

CITY OF OAKLAND

AGENDA REPORT

2007 NOV 29 PM 10:47

TO: Office of the City Administrator
ATTN: Deborah A. Edgerly
FROM: Finance and Management Agency
DATE: December 11, 2007

RE: Action on a Report on Payroll Controls and Improvements and a Response to an Audit of the City's Payroll and Compensation Practices Conducted by the Office of the City Auditor

SUMMARY

In late 2005, the City Council charged the City Administrator with the task of improving payroll controls and oversight. This report will discuss a number of initiatives that Staff has put in place since the 2006 restructuring to strengthen the City's payroll control and operations. These includes, but not limited to the following:

- Improve payroll processing and internal controls, to increase efficiency and streamline workflow.
- Address various concerns e related to: Federal and State taxes, CalPERS reporting and audit findings.
- Upgrade payroll systems to improve performance and eliminate customization.
- Improve time and attendance by implementing self-service time keeping for eligible departments.
- Update payroll policies to be in line with MOU's, Federal and State regulations.
- Improve communication with departmental payroll representatives, as well as provide on-going training.

The Finance and Management Agency proposes to centralize City payroll functions under the Treasury Division.

The newly elected City Auditor chose the City's payroll and compensation practices for her first audit subject. It is not surprising, that her audit revealed some of the very control issues that staff is in the process of correcting. Management's response to this audit is included as an attachment to this report.

Staff requests Council's guidance on conflicting opinions surrounding the award of management leave to Managerial and Supervisory employees as well as elected officials.

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FISCAL IMPACT

There is no fiscal impact as a result of this report responding the findings of the Audit. However, the actual process of conducting the Audit has had an estimated fiscal impact of \$200,000 to the City. This is the estimated cost of \$82,000 fee paid to Sjoberg Evashenk Consulting combined with the approximate staff cost of \$150,000 to facilitate the audit.

BACKGROUND

For several years, the City's payroll functions were part of the City's Personnel Department. In 2003, when the Office of Personnel Resource Management was placed under the newly created Finance and Management Agency, oversight was moved to the Accounting Division under the City's Controller. Payroll continued to have various problems some of which originated from Oracle implementation. Little or no improvements were being made and, furthermore, personnel related matters made it very difficult to attain the desired results.

In early 2006, responsibility for payroll was moved to the Treasury Manager, because Management felt that she possessed the organizational skills, technical knowledge and management abilities to make the improvements that the City Council and Management sought. At the FY06-07 mid-cycle budget hearings, the City Administrator recommended and City Council approved the addition of three positions to the central payroll function to support the planned improvements.

The City's payroll process was and continues to be decentralized. Departmental payroll representatives are responsible to a great degree for the input, review, verification and accuracy of payroll information. Each City department directly responsible for inputting all time and attendance information for each of their employees and for providing the appropriately completed and authorized paperwork for all new employees, salary and/or assignment changes, and all payroll adjustments. The primary responsibility for overall payroll accuracy currently lies with each individual department.

The City's Treasury Division (a division of the Finance & Management Agency) is the overarching division, which acts as the central repository for all payroll information except timecards and personnel-related documents. To that end, the Payroll Group's tasks include but are not limited to the following:

- Processing and distributing standard bi-weekly payroll once submitted by the departments;
- *Processing supplemental payrolls based upon each department's information;*
- Retaining and storing payroll related documents for all supplemental payrolls;
- Providing necessary payroll reports to City departments as requested;
- Processing year-end reports and producing W-2s and 1099Rs; and
- Inputting all salary changes as required by MOUs and Council resolutions.

Other duties include setting up all new hires in the payroll system, processing all terminations and resignations, testing and implementing system upgrades and fixes, assuring compliance with both Federal and State laws, and initiating all monthly, quarterly and annual payments to Federal, States and third-parties. The Payroll Staff, through their review and oversight of departmental transactions, seek to provide reasonable assurance that payroll transactions are correct and proper.

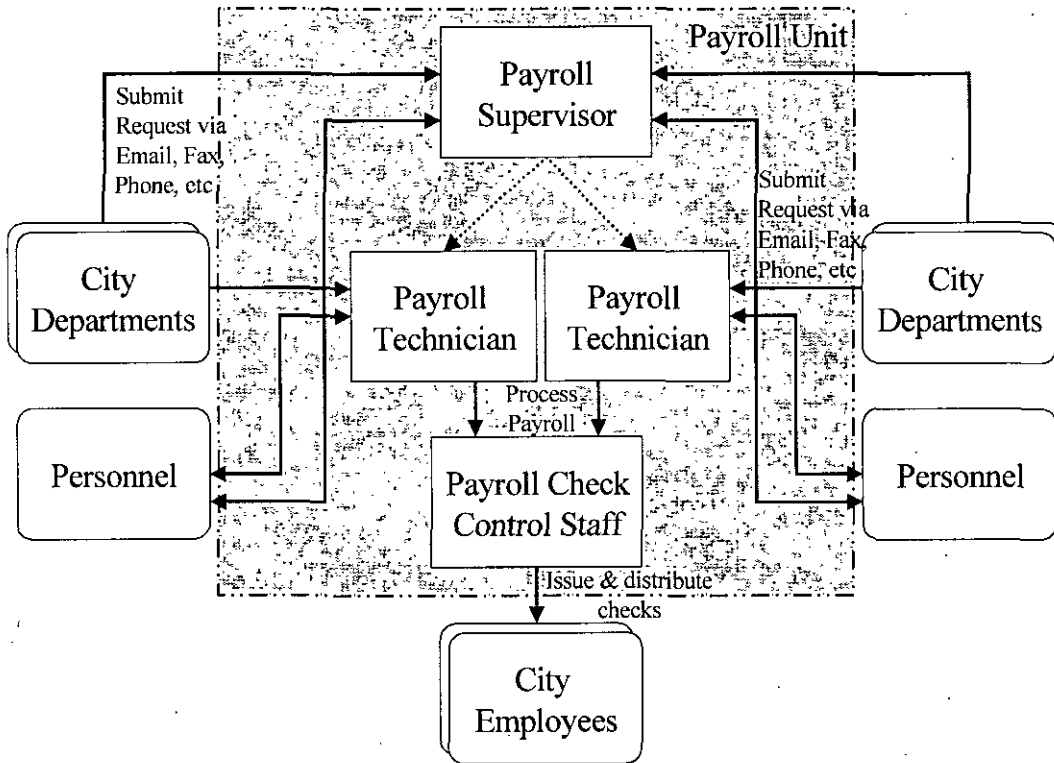
KEY ISSUES AND IMPACTS

Payroll Improvements/Accomplishments:

Since the payroll reorganization in 2006, a number of improvements have been made to improve processes and procedures, tighten controls and improve documentation. Several of these improvement efforts and accomplishments are discussed below:

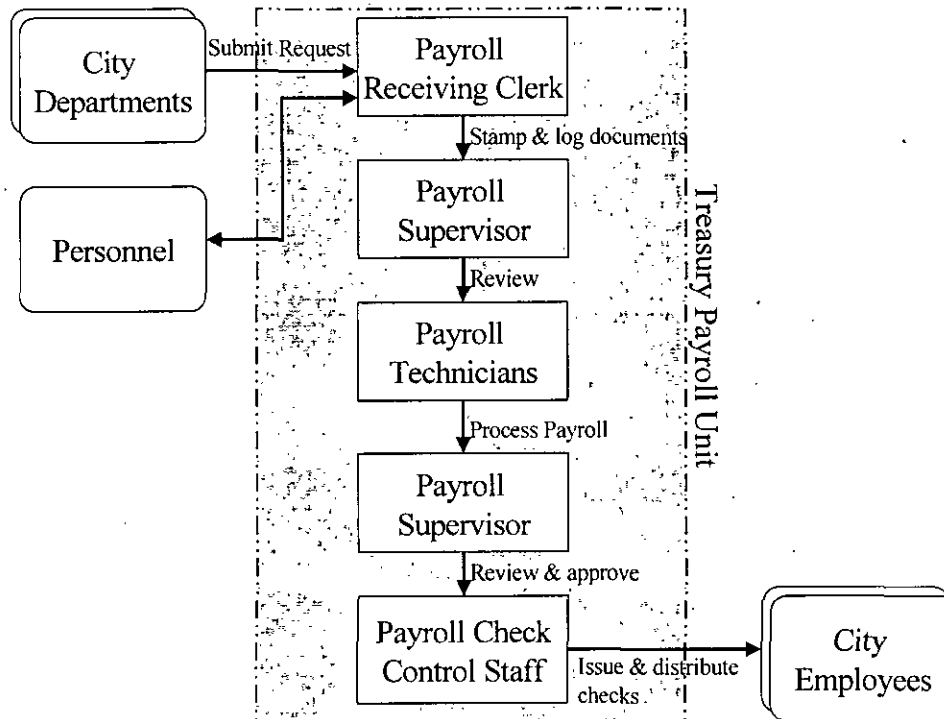
- **Improved workflow, oversight and tracking** -- Staff restructured workflow of the payroll section to improve controls, oversight and tracking of payroll documents. Previously, City departments and Personnel submitted payroll documents directly to Payroll Technicians and, sometimes, to the Payroll Supervisor. There were no tracking procedures in place, which often resulted in misplaced documents, lack of accountability, duplicate transactions and delays in making changes and corrections. In addition, there was no coordinated review of input documents or the results of processed transactions.

Payroll Workflow before Reorganization



Staff created a single point (Payroll Receiving Clerk) of submission of payroll documents. All documents are now logged and tracked to ensure timely processing and accountability. All documents flow through the Payroll Supervisor, who audits them for proper authorization, documentation and compliance with MOU's, AI's and other payroll procedures. Documents that do not meet standards are returned to departments for correction. The Payroll Supervisor also reviews transactions, once they have been processed, to ensure no processing errors were made. Staff has found that this revised workflow has increased productivity, reduced errors and helps maintain consistency between and within departments.

Payroll Workflow after Reorganization



- **Staff reorganization** – Payroll staff has been reorganized into three key functions – Payroll Operations, Payroll Systems and Payroll Control. Roles and expectations for each section and for each employee within the section have been clearly identified.
- **Improved communications and training** -- Increased communication and education has helped eliminate various problems and errors that were common prior to February 2006. In 2006, the Treasury Manager solicited comments and suggestions from City departments to identify areas for improvement. She also implemented quarterly meetings with department representatives. These meetings are used for training and education, discussion of problem areas and to ensure consistent standards and procedures throughout the City. Departments have a better understanding of payroll requirements and AI provisions. Payroll practices are now applied consistently between and within departments.
- **Transfer of System Analyst positions from Information Technology (IT) to Payroll** – Two System Analyst positions, which provide technical support and system oversight for the payroll system, were transferred from IT to Payroll. By physically moving these positions to Payroll, and placing them within the Payroll chain of command, their work is better integrated with that of the Payroll Group and their priorities better match the Group priorities.

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- **CalPERS reporting** – Staff researched and corrected a number of reporting problems uncovered in CalPERS’ 2004 audit. A number of long-standing problems, which caused delays, over/under statement of service hours and duplication of efforts between the City and CalPERS, have been resolved and audit reports created to ensure the integrity of future reporting. In addition, staff has created reports to track hours of part-time and temporary employees to ensure compliance with CalPERS hour limits.
- **Federal and State tax reporting** – Staff has researched and corrected various tax and wage reporting problems over the past few years. Some of these problems resulted in potential financial penalties for the City, which Staff was able to have removed. New reporting and reconciliation procedures have been put into place to avoid issues in the future.
- **Updating of Administrative Instructions (AI’s)** – Staff has updated a number of payroll-related AI’s, discussed the changes with department payroll representatives and implemented strict compliance procedures. In addition, staff is currently updating all payroll and personnel-related (Series 5XX) AI’s and plans to have that project completed by the end of this calendar year. AI’s already updated include:
 - 516- Management and Executive Vacation Leave
 - 545 -Vacation Leave Buyback and Sick Leave Buyback/Conversion Policy
 - 555 -Payroll Procedure Policy
 - 556- Early Release of Paychecks/Vacation Advances/Emergency Advances
 - 586- Direct Deposit
- **Tightened salary advance procedures and recovery of past amounts** – Staff has put into place tighter procedures and standards for salary advances and eliminated repeat advances to certain individuals. Staff also researched and documented balances due from nine employees, for advances received within the past three years. Staff has already collected \$9,700 from seven of the employees and sent the amounts due from two former employees to collections. There have been no outstanding balances arising from advances since the 2006 payroll reorganization. *All requests for salary advances are personally reviewed by the Treasury Manager.*
- **Implementation of new payroll time-entry module** – Payroll Staff and IT have implemented Oracle’s time and labor module (OTL) to replace the unsupported third-party module in place since 1999. System updates to the Oracle system repeatedly “broke” the old third-party system and required “band-aid” fixes to keep the system in operation. Not only is the new system fully integrated with the City’s payroll system, it provides greater controls and electronic approval documentation. Staff continues to implement OTL throughout the City. In addition, Staff has integrated OTL with the Fire Telestaff system and eliminated redundant data entry.

- **Creation of approval/documentation matrix** – Payroll Staff has created an approval/documentation matrix. This matrix details the approval and back up documentation requirements for each type of payroll transaction (salary advances, leave buy-backs, etc.). It is used internally to ensure consistency and compliance.
- **Paycheck audit** – As a best practice, and to ensure no “ghost employees” exist in the payroll system, staff performed an audit of all paychecks and direct deposits for a recent payroll. Each City employee was required to present picture identification and personally pick up his/her check or payment advice. This audit entailed the coordinate effort of over 100 employees from the Finance and Management Agency and departmental payroll representatives. Such an audit had not been performed in the City in over 25 years. Though no instances of fraud were discovered in this audit, staff will continue to perform audits on a random basis.
- **Reporting library** – Staff created and continues to develop and fine tune various audit and payroll exception reports. These reports are placed in a library and are run on an appropriate basis – each payroll, monthly, quarterly or annually. This growing library of reports provides improved controls in a much more efficient matter than simple manual review of payroll output.
- **Upgrade of payroll system** – Staff has worked with IT to bring the payroll system to its current release. By keeping the system current, staff is able to obtain support from the vendor, Oracle, and overall system maintenance demands are reduced. This allows the technical staff to provide more direct support to the Payroll Operations and Payroll Control staffs.

Future Steps:

The above changes were implemented as part of staff’s goal to implement best practices and improve payroll controls and oversight. Staff understands that in order to adopt best practices, existing practices must be continually scrutinized in order to better facilitate the needs of the City. Payroll Staff is also actively working to achieve the following:

- **Update of existing policies and procedures** – Staff plans to review and update all existing payroll policies and procedures by the end of the first quarter of 2008.
- **Complete implementation of Oracle Time and Labor** – Staff is working to complete the implementation of OTL across all City departments by June 30, 2008. In discussions with the City’s outside financial auditors, the Auditors and Staff agree that OTL will provide a much higher level of control than the current time entry process. OTL will require all supervisors to electronically review and approve employee timecards. Many

supervisors currently approve paper timecards. The information entered in the payroll system may differ from the paper timecard, without proper review and oversight.

- **Continue regular meetings with departmental Payroll Representatives** – Regular meetings, education and training for the departmental representatives are key factors in the proper functioning of the City's decentralized payroll function.
- **Review opportunities for payroll centralization** – Staff plans to review opportunities to gain greater control and efficiencies through centralization of the City's payroll function. Staff will review various logistical and organizational issues and bring recommendations to City Council as part of the mid-cycle budget review.

Outside Audit/internal control reviews:

The City's outside auditors perform an annual audit of payroll internal controls, compliance with stated policies and for fiscal soundness. To date, the City has not received any major negative findings in any of these areas. Additionally, the City's Accounting Division is charged with the responsibility of performing, daily, monthly and annual reconciliation of payroll activities. In an effort to correct past practices that occurred before the 2006 restructure, the Accounting Group together with the Treasury Payroll Section have worked tirelessly this past year to clean up past mistakes and errors, dating back 3-4 years.

Performance Audit by the City Auditor:

Staff has prepared an extensive response (Attachment A) to the City Auditor's audit report. The response addresses seven key areas of the audit as presented by the City Auditor and Sjoberg Evashenk Consulting. It is interesting to note, that in discussions with Sjoberg Evashenk, a partner noted. *"It seems that every time we discover an issue, Katano [the Treasury Manager] has already fixed it."* The performance audit noted no instances of fraud and found only an isolated instance, where a system glitch went undetected, that resulted in an overpayment. Staff finds this to be further evidence that their hard work over the past months is having the intended effect.

It is unfortunate that the Auditors did not fully discuss the details of their findings with staff, during the course of the audit. Had this been done, staff could have corrected erroneous numbers and misconceptions on the part of the Auditors. The Auditors did not provide the backup to their calculations until after the completion of the draft report. Once staff had an opportunity to review the backup materials and informed the Auditors about the problems with their numbers, the Auditors refused to change the numbers nor their conclusions. Finally, 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.

Erroneous assertions made in the audit are detailed below:

City Auditor's Assertion	City's Response
➤ Vacation Leave Buyback \$2.5 million, including \$1.2 million in buy-backs by sworn Police and Fire employees.	<ul style="list-style-type: none"> ➤ Buy-backs are allowable for Fire employees according to Section 6.2.2.4.6 of IAFF Local 55 MOU and for Police through a special Letter of Understanding with OPOA ➤ Some buybacks are cash in lieu at the time of employee termination or resignation. ➤ Vacation balances are the property of employees and cannot be used to fund other purposes as aluded by the City Auditor
➤ Management Leave Buyback \$500,000	➤ MOU allows sale of management leave; with the exception of the Police MOU (which is silent but past practice allows sale of management leave).
➤ Management Leave Extra Week Granted \$341,000	➤ AI 516 updated in 2005 by City Administrator increased management leave by one week.
➤ Sick Leave Buyback \$113,000	➤ Again, City Auditor included sick leave cashed out at the time of employee termination and erroneously identified the date of buy-backs, thus assuming multiple buy-backs in a single year.
➤ Salary Advance unpaid balances of \$68,000	<ul style="list-style-type: none"> ➤ The majority of the \$68,000 balance dated back to 2000, a period of Oracle debacle. The Auditor did not perform the extensive, but necessary, analysis to validate their assertion. Staff did give them an example which demonstrated the early outstanding balances were not correct. ➤ The City researched and confirmed all balances owed from January 2004 (the legally allowed time that the City can collect). Total overpayment since 2004 is \$16,950. This balance has been collected with the exception of \$4,490, which has been referred to collections.
➤ Processing Error \$17,000	➤ The only error identified by the Auditors, in the amount of \$14,000 , is in the process of being collected. This system glitch has been corrected.

Vacation Buy-Backs:

In an effort to ensure consistency between City practices and MOU language, the issue of vacation buy-backs will be addressed during the upcoming union negotiations.

Management Leave Awards:

The City Administrator per AI 516, awards management leave to managerial and supervisor employees to compensate for long hours worked and for superior performance. (Elected officials similarly grant either management leave or special recognition leave to their employees.) Historically, award of management leave has been under the City Manager/Administrator's authority. Leave award programs have gradually increased from 5 days to 15 days over time. The last increase of 5 days was in June of 2005.

The City Attorney later issued an opinion, dated October 3, 2007, to the City Auditor regarding the City Administrator's authority to increase management leave from 10 days to 15 days. In the City Attorney's opinion, he stated that only City Council could increase management leave. *The City Administrator has therefore rolled the management leave program back to two weeks and will bring the issue of the third week and the granting of management, sick and vacation leave to elected officials to City Council as part of the mid-cycle budget review.*

Bonus Program:

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 sectors and is vital in attracting, retaining and motivating quality employees. Management intends to continue this practice.

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 intends to continue this practice.

In addition, the administration has granted bonuses to employees for exemplary performance or taking on special projects or initiatives. *The City Administrator will bring a formal proposal for this employee bonus program to City Council during the mid-cycle budget review.*

SUSTAINABLE OPPORTUNITIES

Economic: Improved payroll processing will translate to savings by reducing errors, overpayments and associated costs.

Environmental: No environmental opportunities have been identified.

Social Equity: No social equity issues are contained in this report.

DISABILITY AND SENIOR CITIZEN ACCESS

No senior citizen or ADA access issues are contained in this report.

RECOMMENDATION (S) AND RATIONALE

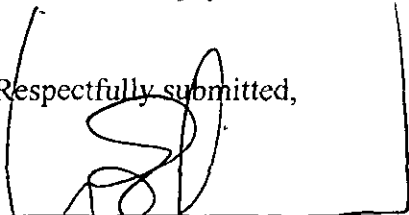
Staff will return to City Council at mid-cycle budget review for consideration of the following items:

- Awarding certain types of leave to elected officials
- Revision of management leave program
- Codifying the employee bonus program
- Consolidation and centralization of payroll functions

ACTION REQUESTED OF THE CITY COUNCIL

Staff recommends that City Council authorize the Finance and Management Agency to begin the planning process for the consolidation and centralization of all payroll activities.

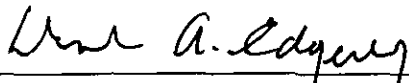
Respectfully submitted,



William Noland, Agency Director
Finance and Management Agency

Prepared by:
Katano Kasaine, Treasury Manager
Treasury Division

APPROVED AND FORWARDED TO THE
CITY COUNCIL FINANCE COMMITTEE:



Office of the City Administrator

Item: _____
Finance and Management Committee
December 11, 2007

**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

ATTACHMENT A

Audit Response

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

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.*

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.*

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.

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 is 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.

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.

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.

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.

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.

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.

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.

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.