasonal employees.

Practices Exist to Ensure Standard Payroll Is Processed Appropriately

The City of Oakland pays its employees on a bi-weekly basis resulting in 26 pay periods per year. The standard pay cycle commences with employees submitting completed timesheets to supervisors whose responsibility is to review the timesheet for accuracy and then to approve them. The supervisor submits the timesheets to the designated departmental payroll representative for processing.

Figure 2: Payroll Process Control Points



Although the City is moving to an integrated, employee self-input timekeeping system, most departments remain on the legacy manual system. This process requires the departmental payroll representative to input each employee's time information into the City's timekeeping application for inclusion in the citywide payroll processing run. Standard payroll occurs every-other Wednesday; thus, to be paid, the system requires the submission of a timesheet for each employee as shown in Figure 2.

Table 1: Payroll Segregation of Duties

Payroll Activity	Departments			Central Payroll		Personnel Division	Accounting Division
	Employee	Employee Supervisor	Payroll Rep	Sr. HR Operations Technician	Payroll Control Specialist	Personnel (OPRM)	Accounting
Assigns Position Control Number						✓	
Establish/Maintain Employee File						✓	
Completes Weekly Timesheet	✓						
Approves Employee Timecard		✓					
Enters Employee Timecard/Hours Worked			✓				
Initiates Payroll Simulation				✓			
Prints Payroll Register				✓			
Reviews Payroll Register for Accuracy			✓				
Requests Payroll Adjustments			✓				
Enters Payroll Adjustments				✓			
Initiates Final Payroll Run				✓			
Prints Payroll Checks					✓		
Distributes Payroll Checks/Remittance Advices			✓				
Maintains Manual Check Stock					✓		
Writes Manual Checks					✓		
Posts Payroll Activity to General Ledger							✓
Reconciles Payroll Bank Account							✓

The roles and responsibilities over the standard payroll process seem designed to afford the appropriate segregation of duties, as reflected in Table 1. For example, the City designated four different divisions or areas to administer payroll and compensation activities—individual City departments, and three areas within the Finance and Management Agency: Personnel Division, Treasury Division/central Payroll Group; and,

Accounting Division. The separation of these groups allow for potentially conflicting duties between timekeeping, payroll processing, check printing and issuance, and access to the general ledger accounting to be appropriately performed by separate individuals. Key functions over standard payroll cycles are also segregated. The City requires first-line supervisors to approve timesheets, payroll representatives in each department input time, and the central Payroll Group processes the payroll.

Furthermore, the City has implemented security controls that protect the automated payroll system from inappropriate access and unauthorized use and also help to ensure the separation of duties. Access to the Oracle HR/Payroll system should be restricted to those individuals whose access is essential to perform their job duties; our review of the system user responsibility reports, provided by the City Treasury Manager, suggests that system access is properly controlled.

Additionally, the central Payroll Group applies certain practices designed to prevent improper access to the payroll and other controls intended to detect inappropriate activities. For example, one business control process applied is that only the central Payroll Group may enter new employees into the Oracle HR/Payroll system. This action is triggered when the central Payroll Group receives all the requisite approved documents from the designated department payroll representative and obtains the position control number assigned by the Personnel Division. Although the Oracle HR/Payroll system does not require the assignment of a position control number in order to add an employee to the payroll system, we noted other internal controls such as department-level review of payroll registers, monthly generation of open position listings, and bi-weekly assessment of the missing timesheet report that assist in deterring and detecting inappropriate activities.

The City has implemented other relevant controls that assist in the processing of payroll. These controls include:

- Approval by departmental payroll representatives of simulated payroll registers prior to the execution of the payroll run by the central Payroll Group, essentially obtaining a second review of basic employee information.
- Runs of “high-low” reports by the central Payroll Group to assess the reasonableness of pay transactions.
- Appropriate physical controls and practices in place to secure payroll assets and check distribution.

Finally, external auditors and other periodic actions provide additional oversight of the standard payroll processing. Each year, the City undergoes a financial statement audit that includes tests by auditors of an external certified public accounting firm. These tests cover payroll processes and transactions and check for accuracy of pay, approval of timesheets, and compliance with some MOU provisions. Also, we noted that recently, the FMA performed a citywide check distribution verification requiring each City employee to personally show identification in order to pickup their paycheck or remittance advice for a selected July 2007 payroll cycle.

The City Needs to Strengthen Oversight, Ensure Validity of Transactions, and Improve Controls Over Off-Cycle Payroll Activities

Our tests of off-cycle payroll procedures revealed that not all transactions include evidence that the action was appropriately justified, supported, and approved. The lack of a formal, written payroll processing manual to provide guidance to departments and to central Payroll Group staff contributed significantly to these weaknesses. A comprehensive set of administrative policies, procedures, and protocols should cover all payroll and compensation practices and be distributed to City employees. Moreover, City staff conducting payroll activities have little formal, written guidance, policy, or procedure stipulating the rules, roles, and responsibilities for executing these varied and sensitive payroll transactions. In fact, it is unclear as to the role and responsibility of the City's central Payroll Group—whether it acts as a key control agency to oversee and monitor all pay-related expenditures or if it serves simply as a service center with the administrative controls and accountability residing at individual departments. Our audit testing revealed the following issues:

- Only 4 of the 7 departments we reviewed maintain supporting documentation for off-cycle payroll transactions.
- 46 of the 68 off-cycle transactions tested at the central Payroll Group were inadequately supported or justified and 18 of the 68 were not properly approved or authorized.
- Salary advance requests generally lacked justification and support to demonstrate the propriety and rationale for the amount advanced or a verification and calculation of the payment, and lacked an effective process to monitor and collect employee receivables.

In addition to not having a set of complete overarching administrative policies, the City is lacking a formal written manual or handbook that serves as a detailed practitioner's guide to implementing pay-related provisions and rules. Although the central Payroll Group uses some standard payroll forms and offers monthly/quarterly training sessions for departmental payroll representatives, the City lacks formal manuals, handbooks, or guides to assist staff with performing the mechanics of payroll transactions and to describe the specific required justifications, verification activities, documentation support, and maintenance of records.

In our testing of various off-cycle payroll actions, executed at the department-level and by the central Payroll Group, we found a disconnect between the roles and responsibilities of each group. As such, it was unclear which payroll area—departmental payroll representatives or central Payroll Group staff—holds the responsibility for verifying, approving, and validating payroll transactions. While some City officials stated that the central Payroll Group is a key control agency, others stated that this group is a payroll processing service and that the departments are responsible for ensuring the validity, appropriateness, and eligibility of transactions and for maintaining the documentary evidence to support the transactions. For example, with leave buyback transactions, it is unclear who was responsible for verifying that the buy-out requested is in fact allowable and eligible under the applicable MOU or AI provisions, securing and

reviewing the appropriate supporting documentation (such as a pay stub or leave record), and retaining the supporting documentation as an audit trail and verification of the transaction.

Our audit also revealed inconsistencies among departments that may have also resulted from the lack of clarity surrounding payroll processing roles and responsibilities. Specifically, at 4 of the 7 departments we visited, copies of supporting documentation related to payroll transactions such as buyback forms and early release of checks forms were not retained—partially due to the belief that the central Payroll Group was the primary custodian of all payroll-related documents. In fact, the central Payroll Group only retains the documents submitted by departments, which lack sufficient detail to provide proper evidence and a full audit trail.

Also, when reviewing salary advances, we found some of the forms for requesting this action, such as “Early Release of Checks” included only an employee name, requested amount, and a payroll representative’s signature—no other documents, such as a printout reflecting the amount of pay for a typical cycle or a leave printout verifying that the amount of advance requested was sufficiently covered by a leave balance, were maintained. In at least one instance, the employee did not even specify the amount to be advanced. Additionally, we noted that the central Payroll Group did not always note on the form the advance amount paid or the rationale for the calculation of the amount in instances where the requested amount was not provided. For example, one employee requested an advance payment of 150 hours, but was only advanced 59 hours of pay with no documented justification for the difference and no explanation for the advance itself.

In other instances, we found retroactive payments stretching two or three years in arrears that were only supported by a spreadsheet reflecting the dollar calculation. The departments did not provide justification or support for these changes; yet, each of these transactions was executed by the central Payroll Group.

Overall, we found that practices citywide need to be tightened to better ensure the integrity and transparency of the payroll activities. If the City established—and followed—a set of written, comprehensive procedures describing roles and responsibilities that provides specific guidance and direction, many of the issues noted during our audit could easily be corrected. In addition, written protocols provided to all City staff processing payroll transactions should clearly delineate roles and guide staff in terms of required authorizations, documentation and support, verification processes, and fiscal record posting to ensure the completeness, consistency, and fairness of payroll actions, particularly in terms of off-cycle or supplemental payroll activities.

Majority of Off-Cycle Transactions Sampled Lacked Appropriate Support and Justification

Internal controls are a set of plans, policies, methods, and procedures adopted by an organization’s management to not only meet its missions, goals, and objectives, but to organize, direct, monitor, and control business operations. Internal controls serve to safeguard assets, prevent and detect errors, fraud, or irregularities, and ensure compliance

with laws, rules, and regulations. As stated previously in this report, the City has adopted few policies, procedures, and standard methodologies for transacting off-cycle payroll transactions. Thus, there is little City-adopted criteria for us to assess the operations in place. Therefore, we applied standards for transaction justification, approval, support, documentation, and validation typically found within government fiscal operations. We selected a sample of 68 off-cycle payroll transactions and applied this standard criteria and found that 46 of the 68 off-cycle transactions tested at the central Payroll Group were inadequately supported or justified, and 18 of the 68 were not properly approved or authorized.

We reviewed various transaction types to determine if they included a reasonable level of support and documentation for justifying and verifying the action as is typically seen in government financial operations, such as: payroll action request form or other appropriate forms, supporting documentation—like a leave balance printout, adjusted time sheet, employee recognition award notification, or authoritative documents to justify a pay change or retroactive payment. Overall, we found inadequate and inconsistent support for transactions related to salary advances, bonuses, retroactive payments, and sick and vacation leave buybacks. Specifically:

- We did not find sufficient documentation supporting most of the 10 salary advances we reviewed, including essential aspects of the transaction such as the calculation used to determine the advance amount. Of the 10 advances tested, at least 8 were not properly approved. In addition to those 10 advances, one other salary advance we reviewed was not even signed by the requesting employee, but rather signed by the respective department payroll representative.
- In 3 of the 4 bonuses we reviewed, there was a lack of support justifying the award of the bonus; rather, these transactions were supported by only a spreadsheet listing the dates and amounts of the bonuses.
- Out of 8 retroactive pay transactions reviewed, 5 lacked appropriate justification. While most of these transactions did include a dollar calculation worksheet, no other justification or explanation describing the reason for the retroactive pay was present.
- Only a few of the buyback forms submitted by departments included a leave printout; however, 18 of the 21 transactions reviewed did not include all relevant data to support days/hours to be converted to cash along with the dollar value of the payment.

Moreover, in addition to these issues, we conducted additional work to independently verify whether the amounts of leave bought-back complied with relevant MOU provisions. Nonetheless, of the documents we obtained from the central Payroll Group, none of the 8 sick leave buybacks or the 13 vacation leave buyback transactions contained support or evidence that the transactions had been checked for compliance with MOU or AI provisions or that the leave balances had been verified and the employee was eligible for the buyback.

Furthermore, our testing revealed inconsistencies in the processing of these sick leave and vacation buybacks. While all transactions included a completed “Buyback and Conversion Requests” form, as required by the AI, we found four different versions of the form. Also, we found that a “Payroll Adjustment Record” was not always attached to the buyback form processed. While the AI does not require a “Payroll Adjustment Record” to be included with the buyback forms, some of the forms we reviewed included instructions to the contrary. Thus, we are unable to determine if standard practice requires the buyback forms to be accompanied by a “Payroll Adjustment Record.” Nonetheless, whether Payroll Adjustment forms are required or not, the transaction should include some form of evidence that reflects that either the departmental payroll representative or the central Payroll Group employee checked the transaction to validate that the action complied with MOU or City rules and that the employee’s leave balance was verified. Thus, inconsistencies in the forms and lack of clear requirements for appropriate support and validation procedures do not facilitate a proper review of sick leave and vacation buyback transactions.

During our fieldwork, we noted that retroactive payments often lacked justification and support for significant amounts paid. For instance, we noted two employees received retroactive payments of more than \$15,000 and \$14,000, respectively. According to the payroll adjustment records maintained by the central Payroll Group, these employees were sports officials who were paid at an incorrect pay rate. Although the transaction was supported by a calculation showing the amount the employees were initially paid and the amount they should have been paid, there was no written justification or authoritative document provided to explain the underpayment and justify the higher rate, therefore supporting the transaction.

In addition to the five types of individual off-cycle payroll transactions tested and discussed above, we performed a limited review of certain payroll adjustments processed during four payroll cycles—7/16/04, 7/01/05, 6/30/06, and 12/29/06, at central Payroll. Our review of the off-cycle payroll transactions revealed similar problems to those we noted in our testing at the seven departments. In particular, we found an overall lack of supporting documentation, approvals, and organization of payroll batches. Specifically, 22 of the 34 additional transactions we pulled from the central Payroll Group files for review were not supported by appropriate documentation such as a payroll adjustment form, buyback/conversion form, or employee recognition notification or bonus award letter. This aspect of our testing focused on the oversight provided by the central Payroll Group and we looked to assess the level of support maintained within the payroll batch, and thus, we did not further inquire with the individual departments whether appropriate documentation resided at their locations. However, based on our interviews with staff involved with payroll processing at the City departments we visited, payroll representatives typically do not maintain supporting documentation or copies of documents submitted to the central Payroll Group for off-cycle transactions and many of the payroll adjustment records that were available at the central Payroll Group lacked the appropriate signature of the designated department official.

Moreover, we could not find evidence that staff at the central Payroll Group were appropriately overseeing and monitoring transactions to ensure consistency,

appropriateness, and adequate support. Specifically, we found few formal procedures stipulating the central Payroll Group to review each transaction for appropriate authorization, justification, and support, or requiring evidence documenting that due diligence was performed and the transaction appropriately executed and dated. Since existing practices do not require departments to provide or retain evidence of validating and verifying transactions, there is no assurance that departments are adhering to even the informal requirements for payroll transactions. Without establishing clear roles, responsibilities, and expectations for departmental payroll representatives and the central Payroll Group requiring the verification of transactions and maintenance of supporting evidence, the City is not assured that the appropriate party is performing the required due diligence to verify and validate off-cycle payroll transactions. As a result, the City cannot be assured that these transactions are appropriate and valid; thus, undermining its controls and weakening its accountability.

Past Practices Related to Controls Over Salary Advances Are Likely to Result in City Losses

The City's central Payroll Group handles a large variety and volume of payroll activities and transactions that create opportunities for inadvertent errors or payroll abuses to occur particularly in the absence of internal controls such as formal payroll guidelines and procedures. Our audit found that the City's past practices of granting salary advances, referred to as "early release of paychecks," to its employees resulted in some payroll abuse. The City granted repeated advances to a number of employees without requiring appropriate documentation or verifying whether sufficient leave time was available for the salary advanced. Further, it allowed prolonged payback periods resulting in what could be considered an interest-free loan program to employees. We believe these problems occurred because the City has few written policies or procedures in place to ensure that salary advances were properly processed and collected. While Finance and Management Agency officials have recently taken steps to more closely monitor and control these advances, past practices have left the City at risk of losing funds due to a number of long-outstanding unpaid advances.

In general, the amount of a salary advance should be based on documented hours worked or the demonstration of leave balances sufficient to cover the amount of salary to be advanced. However, we found several instances where the City granted advances without documenting the basis for the amount. During the period of our review, the City granted 294 salary advances to 134 employees for a combined total of \$560,414. While attempting to validate the appropriateness of several of these transactions, we discovered that a number of employees received advance amounts that were not based on actual hours worked—rather, advances were granted with little or no explanation or documented justification. Even though MOUs and AIs provide for salary advances when an employee is about to go on vacation (provided the employee is not on direct deposit) we found no evidence requiring payroll staff to verify that vacation leave balances were sufficient to cover the advance amounts requested. In one example, in 2006 an advance of \$4,400 was granted to an employee who offered no justification as to why the advance was needed. In fact, the amount of this advance exceeded that particular employee's regular bi-weekly earnings by \$1,300, or 42 percent.

Moreover, we noted 11 employees who received several salary advances during our period of review. Many of these advances were issued in the same year and occurred over sequential pay periods. In essence, the City's salary advance program was functioning as a short-term interest-free loan program.

Our review further revealed at least 42 current and former employees had long-outstanding salary advance balances. In particular, we found that, as of the end of our fieldwork, these employees still owed the City approximately \$68,000 with these transactions dating back at least two years and many going back more than six years. Our research suggests that in some cases, employees may have either been granted a duplicate advance in which only one advance was subsequently repaid or an incorrect repayment amount was recovered and posted. As subsequent advances were paid out to those employees, the unpaid balances simply remained outstanding. We also noted that 18 of the 42 employees who had outstanding balances as of June 2007 are no longer active employees of the City of Oakland. Since the ability of the City to collect these amounts is uncertain—especially from former employees—at a minimum, the City is at risk of losing that portion of the balances owed by former employees—almost \$26,000, or 38 percent of the outstanding balance.

Although the City has some policies addressing salary advances, the City's rules found in Administrative Instruction 556 (*Early Release of Paychecks*), lack the protocols and guidance for the appropriate processing and repayment/collection of advances. AI 556 sets out three conditions for granting salary advances: (1) absent from work on the employee's normal payday due to Management Leave, compensatory leave or vacation for at least five consecutive working days; (2) performance of work at an off-site work assignment or City related business travel on a normal payday; or, (3) need for an emergency advance, subject to approval. Neither AI 556 nor the City's MOU agreements establish guidance as to how much may be advanced to an employee on a given occasion or provide any directions for calculating the appropriate amount of such payments. Additionally, the City has no procedures in place to document and verify that the requesting employee has sufficient vacation leave hours or has already worked the time to cover the requested amount of salary advanced. Furthermore, neither the AIs nor the City's collective bargaining agreements specify how many advances may be granted to an individual during a calendar or fiscal year.

During the course of this audit, however, we noted the City Treasury Manager took steps to recover some of these overpayments to employees. Specifically, in April 2007 she sent a memorandum to at least one employee informing of an "erroneous" payment issued and setting out the employee's options related to the central Payroll Group actions to begin collecting the outstanding amount. In addition, the central Payroll Group has implemented improved tracking and monitoring techniques to ensure employee advances are repaid in a timely and efficient manner. The Treasury Manager also indicated that all advance requests must now be approved by her, which has consequently reduced the number of individuals who request multiple advances. While these steps indicate positive developments in terms of issuing and collecting salary advances, these efforts will not adequately address the associated payroll problems we identified. The City

should develop, implement, and communicate formal written policies and procedures that establish the parameters ensuring salary advances are properly granted, processed, and collected.

Seasonal Workers are Maintained as Active Employees in the Payroll System Year-Round

As previously discussed, we noted that the City appears to have appropriate segregation of duties over standard payroll functions including timecard entry and payroll run processing. We noted, however, an issue related to part-time and seasonal employees who periodically leave and return to City employment. Specifically, during interviews with staff at various departments, we learned that the City employs temporary, part-time, and seasonal employees at various times throughout the year. City departments have reasonable rationale for retaining seasonal employees as “active” during the time they are not working for the City as it eliminates the need for employees to go through the employment process each time they return. Although, during the course of our audit nothing came to our attention suggesting abuse, with literally hundreds of employees entering and exiting the system each year the opportunity for inappropriate transactions to occur related to these employees increases.

For instance, the Office of Parks and Recreation employs numerous seasonal employees, such as lifeguards, recreation leaders, and sports officials during the summer months in order to staff recreational programs. During the off-season, these part-time employees “leave” the City and no longer receive compensation. If the employee returns to the City the following season to fill the same position, he/she does not need to re-apply; rather he/she simply notifies the department of their intent to resume working. However, during an employee’s period of inactivity (which can last many months), his/her status within the Oracle HR/Payroll system remains unchanged and the system recognizes them as an active employee. Currently, departments are not required to notify the central Payroll Group of an employee’s change in status and the lack of submission of a timesheet is the only evidence of an employee’s departure from the City. In each of the two months we reviewed, December 2006 and March 2007, more than 700 employees were in this “dormant” status. With these employees remaining in the system, and without diligent monitoring by either the departments or the central Payroll Group, the potential exists for inappropriate transactions to occur without detection and employees who never return to the City could remain on the payroll roster for years.

To manage seasonal, temporary, and part-time employees within the automated system, it is reasonable that when an employee reaches the end of the employment cycle, the responsible department should complete an exit process to retrieve items such as City property, keys, or pass-cards; this exit process should be expanded to include a step for the department to prepare a formal notice sent to the central Payroll Group notifying them of the inactive status of each employee. The central Payroll Group should establish a related protocol to highlight and monitor such employees to ensure no payroll activity occurs on their records until the employing department sends notification of the reactivation of that individual.

Conclusions and Recommendations

Business process controls and practices are essential to ensuring that transactions executed are appropriate, allowable, and consistent with City rules and MOU provisions. Our review revealed inconsistent practices across citywide off-cycle payroll transactions that increase the risk that inappropriate or inaccurate payments could be, or have been, issued. Standard operating protocols guiding staff responsible for processing all payroll-related transactions would help to mitigate such risks. While some improvements have been recently implemented, other improvements and further action is warranted to ensure City funds are appropriately handled.

To strengthen controls and improve operations regarding activities related to the City of Oakland's pay and compensation, we recommend the following:

1. The City needs to develop, disseminate, and follow a citywide set of comprehensive policies, procedures and protocols for administering all compensation-related activities.
2. The City needs to clearly establish the central Payroll Group as the primary control entity responsible for the accuracy, validity, and completeness of every payroll transaction. Additionally, the City needs to clearly define and communicate the specific roles, responsibilities, and duties of departmental and central Payroll Group staff involved in the various timekeeping and payroll activities.
3. The FMA should establish, maintain, disseminate, and require compliance with a timekeeping and payroll processing manual that sets out:
 - Processes, procedures, and protocols for conducting all types of payroll transactions.
 - Detailed rules and procedures requiring transactions to be adequately supported, justified, and approved.
 - Clear guidance for monitoring and verifying the propriety of transactions and compliance with City rules and MOU provisions.
 - Retention of documents.

A written manual would define the required documentation needed to justify transactions and declare the required authorizations; thus, setting forth to all parties the rules surrounding the action. For example, a detailed procedure for a leave buyback could encompass elements as proposed below:

- ✓ Clarify that payroll representatives are responsible for ensuring the payroll adjustment record is not only signed by the employee and the payroll representative, but is also supported by a leave printout and verification showing that the transaction was eligible under the terms of the applicable MOU. For instance, some leave buy-out provisions require that the employee take a minimum amount of leave in the prior year and retain a certain level of leave balance before they can cash-out; thus, each payroll representative should verify the eligibility and provide evidence to the central Payroll Group.

- ✓ Setting forth the components of a complete transaction packet such as including the “Payroll Adjustment Record” with supporting leave record printout from the Oracle application, would be required for submission to the central Payroll Group for processing.
- ✓ Since supporting detail would be provided by the individual departments, the procedures could then guide central Payroll Group processors to review the support, compare the department payroll representative’s signature on the “Payroll Adjustment Record” to the list of authorized department personnel, and execute the transaction in the Oracle HR/Payroll system.
- ✓ After successfully entering the transaction, the central Payroll Group processor should then indicate on the documentation his or her name, date completed, and noting any change, when appropriate.

Having clear guidelines, such as those suggested here, would not only better ensure that the transaction was appropriate and in compliance with the relevant rules and/or MOU provisions, but would streamline the process as the work would only be done once—at the department level—and the central Payroll Group could be tasked with reviewing, verifying, and executing the transaction. Importantly, the entire transaction packet should be retained by the central Payroll Group in a specified location and the records maintained in accordance with the City’s fiscal records retention policy.

4. Salary advance or “early release of pay checks” policies and procedures should be revisited to determine the purpose and related criteria for this benefit, including provisions for ensuring that the employee has worked the time that is being “released early” or has sufficient vacation accrual to cover the payment. AI 556 relating to Early Release of Pay and any new collective bargaining agreements should include the specific guidelines for requesting advances. FMA’s payroll manual should include guidance for determining the allowable amounts to be advanced and stipulate appropriate supporting documentation that should accompany the request to the central Payroll Group.
5. The central Payroll Group should continue its efforts to obtain repayment on outstanding balances and its efforts to improve tracking and immediate repayment of amounts advanced.
6. City personnel and payroll groups should work together to establish requirements for the activation and deactivation of seasonal, part-time or other intermittent employees. These protocols should ensure that the departments conduct formal exit reviews of leaving employees and report such departures to personnel and payroll. Central Payroll Group should establish a business process control to ensure that deactivated employees have no payroll activity until formally re-activated by the department.

Chapter 2. Guidance for Compensatory Awards is Incomplete and Practices Do Not Always Comply With City Provisions

Under administrative directives and certain provisions of labor agreements, the City has recognized some employees over the years with additional compensatory awards, such as Management Leave, Executive Leave, cash bonuses, and employee recognition payments. The justification for these benefits, some recommended by departments and most approved by the City Administrator, includes recognition of overtime worked, superior performance, and meritorious conduct. Certain administrative and contract provisions generally address the granting of these benefits, but in actuality, City administration retains control over the majority of these awards. These awards are not inconsequential—in total, for the years 2004 through 2006, the City awarded nearly \$388,000 in cash awards for employee recognition or job bonuses alone. Additionally, during the calendar years 2005 and 2006, the City granted Management Leave awards valued at \$1.4 million and \$1.6 million, respectively. Our review found that approximately 30 percent of Management Leave awards were required by provisions included in MOUs. Further, some managers were awarded Executive Leave totaling more than \$97,900 over the three-year period. Finally, the City pays nearly \$700,000 annually for automobile allowances to 238 employees.

With full employee compensation including pay premiums, employer tax costs, and retirement contributions totaling in excess of \$589 million for the 2006-2007 fiscal year, the City's employees are afforded a variety of benefits such as health and other insurance, retirement, and paid sick, vacation, and holiday leave. In relation to employee compensation, during the period of our review we found:

- Management Leave awards averaged \$1.5 million annually, and in 2006, a significant number of these awards clearly exceeded collective bargaining agreement provisions or City rules by \$341,000. Moreover, the City granted Executive Leave awards to at least 10 executive managers valued at \$97,900 during the three years of our review and, contrary to City rules, allowed at least three other managers to carry forward such awards and use or cash-out these leave days.
- City practices afford liberal leave buyback options and do not enforce limitations stipulated within bargaining agreements and City provisions. As a result, employees sold-back at least \$3 million more in leave than allowed—\$2.5 million in vacation leave, \$113,500 of sick leave, and \$500,300 of Management Leave. Further, the City has few limitations on the buyback of other leave and existing processes allowed for an abnormality to go undetected.
- Payment of separate cash employee recognition awards and bonuses to 324 employees citywide ranged from \$75 to \$10,000 per individual award and totaled \$388,000 over the period of our review. We determined that little criteria exists for the award of these cash payments and central guidance is insufficient to ensure fair, uniform, and transparent award of these benefits.

- Monthly automobile allowances ranging from \$137.55 to \$750 per month are paid to an estimated 238 employees nearing a total of about \$700,000 per year or an average of almost \$3,000 per employee.

Compensation comprises a significant portion of the City's expenditures. As such, City officials must establish clear policies, procedures, rules and guidelines for administering and conducting these benefits and transactions. The City needs to revisit and refresh all payroll, benefit and other compensation-related Administrative Instructions and protocols and ensure that MOU provisions and City rules agree and are uniformly and consistently followed. To prudently manage expenditures and liabilities, the City needs to set definitive award and buyback criteria on the various types of leave. Further, rules and budgetary constraints need to be established for the award of employee recognition and bonus payments to ensure that they are made in a fair, consistent, and transparent manner. In addition, the City needs to review its policies and monitoring of automobile allowances to ensure that employees' work necessitates the use of personal vehicles for City business. Finally, City officials must be provided on an established, periodic basis, detailed fiscal information and reports relating to all compensation awards including those for City executives.

Annual Management Leave Awards Provide Some Employees Additional Compensation

Management Leave awards, by design, target upper-level City employees who cannot accrue overtime. City employees are allowed to use Management Leave for additional time off or they may cash-out a portion of this award for additional pay. The award of Management Leave is a generous benefit that creates a significant liability to the City whether employees take the extra time off or cash it out. In total, we estimate the value of this additional leave to be nearly \$1.6 million for 2006 and approximately \$1.4 million for 2005.

Management Leave was awarded to represented and non-represented employees working citywide. In 2006, the City granted more than 28,600 hours of Management Leave (approximately 3,800 days) to 322 non-represented employees and represented employees. This averages to almost 89 hours (or nearly 12 days) per person of additional vacation for the year. Similarly, in 2005, the City granted over 26,460 total hours of Management Leave—about 2,156 hours fewer than was awarded in the following year and to 6 fewer employees. Data revealed that on average, employees were granted about 11.2 days of additional leave time for the 2005 year; whereas, the average was higher for 2006, at approximately 11.9 days per person for the year. Table 2 reflects the distribution of Management Leave across the various City departments.

**Table 2: Management Leave Awarded Dollar Value by Department
Calendar Years 2005 and 2006**

	2005		2006	
	Dollar Value of Awards ²	\$ Percent of Total	Dollar Value of Awards ²	\$ Percent of Total
Administration ¹	\$418,500	29.2 %	\$478,700	29.5 %
City Attorney, City Auditor ³	\$279,300	19.5 %	270,700	16.7 %
Police and Fire	\$161,400	11.3 %	\$196,000	12.1 %
Public Works	\$252,300	17.6 %	\$274,100	16.9 %
Recreation	\$21,100	1.5 %	\$33,500	2.0 %
Library/Cultural Arts	\$75,600	5.3 %	\$82,100	5.0 %
Human Services	\$66,500	4.6 %	\$60,000	3.7 %
Community & Economic Develop	\$158,400	11.0 %	\$229,500	14.1 %
Totals	\$1,433,100	100 %	\$1,624,600	100 %

Source: Management Leave hours awarded provided by FMA.

1- Administration generally includes City Administrator's Office City Clerk, and FMA

2 - Dollar values were determined using actual hours awarded to individual employees and estimating related salary base using a mid-point for the position from the salary ordinance.

3 - This amount includes 2005 awards to 4 City Auditor staff of \$22,700 and awards in 2006 to one City Auditor employee of \$762.

*Table rounded to nearest thousand.

Policy Reflected in City AIs Conflicts With MOU Provisions

The City's formal guidance on the award of Management Leave is addressed in certain labor agreements, AIs, and in the Management Benefits Handbook. For instance, the MOU between the City and the Professional and Technical Engineers Local 21, AFL-CIO (Local 21 MOU) specifies parameters such as the entitled representation units, annual mandated amount of leave, cash-out rules, and the timeframe for using Management Leave. AI 516, which has been amended four times since July 2000 as well as the May 1997 Management Benefits Handbook provide guidelines for the award, use, and cash-out of Management Leave for non-represented employees. Generally, the City Administrator grants the Management Leave not mandated within the MOUs to eligible represented and non-represented employees in recognition of overtime worked and/or outstanding performance during the prior fiscal year.

In reviewing the City's rules, provisions, and practices related to Management Leave, we found conflicting provisions between the Local 21 MOU and the City's AI 516.

Specifically, *Section 9.12 Management Leave* (representation units UM1 and UM2) of the Local 21 MOU provides that:

- "Represented employees in representation units UM1 and UM2 shall be awarded five (5) days of Management Leave July 1 of each year" of leave. The awarding of such additional leave shall be at the sole discretion of the City Manager."

- “Additionally, represented employees who work irregular work hours or who demonstrate superior performance during the eligibility period of July 1 through June 30 of each year may also be awarded an additional zero (0) to five (5) days of leave. The awarding of such additional leave shall be at the sole discretion of the City Manager.”

In contrast to the Local 21 MOU that limits the total amount of Management Leave awarded each year to 10 days, AI 516 (that specifically includes two Local 21 representation units UM1 and later versions adds UM2 in its provisions) allows for the award of up to 15 days of Management Leave annually—five days more than the full amount allowed under the MOU provisions. Furthermore, the City designated employees in representation unit TM1 as one of the groups to receive annually the 5 days of mandated “Local 21 Awards” even though the MOU for Local 21, IFPTE—Deputy City Attorney Unit—does not include a stipulation for Management Leave and, in fact, is silent on the topic. We found that 27 employees in TM1 were awarded the week of mandated Management Leave in 2006. The relevant MOU does not specify these employees as eligible; however, AI 516 specifically includes this group as eligible for Management Leave.

Further, our research reveals that up until the February 2006 amendment of AI 516, both the Local 21 MOU and the City administrative rules determined that Management Leave was “use it or lose it,” and did not provide for unused time to be carried forward to future periods. However, the City Administrator amended the rule for Management Leave for awards related to the fiscal year ending June 30, 2005 and allowed for time to be rolled over. With this change, the AI became in conflict with the Local 21 MOU.

Many Awards of Management Leave Exceed MOU Provisions

During our review, we found that Management Leave for 2006 was awarded in accordance with AI 516 not the Local 21 MOU. As a result, the City granted more than the allotted 10 days of Management Leave to 144 Local 21 employees in units UM1, UM2, and TM2 and to another 23 employees in unit TM1. For that year alone, the amounts in excess of the prescribed 75 hours (10 days) stipulated in the MOU ranged from 2.5 to 37.5 hours per employee. As a result of awarding this leave in excess of contract provisions, the City incurred additional

Management Leave Awarded 2006	
	Dollar Value¹
Local 21 Awards per Contract (1 week yearly)	\$ 486,000 ²
Local 21 Discretionary Awards	\$ 450,000
Local 21 Awards Exceeding MOU Allowances	\$ 246,000
Non-represented Employee Awards (up to 75 hours)	\$ 347,000
Excess Awards for Non-represented employees	<u>\$ 95,000</u>
Total	<u>\$1,624,000</u>

¹Dollar values estimated using actual hours awarded (as provided by FMA) to each employee and applying a midpoint value of the base-pay for the related position from the City's Salary Ordinance.

²This amount includes "Local 21 Awards to TM 1 employees as reflected on reports provided by FMA.

Amounts rounded to nearest thousand.

liabilities valued at over \$246,000. Furthermore, the City Attorney opines that compensatory benefits, such as Management Leave, for unrepresented employees should mirror and not exceed those negotiated for the City’s represented staff. As such, we estimate that of the 71 unrepresented employees awarded Management Leave in 2006, 40 employees were granted amounts exceeding the two-week maximum negotiated during the bargaining processes, equating to about \$95,000.

Overall, of the total number of Management Leave hours granted in 2006, the City reports that about 9,263 hours, valued at over \$486,000, were awarded to 251 represented employees as mandated “Local 21 Awards.” This figure includes the nearly \$63,000 paid to the 27 IFPTE employees whose contract does not mandate such awards.

Our analysis also found that of the total 322 employees receiving Management Leave, 114, or over 35 percent, were awarded the full 15 days of additional leave, while another 147 were granted at least two weeks—with the majority of these individuals seeing 12 additional days added to their standard leave balances. Another 71 non-represented employees received the remaining hours of Management Leave granted during that year, totaling about \$442,000 in additional compensation costs. In total for 2006, City management discretionarily awarded approximately \$1.14 million in Management Leave.

Some Buybacks of Management Leave Exceed Allowances

Both AI 516 and the Local 21 MOU include provisions that permit Management Leave to be bought-back annually at the discretion of the employee. While the MOU is silent as to the amount of leave allowed to be bought-back, AI 516 restricted these buy-outs to 5 days per year until February 2006, when amendments to the AI increased the buy-out limits to 10 days per year for Management Leave awarded for the 2005 year and forward. Applying these provisions, our review disclosed that for the 3½ year period of our audit the City did not adequately enforce the prescribed ceilings on the amount of Management Leave buybacks. As a result, employees were allowed to sell-back significantly more leave than allowed under City provisions.

Table 3: Management Leave Buybacks: 1/1/04 – 6/30/07

	FY 03-04	FY 04-05	FY 05-06	FY 06-07	Total
Amount Bought-back	\$277,395	\$573,643	\$399,487	\$588,234	\$1,838,759
Number of Employees Exceeding Limits	49	135	38	32	254
Amount of Buybacks Exceeding Limits	\$95,048	\$239,079	\$93,901	\$72,321	\$500,349

Source: Data provided by FMA.

Specifically, between January 1, 2004 and June 30, 2007, as reflected in Table 3, our analyses revealed that over \$500,300 of the \$1.8 million bought-back, or 27 percent,

exceeded the City's maximum allowable limit for Management Leave buybacks. We found that 254, or 45 percent, of the buybacks exceeded the allowable limits set by AI 516 in place for the period. These buybacks averaged nearly \$6,500 per employee, with single buyback transactions ranging from a low \$143 to a high of more than \$13,074.

Even though the Local 21 MOU has been in place since July 1, 2002 and AI 516 has not materially changed until recently, we found that during the period of our review the application of the provisions related to Management Leave have been uneven and out of compliance with City rules. Moreover, the City's guidance proves unclear and, at times, conflicts with the City's labor agreements in terms of eligibility requirements.

For instance, one version of AI 516 (effective from 7/1/05 to 2/15/06) identifies only 10 representation units as eligible to receive and subsequently sell-back Management Leave. In particular, this more recent version of the AI added representation unit UM2 whereas prior versions did not include that unit. However, the Local 21 MOU (in place since July 2002) includes this group as a recipient of Management Leave. In addition, all four versions of AI 516 we reviewed identify employees in representation unit TM2 as eligible recipients of between zero and fifteen days of Management Leave and stipulate an option to sell-back up to five days. However, as previously discussed, there is no provision in the Local 21 MOU for employees in representation unit TM2 to receive Management Leave; yet, for the three-year period of our review, six individuals from TM2 sold-back more than \$58,000 in Management Leave. These transactions clearly suggest that employees from this labor unit were recognized by the City as eligible for Management Leave and thus, the AI appears to create an additional compensation benefit beyond that agreed-to in the Local 21 MOU.

Besides TM2, two other representation units, UN2 and FQ1, had employees who sold-back Management Leave, but were not included among the eligible groups listed in AI 516 as eligible to receive (and sell-back) such leave. Although the combined amount cashed-out by employees from these two units was more than \$39,000, or 2 percent of the total, their presence within our population of Management Leave cash-outs suggests the City is awarding these additional benefits to employees without closely applying applicable criteria as defined in the City's policies and labor agreements. According to the City's Treasury Manager, representation unit UN2 is a newly created unit for the Police Captains and Deputy Chief. This unit was previously classified within representation unit PP1; yet, according to Article II.E of the Police Officer's MOU these employees are not eligible for overtime compensation—hence, these employees were eligible to receive up to 10 days of Management Leave each fiscal year. Nevertheless, there are no provisions in either the Police Officer's MOU or AI 516 for members of representation units PP1 or UN2 to sell-back Management Leave. Similarly, we identified two employees from the Fire Department representation unit (FQ1) who sold-back Management Leave. Again, neither the Local 55 MOU nor AI 516 mentions employees from representation unit FQ1 as eligible to receive Management Leave, let alone the conversion of that awarded time into cash.

Rules for Granting Executive Leave Awards Were Not Always Followed

City directives in place during the period of our review state that Executive Leave is intended to provide leave time for new executive management employees who enter City employ with no leave time, as well as allow the award of this leave to executives in-lieu of salary bonuses. For example, in 2006, eight executives were awarded 10 extra days and one employee 5 days of Executive Leave—costing the City over \$60,300. In total, for the three years of our review, at least 145 Executive Leave days were awarded with a value of nearly \$97,900. Further, while City provisions specifically stipulate that this leave may be granted at any time, it must be used by June 30 of each year or forfeited and that this leave may not be cashed out. Nonetheless, we identified at least 3 executives who were allowed to roll-forward Executive Leave over several years and either used this leave or cashed it out.

Although officials from the Finance and Management Agency provided a listing of Executive Leave for 2006, they were unable to provide a listing for the two prior years. Nonetheless, other data we gathered during our audit, while not definitive, provides a reasonable estimation for this benefit for 2004 and 2005. Thus, we estimate that for the three years, at least 145 days of Executive Leave was awarded to 10 individuals. A summary of the value of these awards are as follows:

- In 2006, nine employees, 85 days valued at \$60,340
- In 2005, six employees were awarded 30 days amounting to over \$18,500
- In 2004, five employees were granted 30 days valued at over \$19,000.

According to the Management Benefits Handbook dated November 1997, one of the only related authoritative documents in place during the period of our review, Executive Leave was envisioned to afford “Department heads new to City employment...an added week of vacation until they begin to accrue three weeks of vacation per year.” The AI related to Management Leave (AI 516) that appears to cover 2004 and 2005 was silent in terms of Executive Leave; however, this AI was amended in February 2006 and was expanded to discuss this benefit. Specifically, under the amended AI, the granting of Executive Leave could be used as a hiring incentive by allowing the City Administrator to award up to 14 days to new executive management employees entering City employment with no leave time, but also Executive Leave (up to ten days) could be awarded in-lieu of a salary bonus.

Both the Management Benefits Handbook (and the revised version issued in March 2007) and AI 516 stipulate that this leave must be taken as time off in the year awarded and may not be carried forward or converted to cash. However, we identified at least 3 executive employees who, according to the City Administrator, were awarded Executive Leave prior to 2004 but were allowed to roll this benefit forward into 2004, 2005, 2006 and in some cases 2007 and was either used or converted to cash.

It appears that, in practice, the City expanded the parameters for awarding Executive Leave prior to the amendment of AI 516 for 2006. In particular, the Management

Handbook in effect until March 2007 stipulates that “Executive Leave gives department heads an added week of vacation until they begin to accrue three weeks of vacation per year.” City provisions state that management employees earn two weeks of vacation during their first four years of City service and add a third week in year 5. Thus, employees with 5 years of service (and leave accruals of 3 weeks or more) do not appear to be eligible for this award. Our review reveals that in 2004 five executives were awarded this leave—three had hire dates within 5 years whereas the other two had long tenures with the City. Similarly, in 2005, the same three “newer” employees were awarded another week’s leave, while the same two other employees with more than five years of service were also again afforded this benefit. Finally, in 2006 when the new AI provisions can be applied, 4 of the 9 recipients qualified as “new” employees whereas the leave granted to the remaining staff would have to qualify as leave “in-lieu of salary bonuses.”

Buyback of Employee Vacation and Sick Leave Exceed Allowances

In addition to other compensatory benefits, such as cash bonuses, Management Leave, and executive vacation, the City also allows its employees to “sell” portions of unused leave back for cash. This policy is spelled-out in several of the City’s labor agreements as well as in relevant AIs. However, we identified weaknesses in business processes relative to the administration and oversight of employees selling back vacation and sick leave whereby employees were allowed to sell-back leave in excess of allowable amounts. Further, we found that even employees not eligible to sell-back this leave time were permitted to do so and received cash compensation.

We found that different provisions apply to the buyback of vacation leave depending on the employee’s representation unit. For instance, MOU for Local 21 provides that employees represented by that agreement may generally sell-back up to fifteen days of accrued vacation each calendar year. By contrast, employees covered by Local 790’s MOU and, Local 1245, are permitted to sell-back up to ten days of vacation each calendar year. However, those employees in Oakland Park Rangers Association may only sell-back up to five days. While AI 545 generally agrees with MOU provisions, the vacation buyback rules for unrepresented employees are unclear. Specifically, AI 545 states that “approvals [for non-represented and executive management employees] are made on a case-by-case basis. Authorization is given by either the Treasury Manager, Finance Director, or City Administrator.” In contrast, the “Management Benefits Handbook,” published in 1997 as the City’s guide for non-represented and executive management employees, stipulates that employees “may choose to be paid for up to five days of vacation instead of taking the days as vacation time.”

Furthermore, in many instances employees must meet certain criteria to sell-back vacation depending upon their representation unit. According to AI 545, eligible City employees may receive pay for a designated number of accrued vacation days, instead of taking the time off work. In general, the City pays out vacation leave on a one-to-one ratio, whereby each hour of leave sold-back is equivalent to one hour of regular pay. In most cases, employees are considered “eligible” to sell-back unused accrued vacation leave when they have taken at least ten days of vacation in the preceding year. However,

certain bargaining agreements set additional conditions for employees regarding eligibility for buybacks. For example, the Oakland Park Rangers Association requires employees to have at least ten days of accrued vacation leave at the end of the calendar year and have at least five days of vacation leave left in his/her balance after the buyback has occurred.

Our review found that City employees sold-back significant amounts of vacation time. Specifically, during the three-year period of our review, the City processed 2,737 vacation leave buyback requests for 889 employees with a combined value of approximately \$6 million. As the most frequent and costly of all buyback transactions handled by the City's payroll staff, vacation buybacks generally constitute a significant component of the City's off-cycle "supplemental" payroll runs. Specifically, in just two sampled months, December 2006 and March 2007, we noted that vacation buybacks comprised nearly 25 percent and 27 percent, respectively, of the total value of supplemental earnings processed by the central Payroll Group.

In general, employees wishing to sell-back a portion of unused leave time are instructed to provide a "buyback" request to their designated departmental payroll representative who, in turn, submits the form to the central Payroll Group in order to generate the payment. However, our review identified inconsistencies in the business processes in administering and overseeing the selling back of vacation and sick leave, allowing employees to sell-back leave in excess of stipulated limits. Further, we found that even employees not eligible to sell-back this leave time were allowed to do so and received cash compensation.

Specifically, our audit disclosed that, when employee's records for these leave buybacks were combined for a full year, the total of the vacation buybacks requested and paid by the central Payroll Group exceeded individual allotted limits as promulgated by the City's labor agreements and AIs. As a result, we noted that approximately \$2.5 million of the \$6 million paid out to employees, or 41 percent, exceeded the intended ceiling set out by the City and collective bargaining agreements.

While the distribution of employees who sold-back more vacation leave than allowed is relatively consistent across representation units, employees from two representation units (FQ1 and PP1) sold more than \$1.2 million of vacation leave—even though the City has no provisions permitting this benefit to these two groups. These two representation units relate to the City's sworn Police (PP1) and Fire Officers (FQ1), represented by the Oakland Police Officers' Association and the International Association of Firefighters Local 55, respectively. Provisions of these MOUs are silent to selling back vacation. However, AI 545 (version effective through December 28, 2006) specifically addresses only "non-sworn" employees and the subsequent version of the AI cites that Local 55 and Oakland Police have "no provision" and vacation buy-out is "not applicable." Nonetheless, the existing payroll business processes allowed employees in the ineligible representation units PP1 and FQ1 to sell-back vacation. Specifically, in 2004, the central Payroll Group processed 96 vacation buy-out transactions for these two groups totaling over \$506,800. In 2005, only one transaction of approximately \$1,900 was processed for Police Services, but 54 transactions occurred for Fire Services employees totaling nearly

\$488,600. Further, in 2006, 14 Fire Service transactions took place for over \$168,200 in vacation leave buybacks. For instance, an employee from FQ1 sold-back 1,200 hours of accrued vacation time for a single gross payment of \$43,094.

Similarly, our analyses show that the City bought-back more sick leave time than allowed by MOU provisions. For the three-year period from July 2004 through June 2006, the City processed 410 sick leave buyback transactions for 243 employees with a combined value of over \$633,500. In particular, we noted that employees from 15 different representation units converted sick leave to cash—all of which were covered by the same blanket provisions that allow employees to do the following:

1. Continue to accumulate sick leave credits up to the 150-day maximum;
2. Convert unused sick leave earned in excess of 60 days to vacation at a ratio of two 2 sick days to 1 day of vacation up to a maximum of 6 vacation days; or
3. Convert unused sick leave earned in excess of 60 days to cash at a ratio of 2 sick days to 1 day of pay up to a maximum of 6 days of pay.

Despite the consistency of sell-back provisions across the City's labor agreements and with other related City guidance applicable to non-represented and executive management employees, we noted that sick leave bought-back by the City exceeded these rules. Specifically, our audit revealed that \$113,525 of the \$633,530 paid out in sick leave buyback conversions, or 18 percent, were in excess of allowable annual limits.

While the majority of the excessive buybacks resulted from employees requesting multiple buybacks during a single calendar year, we also found a number of single transactions that alone exceeded allowable limits. For example, we noted one employee from the Public Works Agency in representation unit SC1, who sold-back 480 hours of sick leave. Existing rules under the related MOU for Local 790 allow for a maximum of 12 days, or 96 hours of sick leave to be converted to vacation and sold-back for cash. This employee was allowed to sell-back 480 hours or 60 days of sick leave totaling approximately \$6,300. That single transaction was 5 times more than the ceiling stipulated within the MOU. We also noted other single occurrences where sick leave buy-outs exceed allowances by as much as 90 to 180 hours without detection. We noted however, that the number of sick leave buybacks processed during 2006 markedly decreased. Nonetheless, this issue warrants continued monitoring and improvements in the related business processes.

Given the variety of leave buyback options available to City employees, there are significant opportunities for individuals to enhance their total compensation beyond provisions set forth in the City's salary ordinance, especially when allowable buyback limits are exceeded. Moreover, there is a lack of clarity, uniformity, and consistency of who may or may not sell-back portions of unused leave time. Not only has the central Payroll Group allowed employees to sell-back significant amounts of leave time beyond the limits set by the AI and MOUs, they have also allowed the sale of leave time by employees who apparently are not eligible to exercise the buyback option.

Further, our tests also revealed that City staff did not always ensure compliance with other MOU and administrative provisions. For instance, we noted that although there are ceilings on sick and vacation leave accumulations that were established in bargaining agreements, there appears to be no effective mechanism to monitor those balances and stop the accrual of the leave once ceilings are met. Moreover, although some MOUs and City guidance stipulate that sick or vacation leave may be sold back only during a certain month of the year, the City does not enforce those provisions and allows buybacks year round. Thus, these and other business process inconsistencies we noted within the control environment over the payroll system allow for a compensation regime that does not adequately protect the City's interests.

The City Applies Few Limits to "Other" Leave Buybacks

As previously discussed, MOUs and AIs reflect the criteria that should guide and limit the buyback of leave. While these rules are designed to establish clear limits and conditions for sick leave, vacation, and Management Leave buybacks, few guidelines exist that relate to other types of leave afforded to employees. Specifically, it appears little guidance exists for the buyback of floating holidays, holiday vacation days, Extra Vacation Day, or other time-off awarded. While MOUs and the Management Handbook discuss the award of these benefits, no guidance exists on whether these additional leave days can be converted to cash.

The central Payroll Group treats these days as it does other leave time and allows for the selling-back of these benefits on an hour-for-hour basis. With this lack of clarity and formal directions for the application of these compensation benefits, the City cannot be assured that such benefits are applied fairly and uniformly to all employees. Moreover, given that buy-outs affect the City's cash flow, some monitoring of these "other" transactions is appropriate and prudent.

Existing Processes Allowed an Abnormality to Go Undetected

Because there is no tracking or validation mechanism in place at either the individual departments where the buyback transaction is initiated or with the central Payroll Group, the City cannot assure that buyback requests meet the specified criteria or remain within allowable annual limits. While it is unclear whether the department payroll representatives are responsible for validating an employee's eligibility, we found that the central Payroll Group simply processes the transaction through the Oracle HR/Payroll system which automatically calculates, based upon the amount of time input, the amount to be paid to the requesting employee. However, the automated system is not equipped to monitor these transactions on a cumulative or annual basis, which essentially allows multiple buyback requests from individual employees to go unnoticed. More importantly, the City's processes do not require reasonable evidence of verifying that each transaction, when taken in full context of a year's activity, is appropriate.

The City's lack of requirements to prove verification and instill prudent documentation and validation processes have not only allowed excess payouts of sick, management, and

vacation leave, but also have failed to detect abnormal transactions and balances. In particular, the City provides an “Extra Vacation Day” as a retention bonus for employees reaching certain milestones in their tenure with the City. Under provisions of the MOUs and Management Handbook, Extra Vacation Days are awarded to employees reaching 5 year anniversaries—the award of one extra day in each of the fifth, tenth, fifteenth, twentieth, etc. year of service. We could not identify any other basis for awarding this leave.

During the course of our audit we identified certain payroll transactions that appeared out of the ordinary and related to these Extra Vacation Days. Our research into the payroll records of four employees with such transactions revealed that three of the four cases had reasonable explanations. In the fourth instance, we found a significant exception—an executive employee was awarded 22 Extra Vacation Days over a 14-month period. Generally, during these months, the employee was awarded one day in each pay period. However, in March 2007 the employee was awarded eight Extra Vacation Days. The individual left City employ in April 2007 and, according to City management, was paid out the entire 22 Extra Vacation Days valued at more than \$17,000. The City Treasury Manager stated that a system “glitch” allowed the posting of these awards and that the volume of work prevented central Payroll Group employees from detecting this anomaly.

However, we find that this occurrence further illustrates the problems with the business process control environment related to off-cycle payroll actions—particularly in the areas of leave buy-outs. While departmental payroll representatives may not have the needed level of access to an employee’s file to fully verify a buy-out or termination payment, the actions taken at the department level should be documented and evidence of those activities, such as printing the appropriate supporting schedules, should be attached to the “payroll action document.” Especially in terminations, protocol should require that the central Payroll Group analyst fully review the employee’s payroll record to identify all eligible balances to be paid out, but also to assess the various balances for reasonability and accuracy. Such a review of the employee’s file in this case would have revealed an extraordinarily large balance in the leave code for Extra Vacation Days.

The City Treasury Manager cited the cause of this instance to be a system glitch; as such, the City should fully investigate this situation to identify whether any other employees were similarly impacted. Further, such a system problem is troubling from a control view point and could be costly to the City if not diagnosed and rectified.

Without appropriate controls, both at the departments and the central Payroll Group, to monitor and require compliance with administrative rules and negotiated agreements, the City cannot ensure the integrity of the off-cycle payroll business process and appropriately protect City assets.

Little Guidance Exists for the Award of Cash Bonuses

During the period of our review, the City issued a number of bonuses to City employees. As noted earlier in this report, Management and Executive Leave awards apply primarily to supervisory, and management level employees. However, the City awarded bonuses

and employee recognition cash payments to individuals in a variety of job classifications and representation units. Specifically, our audit revealed the City provided 384 cash recognition awards and bonus payments to 324 employees during the period of our review. These one-time payments ranged from \$75 to \$10,000.

We found that City administrative guidelines and rules for cash awards and employee recognition payments are dated, non-specific, and left largely in form and practice to various City executives. Specifically, while it appears that the City Administrator must approve all awards, the parameters for making such awards were generally left to the discretion of the departments.

In practice, it appears that bonuses are separated into two areas: employee recognition awards, which originate at departments, and bonuses determined by the City Administrator. We conducted further analysis to ascertain the amount of the awards, related employing departments, and job classifications and representation unit of employees receiving the awards.

Table 4 illustrates the dispersion of the bonuses by amount over the three calendar years 2004 through 2006. As shown in the table, the vast majority of individual payments were relatively small—264, or 64 percent, of the payments were less than \$800. Moreover, when further reviewed, 88 percent were concentrated in amounts \$1,500 or less. Specifically, 338 of the 384 individual payments ranged from \$75 to \$1,500—reflecting an average of \$609 per payment. In fact, the lower level payments were most prevalent with 150 payments in the range of up to \$500 and another 71 bonuses for \$600 provided primarily to non-management employees.

**Table 4: Dispersion of Bonus Payments by Amount
Calendar Years 2004 – 2006**

Amount of Bonus	Number of Payments	Dollar Amount of Payments	Percent of Total Payments
\$75 - \$1,000	246	\$101,045	26.1 %
\$1,000	49	\$49,000	12.6 %
\$1,001 - \$1,499	31	\$37,947	9.8 %
\$1,500 ¹	12	\$18,000	4.6 %
\$1,800 - \$2,000 ¹	10	\$19,407	5.0 %
\$2,001 - \$4,999	19	\$62,198	16.1 %
\$5,000	14	\$70,000	18.1 %
\$10,000	3	\$30,000	7.7 %
Total for the Periods	384	\$387,597	100 %

Source: Data provided by FMA and obtained from individual Oracle pay records.

¹ No awards were given out for amounts between \$1,501 and 1,799.

We also analyzed the bonus payments by department. As reflected in Table 5, some employees working in all departments received bonus payments. However, the Administration section, which includes the City Administrator, City Clerk, City Attorney,

and the Finance and Administration Agency, received over \$170,000, or more than 44 percent, of the nearly \$388,000 bonuses paid in during the three-year period. Public Works Agency employees received over \$100,000 of bonus awards or nearly 26 percent of the total. Thus, approximately 70 percent of the bonuses paid went to employees in Administration and the Public Works Agency.

Table 5: Total Amounts of Bonuses by Department

Department	Less than \$1,000	\$1,000-\$2,000	\$2,001-\$4,999	\$5,000	\$10,000	Total Bonuses by Dept.	Percent of Total
Administration*	\$39,525	\$ 44,689	\$46,305	\$30,000	\$10,000	\$170,519	44.1 %
Public Works	\$55,470	\$ 35,072	\$ 4,894	\$ 5,000	-0-	\$100,436	25.9 %
Police and Fire	\$ 5,850	\$ 22,407	\$11,000	\$ 5,000	-0-	\$ 44,257	11.4 %
Library and Arts	-0-	\$ 8,300	-0-	\$10,000	-0-	\$ 18,300	4.7 %
Parks & Recreation	-0-	\$ 5,200	-0-	\$ 5,000	-0-	\$ 10,200	2.6 %
Community & Econ. Develop	\$ 200	\$ 6,487	-0-	\$ 5,000	\$20,000	\$ 31,687	8.2 %
Other	-0-	\$ 2,200	-0-	\$10,000	-0-	\$ 12,200	3.1 %
Totals	\$101,045	\$124,355	\$62,199	\$70,000	\$30,000	\$387,599	100 %

Source: Data provided by FMA and obtained from individual Oracle pay records.

*Administration generally includes City Administrator and FMA; includes one bonus payment within City Attorney's Office and one within City Clerk's Office.

We also analyzed the dispersion of bonuses by representation units. Of the 324 employees awarded bonuses, 23 were non-represented "management" employees from 6 representation units and 301 were represented employees in 13 representation units. For example, the ten employees in the UK1 representation unit, Executive Management, received more than \$74,000 (or nearly 19 percent) of the bonuses during the period and reflect the highest dollar average approximating \$7,400 per person.

Not all executives were awarded such sizable bonuses; for example, one received a single bonus of \$1,000. Yet, others were larger with five executives receiving \$5,000 payments and two of these individuals receiving bonuses in both 2004 and 2005. Three executives were also awarded \$10,000 bonuses—one of whom was also awarded a \$5,000 bonus in the previous year. Outside of this representation unit, another 6 employees were awarded \$5,000 bonuses in at least one of the three years we reviewed:

- Two from TA1
- Two from UM1
- One from U31
- One from TW1

Twelve other City employees, primarily from 6 other representation units were granted bonus payments ranging from \$2,322 to \$4,296. Overall, bonuses in amounts ranging from \$2,322 to \$10,000 were awarded to 26 individuals and amounted to nearly

\$162,200, comprising nearly 42 percent of the total bonuses awarded during our period of review.

Although the City has paid out approximately \$388,000 in bonuses and employee recognition awards over the three years we reviewed, we found that City administrative guidelines and rules for cash awards and employee recognition payments are dated, non-specific, and left largely in form and practice to department heads and the City Administrator. For example, labor contracts do not address the award of bonuses (although one Memorandum of Understanding does discuss Extraordinary Service Pay for one representation unit), the most recent AI 549 on the Interim Bonus Program, dated December 3, 1986, only partially relates to the topic. In addition, the Fiscal Years 2005-2007 Adopted Policy Budget includes a provision for "Employee Recognition" within its program for Citywide Activities, but only \$35,000 is earmarked for these payments.

Even though existing provisions stipulate that the City Administrator must approve cash awards, the parameters for making employee recognition awards were generally left to the discretion of the departments. In particular, of the seven departments we visited, three had formal guidelines and the others applied informal approaches in the award of cash bonuses. We found that employee recognition awards appear to roughly follow the dollar limits reflected on AI 549, which range between \$500 and \$1,500. For instance, the Department of Public Works cites awards from \$600 to \$1,500, whereas, the Police Department sets out criteria for awards of \$100, \$500, and \$1,000. Officials from the FMA informed us it grants awards up to \$2,000. These three departments provided us assorted written guidelines and processes established for nominating staff for employee recognition award, while the other four departments cited following informal City rules. In addition to department awards, the City Administrator also requests annually that departments provide nominations for "Employee of the Year" recognition.

With these varying practices and little formal or authoritative guidance over bonus awards, it appears that the City Administrator has exercised significant discretion and latitude in determining and granting bonus without having the clear authority to do so. During the period of our audit, we found not only a broad range of bonus amounts, but also that some employees received multiple awards—some in the same year, some in different years. Further, these bonuses were granted to both non-represented personnel, and rank and file employees.

Given the sensitivity and cost of employee recognition awards and cash bonuses, appropriate direction needs to be established by City officials and formal guidance and procedures established by the City Administrator. Departments should then be required to follow such provisions. As previously stated, the City has issued very little guidance in terms of employee recognition awards and cash bonuses. Further, even though some departments did establish some guidance, other than the long-outdated AI 549, the only memoranda we located was sent from the City Administrator to departments soliciting nominations for Employee of the Year awards. The City did not provide criteria for other cash bonuses.

Because these bonuses and awards prove to be significant expenditures of the City—approaching \$400,000 in total over the three-year period—the City should establish some formal direction and instruction for the award of the various levels and types of bonuses to ensure department officials understand and uniformly follow the same set of standards. Further, employees should be fully aware of such awards and opportunities to earn recognition for superior performance and effort. Additionally, the City Council should request that the City Administrator provide a listing of all individuals recognized each year and consider establishing a bonus pool during the budget process to set aside sufficient funding to cover amounts paid.

Automobile Allowances Should be More Closely Monitored

In addition to the City’s various other compensatory benefits, a number of employees also receive automobile allowances. These allowances are granted to employees to “facilitate the transportation of City officials and associates conducting City business, such as attending community meetings, professional training and development, off-site inspections and field work, and other officially sanctioned City business.” For instance, for Fiscal Year 2006-2007, the City paid out approximately \$700,000 to employees who have been approved to receive a monthly automobile allowance. According to the City’s Treasury Manager, there are currently 238 employees who receive this monthly allowance, ranging from \$137.55 to \$750 per month. Specifically, the City’s AI 4403 (last updated October 2000) details four specific “categories” of employees who are eligible to receive auto allowances as shown in Table 6.

Table 6: Auto Allowance Categories and Eligibility

Category	Eligible Employees
Category I	Provides a monthly allowance to the Mayor, Vice Mayor, City Council Members, City Manager, City Attorney, and City Auditor.
Category II	Provides a monthly allowance to designated employees in representation units UK1, UM1, U31, and U41, including City Manager’s executive staff, agency heads, department heads, assistant or deputy agency directors, division managers and others as recommended by the Agency Director or Department Head. The approving authority is the City Manager; or the City Attorney or City Auditor for associates within their departments.
Category III	Provides a monthly allowance to associates whose work assignment requires the use of a personal vehicle on a regular basis. The approving authority is the Agency Director or Department Head; or the City Attorney or City Auditor for associates within their departments.
Category IV	Provides mileage reimbursement to associates who drive their personal vehicles on an intermittent or occasional basis. The approving authority is the Agency Director or Department Head, City Attorney or City Auditor.

Source: Administrative Instruction 4403 (last updated October 2000)

The amount of an automobile allowance varies between these four categories as well. Under current provisions, automobile allowances are provided as follows:

- 129 employees receive \$137.55 per month
- 88 individuals and 8 managers receive \$350 and \$400 per month, respectively
- 11 managers receive \$550 per month
- 2 executives receive \$750 per month.

In total, these 238 automobile allowances translate to an average addition to each employee's compensation of nearly \$3,000 per year.

According to AI 4403, the City Council must approve the allowance rate for Category I employees, but the City Administrator has the authority to set the rate for Categories II, III, and IV. Generally, the rate for an auto allowance for represented employees is set by their respective labor agreements. Specifically, Local 21 (AFL-CIO) and Local 790 (SEIU) both include provisions in their agreements with the City for certain representation unit members to receive auto allowances "when required for official City business." To qualify for Category III status (\$137.55/month), represented employees must demonstrate to their department management that more than one-half of the employee's work schedule requires the use of an automobile. Category III employees not only receive the monthly allowance, but also receive mileage reimbursement for actual miles driven. Category IV serves to reimburse employees who use their vehicles intermittently or less than one-half of their work schedules at the rate established by the U.S. Internal Revenue Service.

Although automobile allowances are one of the compensatory awards that are clearly defined, the need for such allowances should be periodically revisited, particularly in a budget-streamlining environment. While employees in Categories I and II are generally afforded allowances by means of their position, employees allowed Category III allowances are need-based. However, it appears that little monitoring and oversight are exercised for these employees once awards are granted. According to City officials, claims for mileage reimbursement are indicative of actual business use of employee automobiles and, in many cases, Category III reimbursements for actual miles driven are low or non-existent. Officials also noted that it is likely that some employees receiving Category III allowances may no longer meet the criteria for such awards—using their automobile on a regular basis for one than one-half of the employee's work schedule.

Thus, the City should re-evaluate its policies related to granting auto allowances. Costs related to affording this benefit under Category I and II awards should be periodically reviewed to ensure that such awards are in the best interest of the City. Moreover, the City needs to establish monitoring and reaffirming processes for Category III allowances to ensure their work necessitates the use of personal vehicles and that employees receiving the allowance meet the established criteria.

Top Management and Elected City Officials Need Detailed Fiscal Information to Exercise Appropriate Oversight

Compensation and payroll comprises approximately 55.5 percent of the City's expenditures. As such, City executive management must establish clear policies, procedures, rules, and guidelines for awarding and administering these benefits and transactions. Further, executives need detailed fiscal information and the underlying supporting data to assist in their fiduciary responsibilities to oversee and manage City operations and personnel resources. Thus, it is essential that compensation and pay-related information be regularly communicated to the City Council, the Mayor, City Administrator, and other appropriate City executives to ensure that compensation and benefits are administered in a fair, transparent, and deliberative manner with the fiscal implications clearly defined.

Although many basic aspects of pay are predictable—salary ordinances set pay scales, tax code establishes payroll taxes, MOU's set premium and incentive pay, and the City Council agrees to cost of living raises—the City of Oakland also provides a number of additional compensatory benefits that impact these traditional cost factors. We found that the City does not appear to have the management information available to fully understand the implications of these costs and to proactively predict and monitor the exercise of such benefits. The implications of the granting of the various additional awards and the payout of such time, combined with other factors such as overtime, retroactive pay adjustments, premium pay, while individually may not be significant in terms of Oakland's billion dollar budget, when taken together are considerable.

For example, we conducted a limited review of gross pay for employees across all departments to analytically review the full amount of compensation individuals realized in 2006. Our review revealed that significant numbers of individuals—nearly 400 in 2006—had “gross” salaries exceeding \$150,000, even though only a small number of City employees have “base” salaries in that range. Therefore, due to the various supplemental elements for pay, City employees received significant additions to their base pay. In 2004, for example, we identified three non-sworn employees who earned in excess of \$200,000 while their base salaries were estimated at \$97,500. In fact, two of these three employees earned these amounts in each of the three years of our review. We found that overtime pay contributed to a major portion of these earnings, yet other premium pay items such as meal allowances and bilingual pay also bolstered these employees' take-home compensation. Although these employees appear eligible for these benefits under their respective labor agreements, the sheer fiscal implications of this compensation to the City warrant close monitoring and oversight by City leadership.

To further understand the implications of these additional compensatory activities, we reviewed leave and cash payment awards for a limited number of City management employees. We determined that many of these executives were awarded multiple leave and cash awards, even within the same year, with the pattern of awards suggesting that these employees have received these benefits in a number of years. Specifically, we identified 15 executives who were granted multiple leave awards and cash bonuses during the period of our review. Within this group, we found that 5 executives received Management Leave, Executive Leave, and a cash bonus all within the same year—

contrary to AI provisions. Thus, it appears that the City does not have mechanisms in place to review compensation in total, either prospectively or retrospectively, to assess the result of the combination of all the various additional factors awarded. Although the group of 15 managers we assessed is not comprehensive or complete, we believe that this group provides valuable insight into the implication to the City of the costs related to these various additional compensatory benefits.

For instance, for the 15 individual executives we reviewed, the total cash value of Management Leave, Executive Leave, and employee recognition/bonus payments is significant—nearly \$517,800 over the three years of review. These supplements to base salary ranged from nearly \$2,400 to over \$24,500 for a single year, averaging within this group of fifteen individuals additional compensation for these three elements alone of nearly \$11,800 per person per year.

As mentioned earlier in the report, we found varying types of additional compensation benefits were provided to management and other employees and these additional benefits were not always awarded and paid-out in a consistent manner or administered in compliance with City rules and MOU provisions. Further, there is little guidance for the award of such benefits and limited information available to City executive levels to oversee the award and costs of these additional benefits. Although the Director of Finance and Management Agency suggested that a City Council Report was issued that related to raises, bonuses, and other compensation matters for City management, this report could not be located. If indeed this report provides specific criteria or circumstances guiding the provision of additional executive compensation benefits, in addition to the related AIs or provisions of the Management Handbook, this guidance should be made available to relevant city employees and incorporated into a set of comprehensive compensation policies. City executives need to address the significant liabilities incurred for these various benefits and also be fully informed of the associated implications of cashing-out these awards in terms of cash flow concerns for the future.

Conclusions and Recommendations

Clearly, compensation and payroll comprise a significant portion of the City's expenditures. To appropriately deliberate, manage, and control the award and payout of all compensation elements, we recommend:

9. Practices surrounding the MOU process should be improved as follows:
 - a. During the collective bargaining process, the City should focus special attention on ensuring that provisions included in MOUs are aligned with administrative intent and policies and that MOUs are complete and accurate.
 - b. The City must also ensure that AIs and other administrative directives comply with terms of the MOUs and that provisions are not in conflict.
 - c. Any matters identified subsequent to the execution of these agreements should follow a formal process for City adoption and not be implemented by informal understanding.
 - d. City executives need to ensure that provisions and collective bargaining agreements are followed.
8. All payroll, benefits, and other related AIs need to be revisited and refreshed. In particular, City executive management should consider the various benefits allowed City employees—both represented and non-represented—and establish administrative guidelines and protocols for the award of all such benefits.
9. The City Council should approve and budget for all forms of compensation such as Executive Leave, Management Leave, and employee recognition and bonus awards. For each type of award of leave or cash payment, criteria and formal processes should be established to ensure transparency, fairness, and integrity of benefits. Furthermore, the City Council, along with the City Administrator, should establish a bonus pool during the budget process to set aside sufficient funding to cover all extra compensatory awards.
10. City officials need to formally determine, establish, and require compliance with policies and rules for awarding and cashing-out leave. Further:
 - a. Appropriate controls, both at the departments and within the central Payroll Group, must be established to require that departments demonstrate the verification of an employee's eligibility in terms of meeting MOU or AI provisions for buying-back vacation, sick, and other leave. This verification should be submitted with the request form to the central Payroll Group.
 - b. Department payroll representatives and the central Payroll Group need to establish rules for monitoring sick leave and vacation accruals to ensure balances do not exceed stipulated limits and that, once limits are reached, accruals of such leave is suspended.
 - c. For employee recognition awards, the City should centrally establish guidelines and criteria for the departments to follow in general, and

departments should refine these requirements to match the environment and personnel working within its jurisdiction.

- d. The central Payroll Group should ensure that all leave and other compensatory balances are fully reviewed and verified for reasonability and compliance with City and MOU rules.
 - e. Specific protocols and verification processes should be established and disseminated for payments related to termination pay to ensure that amounts paid out for leave and other compensatory awards are earned, reasonable, and supported.
11. During the collective bargaining process, the City should clarify whether employees should be able to buyback holiday, extra vacation days, Executive Leave, or other time awards. Further, the City Council should immediately evaluate City policies and practices related to such buybacks and the fiscal impacts of such policies.
 12. FMA needs to investigate how the Oracle HR/Payroll system allowed the posting of excessive numbers of Extra Vacation Days and ascertain whether this was an isolated occurrence or systemic issue. As such, FMA should review the payroll records to identify other records in the population that were affected by the problem. Moreover, the FMA should correct the system deficiency or institute mitigating controls.
 13. The City should re-evaluate its policy related to auto allowances. Given the number of employees receiving this benefit and the implications of the related annual costs, the need for such allowances should be periodically revisited. Moreover, the City should periodically assess and monitor eligibility and need of individuals to ensure compliance with the intent of City policy and to assess the cost/benefit of these awards.
 14. The FMA should provide to top management and elected officials, on an established periodic basis, detailed financial management information relative to current standard and off-cycle payroll costs, personnel levels, award of Management and Executive Leave, bonus and employee recognition cash awards, and cash-outs of leave time. In addition, each year City Council should be provided a report of all individuals recognized with additional compensatory leave and cash bonuses and this report should include calculations of the fiscal impact, by employee, of leave awards granted.

Appendix A: A Listing of Employee Represented and Unrepresented Units

Represented Units		Unrepresented Units
MOU Agreement with	Number – Name	Number – Name
Service Employees International Union, Local 790	<ul style="list-style-type: none"> • SB1 – Craft employees • SC1 – Field & Operations employees • SD1 – Office & Technical employees 	<ul style="list-style-type: none"> • CON –Temporary Contract Employees • U31 -Unrepresented Confidential Employees • U41 -Local 21 City Attorneys • U51 -Exempt Limited Duration Employees • UG1 –Unrepresented Part-time • UJ1 - Senior Aides • UK1 –Executive Management • UN1 –Chief of Police • UR1 –Chief of Fire Services • US1 -IAFF Fire Trainees • UX1 –Elected Officials • UU1 –Deputy Chiefs of Fire
Service Employees International Union, Local 790 – Part-time	<ul style="list-style-type: none"> • S11 – Miscellaneous Part-time employees 	
The Professional & Technical Engineers Local 21, AFL-CIO	<ul style="list-style-type: none"> • TA1 – Confidential Employees • TF1 – Professional Employees • TM2 – Supervising Engineers • TW1 – Administrative, Professional & Technical Employees • UH1 – Supervisory Employees • UM1 – Exempt Management Employees • UM2 – Management Employees 	
Deputy City Attorney Unit Local 21, IFPTE	<ul style="list-style-type: none"> • TM1 	
International Brotherhood of Electrical Workers, Local 1245	<ul style="list-style-type: none"> • IE1 – Electrical Workers • TV1 – Part-Time Electrical Workers 	
International Association of Firefighters, Local 55	<ul style="list-style-type: none"> • Unit Q – FQ1 	
Oakland Police Officers' Association	<ul style="list-style-type: none"> • PP1 – Uniformed Police Officers • PT1 – Police Officer Trainees 	
Oakland Park Rangers' Association	<ul style="list-style-type: none"> • RO1 – Park Rangers 	

CITY OF OAKLAND



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City Administrator

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November 16, 2007

Dear Courtney,

Attached you will find a response by the Finance and Management Agency to the “Audit of the City’s Payroll and Compensation Practices” conducted by Sjoberg Evashenk Consulting, Inc. for the Office of the City Auditor, dated November 8, 2007.

It is my belief that auditing is essential to government accountability, and I strongly support your stated objectives in conducting this performance audit. From time to time the operations of any business or government entity should be assessed in order to streamline and optimize core business functions. In the public sector, audits should provide an independent assessment of the government’s stewardship of taxpayer dollars.

The goal of this audit was to review the performance of the City of Oakland’s payroll and compensation practices. The auditors’ most significant conclusion: **there were no issues with the City’s standard payroll transactions, which represent 95 percent of payroll activities, and proper controls are in place for standard payroll.**

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Having found no problems with the bulk of payroll practices, the scope of the analysis presented in their report was limited to “off-cycle” transactions (buy-back of paid leave, final paychecks, salary advances) for non-sworn employees. To put this scope in context, most of their audit findings focused on less than two percent (2%) of all City checks issued.

The time frame of the audit focused on January 2004 — June 2007. Some of the audit’s findings mirrored our own previous assessments which, in February 2006, prompted the Finance and Management Agency to reorganize payroll operations by transferring responsibility for oversight of the City’s payroll function to the Treasury Manager. Management felt that the Treasury Manager would be able to effectively address a number of the issues in the City’s payroll processes, some of which are called out in this audit, and many of which have since been fixed. Structural changes to the Payroll Group have significantly improved payroll staff productivity, accuracy, efficiency, internal controls, oversight and record keeping. Other changes are in progress which will further enhance payroll controls and operations.

While the audit does, in some instances, reinforce the areas in which we are making administrative adjustments and enhancements, as described above, it contains a number of findings which are simply erroneous, and in many instances the auditors make unverifiable assertions which are inflammatory and misleading. Moreover, the audit clearly ignores the fact that Treasury Payroll staff currently adheres to strict guidelines in the effort to address past

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mistakes and inefficiencies. In numerous instances the auditors infer that there is wrongdoing or abuse, when in fact none was found.

A few key examples:

- 3 • The auditors claimed that back-up documentation and justification were insufficient, yet when presented with virtually identical sets of documents, they deemed one set appropriate and found the other to be unsatisfactory. When asked for clarification regarding what would be considered adequate and proper documentation, the auditors did not respond.
- 4 • The auditors' characterization of salary advances as "interest-free loans" is inflammatory and incorrect. In the past, the City was more liberal in providing salary advances to employees. In some cases, multiple salary advances to an employee resulted in a balance owed to the City. However, as part of the reorganization of the Payroll Group, requirements were tightened and Payroll staff currently adheres to strict guidelines to address past inefficiencies. Outstanding balances have been paid or are being paid through payment plans and collections.
- 5 • Further, the audit exaggerates the magnitude of problems related to salary advances. The auditors expanded their scope to include salary advances dating back to 2000. Using case-specific examples, we have demonstrated to the auditors that data from this period is unreliable because it is associated with the well documented problems that arose during implementation of the new Oracle payroll system. The auditors chose to use this data despite its inaccuracy, calling into question the credibility of this finding.
- 6 • The auditors assert that keeping inactive seasonal employees active in the payroll system creates opportunities for abuse, but they found no evidence of unauthorized transactions. If no time is entered in the system, no paycheck is generated. Our own recent test of the payroll system did not result in a single instance of employees being accidentally or fraudulently paid.
- 7 • The auditors contend that the City Administrator exceeded her authority in granting the option for an additional (third) week of management leave. Management strongly disagrees. Historically, award of management leave and bonus pay has been at the discretion of the City Manager/Administrator, and authority to grant it has never gone before the City Council for approval. Management therefore believes that it acted entirely within its authority when electing to award additional management leave to recognize an employee's superior performance. It is absurd to assume that the City Administrator has the authority to terminate employees for poor performance, but not reward them for excellence. Moreover, this practice has been transparent and well documented in Administrative Instruction 516, which was recently updated to further clarify the parameters for awarding Management and Executive Leave.
- 8 • There are actually five entities which grant additional paid leave: the City Administrator, the Mayor, the City Council, the City Auditor and the City Attorney, yet the audit was silent on the authority of these other entities to award paid leave.

The auditors cite an opinion by the City Attorney that unrepresented employees should not receive benefits greater than those awarded represented employees. Yet in practice, both the City Auditor and the City Attorney have awarded their represented and unrepresented employees and themselves management leave in excess of the former two-week provision and continue to do so through the current year.

- The audit criticizes the City for having inadequate limitations on buyback of earned leave. Leave buy-backs are a cash-out of what the City already owes an employee as earned vacation, management leave, etc. Cashing out these leave balances can have a positive fiscal impact to the City, since it reduces future fiscal liability of the employee cashing out at a potentially higher salary. The audit overstates leave buy-back amounts by improperly including amounts paid outside the scope of the audit period, incorrectly considering several employees' final checks as buy-backs and failing to take into consideration the impact of the City Jail closure (the affected employees, who were being redeployed into lower paying jobs, were allowed to sell back their vacation at their former, higher rates, as required by law). That said, payroll staff continues to enhance its operations and procedures and has set new and stricter buy-back limits, which are currently enforced. (9)
- The audit revealed only one error: an employee (1 out of 5,900) who was incorrectly credited with extra vacation pay. Staff has since resolved the problem and developed a solution to identify the problem should it recur. The City is pursuing reimbursement for the overpaid amount. (10)
- The audit asserted that guidelines for payment of cash employee recognition awards and bonuses are insufficient, yet the auditors never contacted Management to determine what criteria and procedures are used to award bonuses. In fact, the recognition program is well documented and payment of employee recognition awards and bonuses is granted in a transparent manner according to formal guidelines. Management believes that having an annual employee recognition program is itself a best practice. It is important to note that the auditors did not find any evidence of abuse or wrongdoing associated with the granting of employee awards or bonuses. (11)
- The City Administrator holds an annual Employee Recognition Awards ceremony to recognize and encourage superior performance, and the event is attended by all departments and elected officials. Awardees receive cash awards. In 2004 the City Council authorized the City Administrator to award merit-based bonuses to executive staff in lieu of or in conjunction with annual salary increases. This is less costly than an annual increase because it is a one-time payment that does not increase base salary. Management recognizes that the Administrative Instruction pertaining to these long-standing practices is 20 years old, and we are currently updating it to reflect current practice. (12)
- The audit affirms that "automobile allowances are one of the compensatory awards that are clearly defined." Since this pay provision is well documented in current union MOUs and in Administrative Instructions, and since the auditors found no abuse or (13)

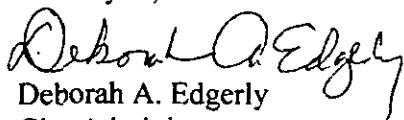
fraud related to payment of auto allowances, it is unclear why it is mentioned in the audit.

In conclusion, we are pleased that the audit has found 95 percent of the City's payroll to be in conformance with appropriate payroll practices. For the past 20 months, the Finance and Management Agency has been re-tooling its payroll organization, processes and procedures to further enhance efficiency and achieve best practices in payroll management. This audit highlights the importance of those changes now underway.

Nevertheless, Management strongly disagrees with the inferences made throughout the consultant's report regarding improper conduct or wrongdoing. Many of the conclusions reached by the auditors were insufficiently supported or based on inaccurate data. As a result, the accuracy of its findings remain in dispute and will be of questionable value to the public.

On December 11, 2007, Staff will present an agenda report to the Finance and Management Committee in response to the Payroll Audit. The report will also provide the Committee an update on improvements to City payroll processes made over the past one and a half years and planned future enhancements.

Thank you,


Deborah A. Edgerly
City Administrator

Enclosure

**CITY OF OAKLAND
FINANCE & MANAGEMENT AGENCY**

Response to

*An Audit of the City's Payroll and Compensation
Practices Conducted by the
Office of the City Auditor*

November 16, 2007

Audit Response

1 Context of Audit. Management believes that it is important for the reader of this audit to understand the magnitude of the findings in the context of the overall City Payroll. While "off-cycle" payroll is an intrinsic part of the City's overall payroll operations, it only comprises a very small portion of the City's payroll process. In fact, "off-cycle" transactions represent less than 5% of the checks issued by the City. Moreover, the City Auditor further reduced the scope of the audit by concentrating on the payroll transactions of only non-sworn employees, which account for approximately 40% of "off-cycle" checks. *The net effect is that most of the Audit findings focus on less than 2% of all City checks issued.* In addition, because "off-cycle" transactions are often smaller payroll adjustments, the dollar amount of the reviewed transactions is well under 2% of the total City payroll.

While the findings should not be ignored, the Audit fails to highlight in depth its most important conclusion: *There were no issues with the City's standard payroll transactions (which are 95% of payroll activities) and proper controls were in place for standard payroll.* Fundamentally, the Audit fails to frame the context of its findings, while oftentimes highlighting erroneous and unverifiable assertions.

As the audit indicates, responsibility for oversight of the City's payroll function was transferred to the Treasury Manager in February 2006. Management felt that the Treasury Manager would be able to effectively address a number of issues in the City's payroll processes, some of which are called out in this audit. Due to the timeframe of this audit, 2004 through 2007, many of the improvements made by the Treasury Manager, throughout 2006 and in the current year, were minimized and not acknowledged. Management also requested from City Council additional positions to improve payroll controls and procedures and Council approved these additions in the mid-cycle budget. As these additional staff were hired during the past fiscal year, they, too, had a positive impact on the improvement of overall payroll operations.

Findings/Conclusions.

Staff takes findings of any audit (whether financial or performance-related) very seriously, and negative findings are even more thoroughly examined given the ramifications on the integrity of the City. At the crux of the negative findings are seven (7) conclusions that imply that City payroll and compensation practices are riddled with problems and shortfalls. Unfortunately, many of the conclusions made by the City Auditor were insufficiently supported or evidenced against inadequate measures or criteria. As a result, the following are Management's response to each of the seven (7) audit conclusions.

1. *The majority of off-cycle payroll transactions sampled lacked appropriate support and justification.*

One of the primary findings by the Auditors is that justification and support for payments is lacking in many transactions. At the heart of this finding is the Auditor's test of 68 particular "off-cycle" transactions. Page 17 of the Audit report states, "46 of the 68 off-cycle

transactions tested...were inadequately supported or justified and 18 of the 68 were not properly approved or authorized." Management feels the justification currently required is sufficient.

Management solicited clear guidelines from the Auditors as to what represented sufficient back-up documentation and authorization. In the examination of seemingly identical off-cycle transaction documentation, one set of documents was deemed appropriately approved, while the other set of documents were deemed unsatisfactory. However, when Management asked what differentiating factor determined sufficiency in one and not the other, no response was received.

Another example cited was the case of the \$15,000 and \$14,000 checks for Sports Officials. Documentation from the department clearly showed that the employees were paid at the Youth Sports Official rate of \$5 per hour and should have been paid at the Adult Sports Official rate of \$15 per hour. The documentation included a pay-period-by-pay-period breakdown of what had been paid and what should have been paid. The appropriate departmental staff signed the requests. When Management inquired as to what additional documentation the Auditors felt was required, the Auditor responded only that the transactions "need more explanation".

Management is unclear as to what constitutes proper authorization and proper documentation in the mind of the Auditors. Management agrees with the Auditor that proper approval and justification of transactions are key elements in a properly functioning payroll system. The Auditors have failed not only to clearly define what level of approvals or authorization is satisfactory, but also to take into consideration past protocols when comparing documents. Moreover, the Audit clearly ignores the fact that Treasury Payroll staff currently adheres to strict guidelines in the effort to address past mistakes and inefficiencies.

2. *Past practices related to salary advances resulted in some payments that could be considered interest free loans and likely to result in losses to the City.*

Historically, the City has been liberal in honoring employee requests for salary advances. However, as part of the efforts to overhaul the Payroll Group with the 2006 reorganization, it was evident that these past practices no longer fell in line with modern day financial scrutiny. As a result, Staff worked hard to tighten the requirements for approval of salary advances, especially to eliminate repeat advances, even prior to this audit. It is important to note that all salary advances dating back to January 2004 have been reviewed and any identified outstanding balances that were within the three-year statute of limitations have been repaid, are being paid through payment plans or are being pursued through collection procedures. The Treasury Manager currently reviews all requests for salary advances personally.

The magnitude of problems related to salary advances are exaggerated in the audit report. The Auditors expanded the scope of the audit to include salary advances dating back to year 2000. Management warned the Auditors that due to system issues in the implementation of the City's then new payroll system, many of salary advances that appeared to be outstanding

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had, in fact, been repaid. Management does not agree with the \$68,000 outstanding balance figure put forward by the Auditors and has demonstrated to them that the figures are unreliable when they questioned individual balances. Finally, in the context of seven years of \$0.5 billion payroll costs, the \$68,000 represents two one thousandths of one percent (0.002%) of that cost.

3. *Inactive seasonal employee files remain active within the Oracle HR/Payroll system year-round creating opportunities for unauthorized transactions to occur.*

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CalPERS restricts part-time employees to 960 hours per year. The City uses a number of part-time employees throughout the year, but as they approach the 960-hour limit, their scheduled hours are reduced to zero. The employees are not terminated by the City and are held on the payroll, until the new fiscal year, in which they can once again accumulate work hours.

In addition, the City's Deferred Compensation Plan had a provision that when temporary employees were terminated, their deferred compensation balances were to be paid out. Once the employees' balances were paid out, they were ineligible for reemployment in the City for a period of nine months. Therefore, part time employees consistently stayed on the payroll system. In August 2007, the Deferred Compensation Committee removed that provision from the Plan.

Payroll time entry for these employees is on an exception basis. If no time is entered in the system, no paycheck is generated. While the Auditors assess that this practice created "opportunities for unauthorized transactions," the recent Citywide check distribution audit found no evidence of unauthorized transactions. The Auditors noted no instances where such employees were accidentally or fraudulently paid.

Payroll has been working with City departments to review these inactive employees and, in cases where the departments do not expect the employee to return, to terminate them in the system. Payroll will do this on a regular basis going forward to ensure system integrity.

4. *Management leave awards averaged \$1.5 million annually and a significant number of these awards clearly exceeded collective bargaining agreement provisions or City rules by \$341,000. Moreover, the City granted Executive Leave awards to 13 executive managers valued at \$97,900 over the three years of review.*

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There are five authorities in the City who grant Management Leave, Executive Leave and Special Recognition Leave. The Mayor and City Council grant Special Recognition Leave. The City Auditor, City Attorney and City Administrator grant Management and Executive Leave. Initially, Management Leave was awarded for up to five days. In 1996, the City Manager increased the possible award to ten days. This increase was subsequently memorialized in various bargaining agreements.

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The City acknowledges and has informed the Auditors before the audit of inconsistencies between the City's Administrative Instructions (AI's) and MOU's regarding management

leave. It is the City's intent to correct these conflicts and errors during the next round of negotiations with the labor unions and all payroll-related AI's are currently under revision, or have been recently updated.

With the exception of two elected officials, it has been the City's practice to award management leave to managerial and supervisory employees as a performance incentive for those employees who work long hours but are ineligible for overtime. Similarly, Executive Leave was designed as a fringe benefit to recruit and/or retain high-level employees.

In 2005, the City Administrator revised the management leave program to allow for the option of awarding an additional week of leave. The City Administrator notified the City Council, City Attorney and City Auditor through a memo and revised Administrative Instruction (AI 516). These elected officials awarded to their employees, on average, an additional two days of management leave (over the previous two-week allowance). Awards approved by the City Administrator averaged one additional day over the previous allowance. In May 2007, AI 516 was again updated to better define the parameters for awarding Management and Executive Leave.

The Auditors contend that the City Administrator exceeded her authority in granting the option for an additional week of management leave. The Auditors further cite an opinion by the City Attorney that unrepresented employees should not receive benefits greater than those awarded represented employees. In practice, both offices have awarded their represented and unrepresented employees and themselves management leave in excess of the former two week provision and continue to do so through the current year.

5. *City practices afford liberal buyback options and do not enforce limitations stipulated within bargaining agreements and City provisions. As a result, employees sold-back at least \$3 million more in leave than allowed – \$2.5 million in vacation leave, \$113,500 of sick leave, and \$500,300 of Management Leave. Further, the City has few limitations on the buyback of other leave and existing processes allowed an abnormality to go undetected.*

Historically, the City has been liberal in processing "buybacks" for its employees given that "buybacks" are technically no more than cashing out what is already owed to the employee—be it vacation, sick, or management leave. However, in recent years, there has been an increasing movement, not only within this City, but also in other local governments and corporations, to limit vacation, sick or other accruals, and thereby limit the overall financial liability resulting from these accruals. The current MOU's for civilian employees, for example, now provide for caps in accrued vacation. Currently staff adheres to MOU, AI and other payroll standards as part of the re-organization goals and objectives.

However, the City Auditor's portrayal of the extent of the buy-backs is inaccurate. Primarily, the above fails to take into account the agreement with those employees impacted by the closure of the City Jail who were allowed to sell back their vacation leave at their current rates as many of those employees were redeployed into lower paying positions. In addition, when the caps for accrued vacation went into affect, this spurred many employees to sell back their leave in order to prevent losing more accruals. Also, in some cases,

although the "Vacation Buyback" element was used, the transaction was actually "Vacation Cash-in-Lieu", which is technically an employee's final payout at termination or resignation.

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Additionally, the Auditor did not fully research its finding before rushing to conclusion. It is untrue that there is no provision for the selling of vacation Leave for units PP1 and FQ1. A Letter of Understanding dated April 6, 2004 between the City and OPOA stated that between January 1, 2004 and December 31, 2004 PP1 employees were eligible to sell back a number of vacation hours equivalent to that which they had taken in the previous year. The Memorandum of Understanding between the City and IAFF employees allows them to sell back vacation hours if their scheduled vacation fell in a period when they were out on a work-related injury and they have been unable to reschedule the vacation.

19

The specific example of an employee who sold back 1200 hours was actually a cash-in-lieu payment (employee final payment), because the employee had been out on a work-related injury for 10 months prior to the payment and then retired without ever returning to work. Similarly, the payment to the SC1 employee who sold 480 hours was actually cash-in-lieu payment paid on the same check as his Comp-time and Vacation Time cash-in-lieu payments for his final check.

9

It should also be noted that to portray buybacks as negative is inaccurate. In fact, cashing out these "leave" liabilities have a positive fiscal impact to the City's long-term bottom line as the employees are always cashed out at their current pay rate, and not their future pay rate (which may be higher). In addition, if the employee were to elect to take their vacation, for example, rather than cashing it out, the employee would also be subject to vacation accruals during that time as well.

20

Amounts reported as sick leave buybacks for 2004 and 2005 were overstated. Once the City runs a regular payroll, that payroll period is kept open (for off-cycle transactions), until the following payroll is run. What the auditors counted as excess buyback payments in a year for pay periods ending 12/31/04 and 12/30/05 were actually buyback payments made in early January (the designated buyback period) of the following year. Had the Auditors reviewed their findings with Payroll staff as the findings were made, these various inconsistencies could have been pointed out.

21

The Auditors uncovered a single error where the system incorrectly credited an employee with an extra vacation day each pay period. The employee subsequently cashed out the incorrectly granted leave and left the City. The error amounted to \$13,900 (rather than the \$17,000 identified in the audit). The issue was not caught by the payroll exception reports that were used at that time. Staff has since resolved the problem and has developed a report that will identify this problem, should it recur. This report has been added to a library of audit reports that are run each payroll cycle. Staff has contacted the ex-employee and are in the process of seeking reimbursement.

6. *Payment of separate cash employee recognition awards and bonuses to 324 employees citywide ranged from \$75 to \$10,000 per individual award and totaled \$388,000 over the period of review. We determined that little criteria exists for the award of these cash*

payments and central guidance is insufficient to ensure fair, uniform, and transparent award of these benefits.

It has been a long-standing tradition to have annual Employee Recognition Awards to recognize and encourage superior performance. This is a very public and transparent event that includes participation from all departments and elected officials. Management believes that employee recognition is a best practice in high-performance organizations in both the public and private sector and vital in attracting, retaining and motivating quality employees.

12

In addition, the City Administrator, as authorized by Council, awards merit increases in the form of bonuses in lieu of or in conjunction with annual salary increases. This is less costly than an annual increase because it is a one-time payment that does not increase base salary and is not included in retirement-subject wages.

Management acknowledges that the AI 549 regarding bonus awards needs to be updated to reflect current practice and set clear guidelines for awards. This update is currently underway. However, the City Administrator's Office has a well documented employee recognition program that clearly outlines procedures for providing awards. In addition, the City Administrator grants some latitude to her agency heads to craft employee recognition programs that are best suited to their agencies. City departments then submit their guidelines, justifications and proposed awards to the City Administrator's Office for review and approval. The Auditors did not contact the Administrator's Office to request any of this information.

7. *Monthly automobile allowances ranging from \$137.55 to \$750 per month were paid to an estimated 238 employees nearing a total of about \$700,000 per year or an average of almost \$3,000 per employee.*

Management is aware of the City's provisions for automobile allowances. This issue has been discussed publicly with City Council as it pertains to the City's fleet policies and those discussions continue.

13

The audit affirms that "automobile allowances are one of the compensatory awards that are clearly defined." Since this pay provision is well documented in current union MOUs and in Administrative Instructions, and since the auditors found no abuse or fraud related to payment of auto allowances, it is unclear why it is mentioned in the audit.

Office of the City Auditor's Response to the City Administration's Response

To provide clarity and perspective, we are commenting on the Office of the City Administrator and the Finance and Management Agency's response to the Office of the City Auditor's (Office) report. In the Office of the City Auditor's response, the Office of the City Administrator and the Finance and Management Agency will be referred to as the Administration.

At the outset, it is important to note that despite the Administration's assertions regarding the accuracy of the audit report, after a detailed and careful review of their responses, the Office sees no need to change a single word in the report.

The audit was conducted in full compliance with Government Auditing Standards, including rigorously gathering and reviewing evidence to support all of the findings and conclusions made. Among other requirements, these standards demand that auditors assess whether key management and internal controls are present and being followed at the entity being audited. Without tests of appropriate controls, City leaders, administrators, and residents cannot be assured that tax dollars are being spent as intended.

Despite the Administration's contention that they have retooled the payroll operations and controls over the past 20 months, the audit found that significant weaknesses in management and internal controls, oversight and monitoring regarding off-cycle payrolls, bonuses and leave buy-backs continue to exist over this period. Moreover, written policies, procedures and guidance to assure appropriate payment of these taxpayer funds are lacking, yet the Administration is silent on what, if any, changes will be made to correct identified deficiencies.

The weaknesses in the system of management and internal controls increase the risk that inappropriate or inaccurate payments could be, or have been issued. However, if the recommendations we make are implemented by the Administration, the current environment of weak off-cycle payroll controls, oversight, policies and procedures will be improved—and in so doing, mitigate the potential of abuses in the future.

Finally, some information and documentation we requested from the Administration was never provided during the more than six months of the audit, or the seven weeks since the Administration has had a draft report to review. In a few instances referenced below, the Administration's formal response is the first time some of the requested information is described to us. Obviously, at this late date, it is not possible for us to validate or verify any of this new information.

The numbers below correspond with the numbers in the margin of the Administration's response.

1. The Administration is attempting to diminish the importance of the problems we identified related to non-standard payroll actions by claiming that such transactions are only 5 percent of payroll activities. The fact that these non-standard or “off-cycle” transactions require several layers of human intervention and occur outside of the structure of the regular bi-weekly payroll is precisely why these types of transactions are the most vulnerable and pose the greatest risk to the City. The fact that the City pays out literally millions of dollars through these off-cycle transactions and that, as evidenced in our findings, at least \$3 million in payments were not in compliance with City rules or protocols supports the report’s position that significant improvements in these processes are warranted to establish and require compliance with rigorous business process controls and monitoring.
2. Contrary to the Administration’s comment that the audit ignored certain measures taken by the City Treasurer to address some issues, the report identifies, in several places, steps the Administration has taken or issues addressed relative to past practices. Nonetheless, we did not find significant improvements, as our report illustrates, and we believe much more needs to be done to ensure the integrity of all payroll transactions and to protect the public’s interests in the City’s practices related to compensation and benefits. As demonstrated throughout our audit, contrary to the Administration’s assertions, we did not find evidence of written, strict guidelines to be followed by the central Payroll Group. Furthermore, the Administration asserts that “the auditors infer that there is wrongdoing or abuse” but this comment is erroneous as we make no such statements or inferences.
3. The Administration states that we were presented with “virtually identical documents” and we deemed one set as appropriate and another unsatisfactory. In this comment, the Administration confuses the issue, and is out of context and incorrect in its statements. To conduct transaction testing of the sample of 68 items, we established distinct audit steps and procedures to ensure a consistent evaluation of off-cycle payroll transactions, including reviewing for justification, approval, accuracy, and evidentiary support. Our tests assessed the evidence used and maintained by the central Payroll Group representative at the time the transaction was executed—thus, we determined the sufficiency of documentation and support used by the representative at the time the payroll transaction occurred. Our findings apply only to those documents that were included in the City’s files as part of the specific, individual transactions tested. As our results reveal, the vast majority of the support available to the payroll representatives to execute these off-cycle transactions was insufficient and lacked appropriate authorizations and justification.
4. We recognize that the City Treasury Manager has taken some measures to strengthen controls relative to salary advances. However, we stand by our assessment that many of these salary advances effectively resulted in interest-free loans and remain concerned about the Administration’s view that “in the past, the City was more liberal in providing advances to employees.” Further, although the

Administration claims that outstanding balances have been paid or are being repaid, this is contrary to previous statements made to us by City officials indicating that the City may not be able to recover some unpaid advances related to older transactions.

5. We disagree with the Administration's assertion that we exaggerated the magnitude of problems related to salary advances. To the contrary, we identified 42 current and former employees with outstanding salary advance balances in the payroll system. During our audit, we provided a listing of these employees and related balances to the City Treasury Manager for review and comment. The City Treasury Manager responded that she researched and verified 13 of these employees and confirmed their balances and indicated that she did not research the others balances because it would take too much time. We provided this listing a second time to Finance and Management Agency staff along with details supporting all the outstanding balances and have received no comments or support regarding that any of these June 2007 balances were incorrect or erroneous. Moreover, the Administration claims that these balances could be attributed to issues during the conversion of the payroll system to Oracle in 1999. However, the salary advance transactions in question took place in 2001 and beyond, long after the implementation of the Oracle system.
6. While the Administration correctly references our statement that we did not find evidence of unauthorized transactions relative to inactive employees, as we state in our report, this issue is brought to management's attention to ensure that improved controls are established to mitigate the potential for abuses happening in the future. The Administration must agree with our position as later in their response to our report (see page 58) they indicate that steps have been taken to implement our recommendations on this matter. Finally, while the Administration states that the City conducted its own test of the payroll system—the results of this test have not been shared with us.
7. At no point in our report do we state or contend that "the City Administrator exceeded her authority in granting the option for an additional (third) week of management leave." What we do state on pages 30 and 31 of our report, is that the actions by the City Administrator exceeded provisions included in the MOUs. A City Attorney's opinion questions the City Administrator's authority to grant compensation and thus suggests that awards of Management Leave exceeding City Council approved contracts may not be within her authority. The fact that a compensatory benefit is awarded in excess of City Council negotiated and approved MOU provisions becomes particularly significant when taken in context with the Administration's comment that "historically, award of management leave and bonus pay has been at the discretion of the City Manager/Administrator ...and never gone before City Council for approval." Our belief is that City practices and actions relative to matters covered within MOUs should adhere to these contract provisions and any changes should be formally approved by the City Council. Furthermore, it is our understanding that the City Council is the

only body authorized to set and approve compensation. Additionally, although the Administration claims that the processes for awarding Management and Executive Leave are transparent and well documented, as noted on page 33 of our report, the City could not provide a listing of all Executive Leave granted for 2004 and 2005 and, to our knowledge, neither the City Council nor the Mayor received reports of such awards.

8. Although the Administration's response indicates that five entities may "grant additional paid leave: the City Administrator, the Mayor, the City Council, the City Auditor, and the City Attorney," Administrative Instruction 516 makes no mention of these other entities. It is important to note that under MOU provisions, the Mayor's Office and City Council staff receive Special Recognition pay not Management Leave and our tests of these awards found that amounts awarded complied with the MOU provisions. Further, we were told on numerous occasions that City agency heads (including the City Attorney and City Auditor) receive a listing annually of employees eligible for Management Leave and that these recommendations must be approved by the City Administrator.

The City Auditor acknowledges that recommendations for 2007-2008 Management Leave awards for the Office of the City Auditor's employees were made in accordance with AI 516. As the report points out, AI 516 provides up to 5 more days of management leave for employees than the MOU. In May 2007, when the Management Leave recommendations were made, the City Auditor was unaware that AI 516 was in conflict with the MOU.

9. While the Administration appears to take issue with our position that limitations relative to the buyback of leave should be enforced, its statement that the payroll staff have "set new and stricter buy-back limits, which are currently enforced" suggests that the Administration agrees with our findings and has begun implementing related recommendations. The Administration claims that "cashing out these leave balances can have a positive fiscal impact to the City, since it reduces future fiscal liability of the employee cashing out at a potentially higher salary." Although correct that cashing out at a higher salary is more expensive than at a lower salary, the City's position fails to account for these important personnel and financial impacts of disregarding buyback limits:
 - The concept behind vacation, Management Leave, and Executive Leave is to afford employees time away from work to rest and rejuvenate to maintain productivity, and is not intended to be additional compensation.
 - Cash-out limitations exist to limit the City's exposure for cash-flow purposes and to afford some level of budgetary control over current operations. If buyback limitations are ignored, the City risks cash-flow issues and exceeding budgetary expenditures for compensation.
 - MOUs include accrual limitations for sick and vacation leave which are intended to cap the City's liability for these benefits. Allowing

uncontrolled cash-out of vacation effectively allows employees to never reach prescribed accrual limits and, thus, subjects the City to excessive leave costs.

- Versions of AI 516 issued prior to 2006 included specific “use it or lose it” provisions for Management Leave, and other City rules related to Executive Leave stipulated that such leave was intended only for the year that it was awarded. These provisions demonstrate that the intent of the leave awards was not to generate additional compensation but to afford extra time off, and that any leave not used within the year was lost and thus no longer a liability to the City. The City Administrator’s new provisions allowing the carryover of Management Leave and Executive Leave create additional, significant long-term liabilities to the City.

The Administration is also incorrect in stating that in our calculations of leave buy-backs we included periods outside of our review (see also note 20). We requested and obtained from the Finance and Management Agency (FMA) sick leave and vacation buy-backs for the three calendar years 2004, 2005, and 2006. We conducted our analysis and made our calculations based upon these reports. Further, the Administration claims we included “in-lieu” termination payments in our calculations. These payments, according to the Administration, are to be completed with a different pay code than a buy-back. Thus, it would be inappropriate for the central Payroll Group to process “in-lieu” payments in this manner. Finally, despite the fact that we have discussed this issue over the course of our audit and presented these matters in writing in a full draft report provided to the Administration more than seven weeks ago, no mention was made to us relative to the closure of the City Jail until we received the Administration’s response—thus, we could not have taken into consideration any implications relative to this issue during our audit.

10. The Administration states that our review reveals “only one error.” We find that statement troubling given the numerous issues we identify in our detailed report. In the instance of the irregularity found regarding this “one employee,” the issue has far greater implications than being just “one error.” Specifically, the current payroll control environment not only allowed the undetected improper award of 22 Extra Vacation Days (typically awarded as one day for each five years of City employment) but also the pay-out of this erroneously earned vacation went undetected until we raised this problem during our audit. The fact that the control environment allowed such an occurrence and the Administration did not provide an explanation about the cause and the remediation of this problem should be of great concern to the City and the taxpayers.
11. We take strong exception with the Administration’s statement that we never contacted Management to obtain criteria and procedures relative to Employee Recognition pay and bonuses. We requested on several occasions directly from the City Treasury Manager, the Director of FMA, and the City Administrator

written rules and policies for administering these programs and obtained only AI 549, and a few other documents that we cite in our report. Even after meeting with the City Administrator on two occasions and directly discussing the matters of Employee Recognition and bonuses, no guidelines, City Council directives, or other provisions were provided to us. As we discuss in our report, little information exists for Employee Recognition programs—we obtained some information regarding these programs from 3 of the 7 departments we visited and the primary citywide guidance is an Administrative Instruction relative to bonuses—AI 549—which is twenty years old. Although we did find some limited data for the City Administrator’s Employee of the Year program and the Employee Recognition program (these programs generally apply to lower level cash awards of up to \$1,500), these programs need to be more clearly developed and broadly communicated to ensure uniform and fair application. In addition, we agree that such programs are valuable and our report takes no issue with the program itself.

Our audit did review the policies and procedures related to bonuses in effect at the time. In fact, we found few, if any, related rules or criteria for granting these awards, discovered the exercise of broad discretion by the City Administrator in affording these payments, and identified little transparency in these processes. As a result, we were unable to obtain enough evidence to determine if bonuses were properly justified and authorized.

12. We disagree with the Administration’s assertion that guidance exists for bonus programs. To date, the Administration has not provided us with any documentation despite our numerous requests. Our review found that 46 bonus payments totaling over \$181,500 were in excess of \$1,500 (the Employee Recognition limit) and ranged up to \$10,000 each over the three years of our review. To gain the Administration’s perspective on these bonuses, we provided a listing of all 46 payments to the Administration and we were not provided any tangible criteria for the award of such bonuses, or their related support and justification. Although during meetings with Administration officials we were told that in 2004 the City Council gave the City Administrator authority to give merit-based bonuses in lieu of salary and merit increases, this City Council resolution was not provided to us nor was any evidence showing the justification or calculations demonstrating that the in-lieu bonus payments were limited to the pay increase or merit payment the employees were to have received.
13. The Administration questions the inclusion of automobile allowances in the audit report since we “found no abuse or fraud.” In fact, we did identify weaknesses in the monitoring and oversight of these generous allowances. As the City has a responsibility to the taxpayers to ensure that all City expenditures are appropriate and in the City’s best interest, and since these costs approach \$700,000 each year, we believe it is important that the City ensure that every employee receiving an automobile allowance warrants that benefit and receives the benefit in accordance with MOU provisions and City rules.

14. The Administration incorrectly asserts that it asked us for clear guidelines as to what represents sufficient back-up documentation and authorization and that we did not provide it. In fact, we discussed this matter at length during meetings with FMA describing expected levels of documentation and also conveying best practices employed in other government payroll and fiscal operations. During those meetings, we typically agreed to disagree with the City Treasury Manager who sees her role and that of the central Payroll Group as a service center and not a control agency. However, we believe the central Payroll Group should be a control agency and strongly assert that government best practices and the City's fiduciary responsibility to the taxpayers requires that documentation fully supporting, justifying, and demonstrating the accuracy and validity of all payroll-related transactions should be provided to the central Payroll Group who should then review and verify the transaction prior to payment. Moreover, on page 19 of our report, we provide written guidance of what type of documentary evidence should be expected for processing off-cycle payroll transactions and further expand on these issues in our report's recommendations.

15. The examples included in the Administration's response to our audit relative to the Sports Officials have been at issue during the course of our audit and are described on page 20 of our report. The documents that the central Payroll Group used to make these two large retroactive payments consisted of a Payroll Adjustment Record that included the employee's name, employee identification number, retroactive payment element, and the appropriate approvals. Attached to these documents were simple spreadsheets indicating the prior pay rates and the new pay rates over a period of years. There were no authoritative documents or written explanations to justify the transaction nor were any documents supporting the employees' old pay rates or the new pay rates included. When we initially presented the lack of support and justification for these two payments to the City Treasury Manager, she told us she would provide the documentary evidence for the retroactive payments. Although this matter has been discussed subsequently in numerous conversations and meetings and we were told that this information would be provided to us, we still have not received or seen such documentation. The most important aspect of this issue however, is the fact that the supporting documentation and justification for payments of \$15,000 and \$14,000 were not provided to the central Payroll Group at the time these transactions were executed and thus these payments were made without sufficient evidence.

16. Although the Administration states on page 52 that the outstanding salary advances are all paid or in the process of being paid; on page 57, it states that the audit report exaggerates the magnitude of problems. Consequently, we are not sure of the amount of the overpayments the Administration claims have been or are being recovered. Moreover, the Administration questions why we included salary advances going back to 2000. As outstanding salary advances are an important aspect of payroll we needed to include all unpaid advance balances identified for the three year period of our audit scope. Our approach was to go back as far as needed to identify the underlying transactions that created the

current outstanding balances for the 42 current and former employees we identified with outstanding balances. These transactions occurred between 2001 and 2005, therefore necessitating the need to include the information from prior periods. As noted in footnote 4 of our comments, these transactions took place long after the transition to the new payroll system in 1999. Furthermore, the Administration disagrees with our \$68,000 balance outstanding. However, as we previously stated, despite the fact we provided all the underlying detail to these 42 outstanding balances, the Administration has not indicated which balances they disagree with and, contrary to their assertion, has never provided to us data or otherwise demonstrated errors in our calculations. In addition, we find the Administration has been disingenuous to quantify this issue over a seven year period when any loss to the City is a serious matter. Furthermore, it is the Administration's role as the City's fiduciary to protect all City assets by ensuring strong internal controls and the diligent remediation of any weaknesses or breakdowns in business processes or activities.

17. Contrary to the Administration's statement that the "City acknowledges and has informed the Auditors before the audit" of issues related to conflicts between the MOUs and the City's Administrative Instructions, no one in the City brought such issues to our attention prior to the commencement of the audit. Further, these issues were *not discussed with us during the audit until we brought these matters up with City officials*. During these conversations, City officials did discuss the differences between the AIs and the MOUs and stated they believed that the AI provisions superseded the contractual provisions approved by the City Council in the MOUs.
18. The Administration inaccurately states that the auditors "did not fully research its finding before rushing to conclusion" relative to Vacation Leave for units PP1 and FQ1. In fact, at the commencement of our audit, we requested all MOUs, letters of understanding, modifications to agreements, and other documents relative to the City's processes and responsibilities for payroll and compensation. Further, as part of our quality assurance processes prior to our draft audit report and after we submitted our first draft to the Administration more than seven weeks ago, we requested that the Administration identify any inaccuracies or incomplete information they believed we had included. Now, nearly two months after our initial conclusions were provided to them for consideration, they bring up in their response matters concerning these two units, yet they do not provide any supporting information or data for us to consider. Therefore, at this late date, we cannot confirm, research or disprove this statement
19. In its questioning of two examples of leave buybacks, the Administration attempts to divert the reader's attention away from the serious issue of the lack of appropriate controls that allowed more than \$2.6 million in excessive leave buybacks. The Administration states that the one employee in our example who sold-back 1,200 hours in vacation was actually a termination and, therefore, not inappropriate—this is an incorrect characterization of the facts. Payroll records

reflect that in January 2007 there was a vacation buyback of 1,200 hours—far in excess of the allowable limits for this type of transaction. The Administration points out that this was actually a termination, thus illustrating that the City improperly executed this transaction as it should have been an “in-lieu” payment. This is important, as it again demonstrates the breakdown in the City’s processes, and appropriate controls over vacation buybacks should not have allowed more than the prescribed amounts to be sold-back under a vacation buyback transaction. Moreover, our records reflect numerous other examples of vacation buybacks that demonstrate such control weaknesses.

In the second example, the 480 hours of sick leave were in fact sold-back to the City in July 2004 (and, the transaction was not “in lieu” but was classified in the payroll records as “sick leave buyback”) and, contrary to the Administration’s claim that this was part of a final check, the payroll records reveal that this employee was still actively employed through at least June 30, 2007.

20. We disagree that the amounts we reported as excessive sick leave buybacks for 2004 and 2005 are incorrect. Our calculations were based on reports provided by FMA for the three calendar years 2004, 2005, and 2006. While the Administration contends that we included payments that should have been counted in the subsequent calendar year because the check was issued in January, we applied consistent dates for all periods and used the pay period date (which should be the processing date of record) and not the check date in our calculations. Using our approach is correct since it includes all sick leave payments approved during a specific calendar year – the basis upon which any excessive sick leave buybacks are determined.
21. As previously stated, we discovered the abuse of the payroll system in the award of 22 Extra Vacation Days, and our estimate of \$17,000 for the payout of the 22 days is based upon the employee’s pay rate at the date of separation. The Administration did not provide the basis for its calculation.