



City of Cape Coral City Auditor's Office

TO: Mayor and Council Members
FROM: Margaret Krym, Interim City Auditor 
DATE: October 29, 2010
SUBJECT: Compensation Audit

The Compensation Audit was identified in the City-wide risk assessment performed, and included in the 2010 approved Audit Plan.

A performance audit was conducted on the City's compensation structure focusing only on base pay compensation. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operation, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

During the engagement, we found that the City was generally in compliance with its policies and procedures concerning base compensation, but there were internal control weaknesses that could be improved. These are addressed in the attached final report of the Compensation Audit.

We would like to thank Angela Cline, Compensation Manager and her staff, as well as Jill Luecke, Payroll Supervisor and her staff for their assistance in completing this engagement. Additionally, we wish to thank the Human Resources Director and the Acting Financial Services Director for their participation.

We will be happy to respond to any questions or concerns you may have about the information contained in this document.

Attachments

C: Gary R. King, City Manager
Carl Schwing, Assistant City Manager
Dolores Menendez, City Attorney
Rebecca van Deutekom, City Clerk
Wayne C. Howard, Human Resources Director
Linda Senne, Interim Financial Services Director
Angela Cline, Compensation Manager
Jill Luecke, Payroll Supervisor
Audit Committee



City of Cape Coral

Office of the City Auditor

Compensation Audit

Final Report

Date: October 29, 2010

Executive Summary

The purpose of this engagement was to provide assurance of compliance to the City's policies and procedures as well as review the adequacy of internal controls associated with compensation management.

During the engagement, we found that the City was generally in compliance with its policies and procedures concerning base compensation, but there were internal control weaknesses that could be improved.

The policy used to evaluate and classify a position was outdated and did not reflect actual practice. Therefore, City employees may have not known the process. On an issue as sensitive as establishing the pay rate and classification of a position, it is important for employees to have confidence that the methodology used is applied without prejudice and/or bias. By maintaining an outdated policy that did not reflect actual practice, employee perception and confidence in the process may have been diminished.

Previous audits have shown that controls over access to the software database governing the compensation rates were weak. The software lack of access controls limited the City's ability to segregate duties between establishing pay rates and issuing paychecks. A mitigating control was the review of the audit trail report by an individual independent from the person performing the data entry. Neither Human Resources nor Financial Services had been assigned or had assumed the overall responsibility for the integrity of the database or the control process outside of their own department. Therefore, the mitigating control had been weakened.

We also found that controls to analyze the long-term budget impact of compensation changes prior to implementing a salary increase and to establish contract worker compensation were not uniform throughout the organization due to lack of process owners, insufficient policy and procedures, and decentralization.

Finally, City policy did not require sufficient periodic review and marketplace benchmarking of the City's compensation and accordingly this was not being done. However, a regular review would provide Management with information to determine how well the City's compensation policies are being met, how competitive the City's compensation is, and the ability to forecast future projected needs for compensation.

Full Report

The Compensation Audit was identified in the City-wide risk assessment performed during the summer of 2009, and was included in the 2010 approved Audit Plan.

This audit was conducted as a performance audit. Performance audits are defined as engagements that provide assurance or conclusions based on an evaluation of evidence against stated criteria. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operation, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Article thirteen of the Personnel Ordinance, Compensation, and Payment of Expenses, sets forth Council's intentions for managing compensation. In this ordinance, various objectives define the City's compensation philosophy.

- The City shall maintain fair, equitable, and competitive wages and salaries for its employees.
- The City shall assure equal pay for work of substantially equal value performed under essentially similar conditions.
- The City Council shall approve a General Salary schedule with the Budget each year.
- Salary schedules shall consist of a hierarchical series of pay grades that shall define the wage or salary range for each pay grade.
- Factors such as cost-of-living and competing wages and salaries in the public and private sectors shall be considered in establishing the General Salary Schedule.
- No employee's wage or salary shall be less than the minimum or more than the maximum of the pay grade to which his or her classification is assigned.

The ordinance and several Administrative Regulations then go on to include other specific requirements. Also, the City is bound by union contracts with union employees that govern their compensation. These documents are intentional directives regarding compensation and we used them as the standard for measuring compliance.

Two aspects of Compensation Programs include Compensation Structure and Salary Administration. During our audit work, we touched on these.

Compensation Structure includes such areas as job classification and evaluation, market analysis, and salary structure development. Salary structure can include base pay and differential pay (which may include such things as overtime pay, longevity pay, hazardous duty pay, shift pay, on-call pay, and various other forms of add on pays.) During this engagement, we focused our audit work on base pay as this represented the more substantial dollar cost and potential risk to the City. The risks associated with differential pay (add on pay) will be addressed in a separate future audit.

We reviewed the methodology employed by Management to classify and reclassify positions into the various grades and we tested a sample (see Attachment A) to determine if the methodology is administered on a consistent basis.

Salary Administration includes compliance to the Compensation Structure and compliance to policies, procedures, and legal requirements. In this area, we focused our audit work on the internal controls employed to prevent unauthorized changes from being made to an employee's compensation. We tested various arbitrarily selected samples (see Attachment A) to verify that the internal control was in place and to determine that the transaction was in compliance to the City's Salary Administration requirements.

Purpose

The purpose of this engagement was to provide assurance of compliance to the City's policies and procedures as well as review the adequacy of internal controls associated with compensation management.

Scope

The scope of this audit included the examination and evaluation of the process of determining and managing employee compensation and the related internal controls. It excluded any evaluation as to the adequacy of compensation amounts or the reasonableness of position classifications.

Audit Objectives and Conclusions

Objective one: Provide assurance that the process of changing an employee's compensation contains adequate controls.

The process of requesting and approving a compensation change is well controlled however; we found the controls over access to the software database governing the compensation rates to be weak. Therefore, we are unable to provide this assurance.

The City is using the Kronos Software Application to manage employee compensation and maintain a database of employee compensation rates. This database is used to calculate employee paychecks. Therefore, the integrity of the database is a critical priority. Before and after the implementation of this software, the system and surrounding processes were reviewed by The Transcendent Group, which has expertise in auditing IT applications. In their reports to Council dated January 2008 and

November 2008 they identified a significant weakness in the software application and stated, *“The Kronos system lacks strong access controls and the City needs to rely on mitigating controls to ensure accurate payroll processing”*. They ranked these risks as High. In the Post-implementation Review, they made the following comments:

- *“We recommend that other mitigating controls be strengthened. All changes to critical data should be reviewed through the audit trail reports.”*
- *“We recommend that a reconciliation of the entered information (audit trail report) and supporting documentation is performed by an individual other than the person performing the data entry in Kronos.”*

This system lack of access controls limits the City’s ability to segregate duties between establishing pay rates and issuing paychecks. The mitigating control of reviewing the audit trail report is only effective if it is performed thoroughly, timely and by an individual independent from the person performing the data entry.

The Human Resources Department (HR) generates a Daily Audit Trail Report of all changes made to the database. They electronically share this report with the Payroll Division in the Financial Services Department. The current required internal control then calls for all changes listed on this Daily Audit Trail Report to be verified by someone other than the person performing the data entry. We found the HR staff to have a clear understanding of the importance of this control and for the days we examined we found documentation to evidence that it had been performed. In one case, we noted that a subordinate was verifying her superior’s data entry and we would suggest that the control would be stronger if this was avoided.

Financial Services also posts changes to the database. They stated that they review the Daily Audit Trail Report and that they notify HR via email when they have completed the verification. We arbitrarily selected six days between 4/1/09 and 9/30/09 and requested copies of these emails. Financial Services was able to provide three of these confirming emails. We also could not verify that the reviewer was independent (an individual different from the one who entered the change into Kronos.)

Neither HR nor Financial Services has been proactive to ensure that all transactions from both departments have been verified. Neither department has accepted the overall responsibility for the integrity of the database or the control process. Management practice has not required either department to take any responsibility for changes made outside of their own department. Therefore, the control has been weakened.

Additionally, this review and verification process is tedious and labor intensive. The Daily Audit Trail Reports are not user friendly and some exceed 1,000 pages. Management may wish to evaluate alternative methods for accomplishing a control over this database. These might include:

- Create a Daily Exception Report (in Crystal Reports) of only changes made to the high risk fields (pay rate, addition of new employee, etc.) This Exception

Report could be presented in a user friendly format more conducive to review and could be verified by an independent party. This process would cull out only those changes that presented the most risk and may use our limited manpower more efficiently.

- Continue with the independent daily verification of all changes listed in the Daily Audit Trail Report and ensure that all are verified by an independent party.

Finding #1: We found that the internal control designed to ensure the integrity of the Kronos HRIS database is tedious and labor intensive. We also found that it has no process owner to ensure that it is functioning as intended.

Recommendation #1a: We recommend that Management assess the risk associated with the lack of system designed access controls in the Kronos HRIS database software and that the departments with access to this system meet and agree on a control process that will ensure the integrity of the database.

<i>Management response:</i>

<i>HR will complete a general audit policy outlining how audits are sent, tracked and stored.</i>

Recommendation #1b: We also recommend that Management assign responsibility for the agreed upon control process to one Department. This one Department would then design and monitor the control process across all Departments.

<i>Management response:</i>

<i>HR will continue to email the Audit Report daily and file the responses received from the Financial Service Department. Human Resources will ensure (and track via written procedure) that they receive positive confirmation that reports have been validated by the Financial Services Department (the process owner), including all change requests.</i>
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The process of making a change to the employee compensation data includes controls to ensure that the change is appropriately authorized and in compliance with governing policy.

We arbitrarily selected a sample and examined transactions for the purpose of verifying that controls were in place and applied consistently (Attachment A, Sample one) As a result of this test work it is reasonable to believe that controls are in place in the Human Resources Department and that they regularly verify that a change is authorized and in compliance prior to entering it into Kronos.

We were advised by Financial Services that it is their practice to retain documentation to evidence the authorization for all changes posted by them. During our test work, we examined 13 changes posted by the Payroll Division. Of these 13, we found three that did not have paperwork readily available to indicate that the change was authorized.

Finding #2: We found that, on some occasions, the Payroll Division of the Financial Services Department did not have documentation readily available to evidence authorization for entering a change into Kronos.

Recommendation #2: We recommend that the Financial Services Department require all requests for changes be delivered to them in writing and that they maintain this documentation to support the request. If Financial Services is the source of a posting then we recommend that they in some way evidence that the change has been appropriately authorized and is in compliance with City policy.

Management response:

Financial Services maintains the documentation for requests for changes; however for the 3 instances cited the documentation was retained in email files which are not accessible except by the individual whose e-mail account it is. Therefore if that person is not available, the documentation is not available.

The Payroll Division within Financial Services immediately started a new process whereby going forward all documentation will be printed and retained in the payroll files for each pay period.

When reviewing controls over changes made to compensation, we learned that the responsibility for certain other controls is decentralized and lacks a process owner as well. Examples are as follows:

- We asked both HR and Financial Services if there were any controls within their areas of responsibility that would assure that the impact on budget was considered prior to implementation of a compensation increase. Both the Financial Services Department and Human Resources agreed that it is the responsibility of the Department Directors to validate that the cost of a compensation increase is within their budgetary parameters.
- Compensation amounts for contract workers are not governed by policy in the same manner as compensation for regular employees. Much is left to the discretion of the Department Directors. Although HR must approve of a pay range for a contract position, it is up to the Department Directors to determine what the starting compensation amount will be for a new contract worker and where in the range they will begin. There is no policy to govern this. HR did indicate, however, that new hire contract workers usually start at the entry level of an assigned range.

Once compensation is assigned, it becomes a legacy cost, which moves forward in time past current budgets and into future periods. It is possible that costs may be hidden in the current year by funded vacancies but ultimately will impact the future cost of labor. Budget variance reports may occur too late to prevent these future costs or may have excessive costs in certain positions obscured by vacancies in others.

It is important to have uniform controls across all City Departments that will ensure that Senior Management's intent regarding compensation is accomplished. If these controls lack a process owner, they will be weakened because responsibility is not clearly assigned, the process is not standardized, and the control is not monitored.

Finding #3: We found that there was not sufficient control in place to ensure that the long-term budget impact of compensation changes was considered prior to implementing a salary increase.

Recommendation #3: We recommend that Management assign a process owner to create and implement an internal control, which will ensure that the long term cost effects of compensation changes are considered prior to implementation. This control might include a comparison of the effects of a full 12-month period for the current situation compared to the impact of a full 12 months of the proposed situation. Also, the analysis might forecast at least through the end of the next upcoming fiscal year budget cycle and should identify the annual incremental cost for the next year.

Management response:

HR will add a statement to the status change notice indicating the Department Head is acknowledging that the financial implications of the request have been assessed and that they have sufficient budgetary dollars to fund the request for 12 months if applicable.

Finding #4: We found that it is up to the Department Directors to determine the starting compensation amount for a new contract worker and where that workers compensation will fall within the position range. Currently there is not a City policy that governs compensation for contract workers.

Recommendation #4: We recommend that Management document a policy to communicate their intent regarding compensation practices for Contract Workers. Implementation of this policy will then serve as an internal control and will allow Human Resources to verify compliance prior to implementing a compensation change for a Contract Worker.

Management response:

HR will add policy language regarding the starting compensation for contract employees into AR #29.

Objective two: Provide assurance that the City is in compliance with its policies and procedures regarding compensation.

Based on the audit work performed we are able to provide reasonable assurance that changes made to base compensation are in compliance with the City's policies and procedures regarding compensation. We did not examine differential compensation.

We arbitrarily selected a sample and examined documentation for the purpose of providing reasonable assurance that changes made to compensation are in compliance with City policies (Attachment A, Sample three) All sample items were found to be in compliance.

During this examination, however, we encountered the following items. Compensation Management has created a “Status Change Form - Levels of Approval” and posted this on the City’s intranet. This posting indicates that Add-Pay is required to be approved by two levels of superiors. When we examined detail transactions of changes made to the Kronos Employee database we found a change that was made to increase an employee’s pay by \$20 a month for an Add-Pay for a new certification achieved. The Status Change Form had the signature of the manager who initiated and authorized the change. The form however lacked a second level manager’s signature. We were advised that the change was covered by union contract requirements which lent authority to the change and that new certifications automatically provided for the applied increase.

Finding #5: We found that authorization of a change made to the database had not complied with the “Status Change Form – Levels of Approval” posted guidance. The change was supported however by a contract provision.

Recommendation #5: We recommend that the “Status Change Form - Levels of Approval” be reviewed and clarified to reflect Management’s intended directive. If it is Management’s intent that contractual obligation may replace a second level of approval, then this should be clearly stated.

<i>Management response:</i>
<i>HR will reinforce the policy that 2 signatures are required on all status change notices impacting classification.</i>

Article Twelve of the Personnel Ordinance, Section B, Classification Study states, “At least once every five (5) years the City Council shall consider the City’s need to have a comprehensive study of the Classification Plan conducted.” When we inquired about the frequency of wage benchmarking surveys done by/for the Human Resources Department, we were told by Management that the last City wide survey was done in 2008 by the Waters Consulting Group. Therefore, we are in compliance with this ordinance requirement. We were also advised that currently a wage survey is being done for the Rank and File Firefighters and a wage Battalion Chiefs Survey was conducted in 2008.

In 2006, Evergreen Solutions, LLC provided a Human Resources Performance Review report to the City in which they recommended that the City, “Implement a rotational Salary survey process to review the City’s pay plan on a yearly basis and review pay levels by classification each year for increase determination.” The Personnel

Ordinance, Article Thirteen, Section B General Salary Schedule states, “*Factors such as cost-of-living and competing wages and salaries in the public and private sectors shall be considered in establishing the General Salary Schedule.*” Both of these statements suggest that a more formal and regular plan for reviewing compensation is called for.

Lacking current data, Management’s ability to manage City compensation is constrained. A formal plan would provide Management with information to determine how well the City’s compensation policy is being met, how competitive the City’s compensation is, and the ability to forecast future projected needs for compensation.

Specifically, Management would benefit by tracking the City’s Market Ratio (which compares the average salary for a specific position to the market average for that position) and the Compa-ratio (which compares an individual employee’s salary to the midpoint of their position’s salary range.) Measurements and data, like these ratios, are tools that assist in managing risks like unjustified salary inequities, pay compression, employee dissatisfaction with compensation, and the compromising of the integrity of the merit pay system.

When we consulted the HR staff regarding Compa-ratios, they advised us that the Kronos HRIS Software can provide these but they are calculated using only base pay. Therefore they feel that they are not reflective of overall compensation because they do not include the numerous forms of differential pay (add pays) that are provided to many City employees.

Finding #6: There does not appear to be a formal plan in place for the regular review and market place benchmarking of the City’s compensation structure. Article Thirteen of the Personnel Ordinance requires that competing wages and salaries in the public and private sectors *shall* be considered for the General Salary Schedule.

Recommendation #6: We recommend that the Human Resources Department develop and implement a formal plan to regularly review the City’s compensation and determine the City’s pay position relative to the market place. This plan should include measurements and data that will alert Management to potential future risks related to compensation and provide them with the ability to manage those risks.

<i>Management response:</i>
<i>Human Resources will develop an on-going plan for periodic review of the City’s compensation structure.</i>

Objective three: Provide assurance that a methodology is employed to classify and reclassify positions and it is administered on a consistent basis.

We found a methodology is employed to classify and reclassify positions and for those classification/reclassifications that we examined, we found they were administered consistently. We also found that controls were in place and functioning.

We interviewed Management regarding the process used to classify and reclassify a position. In their process Management has defined six primary controls to ensure its' integrity. They are as follows: the requirement of a business justification from the requesting department; documentation to support the change and provide an audit trail; verification by Human Resources that all required approvals are present, all elements of a request are present and the request conforms to policy; defined compensable factors and classification worksheets to standardize and document the rationale behind a classification; verification by the Budget Division of the Financial Services Department that a new position is budgeted and funding is available prior to implementation; and the requirement of approvals of all classifications or reclassifications according to policy.

We arbitrarily selected a sample of classified or reclassified positions that occurred during the audit period and reviewed the related documentation to determine compliance to the process and to the controls listed above (Attachment A, Sample two) For those examined, we found the controls to be consistently applied.

However, the current process does not comply with the City's Administrative Regulation (AR) #33 Job Evaluation System, which was implemented in 2000. This AR#33 defines a Job Evaluation System to be used by the City when a position is evaluated and reclassified. The AR states that "*The system extracts data from the Comprehensive Position Questionnaire (CPQ) and processes it through a Job Evaluation software program*". We found that the CPQ and the software program are no longer in use but the policy has not been updated to reflect the current practices.

When Policies and Procedures are not kept current and enforced, Management incurs unnecessary risk. They communicate to staff that these policies lack importance and that the policies are not consistently required. It also communicates that Management may not be clearly aware of its intent and this communicates a lack of leadership. Staff may interpret that they have permission to selectively comply and Management's directives are undermined.

Additionally, City employees will not know the actual policy used to evaluate and classify a position. On an issue as employee sensitive as evaluation and classification of a position, it is important for employees to have confidence that the methodology used is applied without prejudice and/or bias. By maintaining an outdated policy that does not reflect actual practice, employee perception and confidence in the process may be diminished.

Finding #7: Administrative Regulation #33 Job Evaluation System is currently outdated and does not reflect the policies and procedures employed by the City.

Recommendation #7: We recommend that AR#33 be updated to reflect Management intent regarding Classification and Reclassification of positions and that subsequently the actual practices employed by the H.R. staff be aligned to this new Administrative Regulation.

<i>Management response:</i>

<i>HR will update the policy to reflect the current practice.</i>

Additional Information – Sample Selections

Sample one: We arbitrarily selected the Daily Audit Report for five days during the months of July, August, and September of 2009. These reports included changes posted to 261 individual employees (236 were made by HR and 25 were made by Financial Services). Of these, we examined postings made to 38 individual employees or 14.5% of the effected individuals. This sample was used for the purpose of verifying that controls were in place and applied consistently. **(Objective 1)**

	Total population	Sample selected
Daily Audit Trail Reports July, August, and September of 2009	66 days/reports	5 reports
Individuals listed on these 5 Daily Audit Trail Reports who had changes made to their Kronos records	261	38
Changes made by HR	236	31
Changes made by Payroll Division	25	7

To provide additional testing to support conclusions reached regarding controls in Financial Services, we requested a report listing all changes made by Financial Services during the period 4/1/09 through 9/30/09. We arbitrarily selected an additional 6 items and examined documentation for the purpose of verifying that controls were in place and applied consistently. **(Objective 1)** Therefore, in total we examined 13 changes made by the payroll division.

	Total population	Sample selected
Individuals who had changes made to their Kronos records by the staff in Financial Services between the period 4/1/09 – 9/30/09	220	13

Sample two: We arbitrarily selected six positions from the listings of classified and reclassified positions during the period from 10/1/08 – 12/31/09. This sample was used to gain reasonable assurance that there is a process in place to classify or reclassify a position and it is being administered consistently. **(Objective 3)**

	Total population	Sample selected
Reclassified positions October 1, 2008 – December 31, 2009	26	3
New Position classifications October 1, 2008 – December 31, 2009	18	3
Total	44	6

Sample three: This sample was selected to enable us to provide reasonable assurance that the City is in compliance with its policies and procedures regarding compensation **(Objective 2.)** We used the sample of 38 test items from Sample One. To this we added an arbitrary selection of nine individuals whose positions were reclassified from the listing of reclassified positions during the period 10/1/08 – 12/31/09 for a total of 47 items examined.

	Total population	Sample selected	Detail of sample
Sample One	261	38	
Reclassified Individuals: October 1, 2008 – December 31, 2009	30	9	

Of this sample of:	47	
Changes that did not impact compensation and were not examined for policy compliance.	21	
Changes impacting compensation that were examined for policy compliance.	26	
<ul style="list-style-type: none"> • Reclassifications with compensation changes 		9
<ul style="list-style-type: none"> • Union step increases 		6
<ul style="list-style-type: none"> • Regular new hires 		4
<ul style="list-style-type: none"> • New hire of contract workers 		3
<ul style="list-style-type: none"> • Changes to add pays 		3
<ul style="list-style-type: none"> • New hire at Charter School 		1