

**Payroll Audit Phase I:
Overtime and Compensatory Time**

May 2010

**City Internal Auditor's Office
City of College Station**

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Payroll Audit Phase I

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Introduction

The City Internal Auditor conducted this internal audit of the City's overtime and compensatory time policies, procedures and practices pursuant to Article III Section 30 of the College Station City Charter, which outlines the City Internal Auditor's primary duties.

An internal audit is an objective, systematic examination of evidence to assess independently the performance of an organization, program, activity, or function. The purpose of an internal audit is to provide information to improve public accountability and facilitate decision-making. Internal audits encompass a wide variety of objectives, including those related to assessing program effectiveness and results; economy and efficiency; internal control; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information.

The results of a citywide risk assessment conducted in October 2007 identified payroll as a potential audit topic for the fiscal year 2010 audit plan. On September 24, 2009, the City Council approved the City Internal Auditor's audit plan, which included a citywide payroll audit.

In March 2010, payroll policies and procedures were reviewed and a preliminary analysis of payroll data from fiscal year 2007 through 2009 was conducted. During the preliminary review, potential overtime and compensatory time cost savings were identified. In order to provide timely information to city management along with appropriate audit coverage, the citywide payroll audit has been divided into two parts. This audit report (Phase I) focuses primarily on overtime and compensatory time, while Phase II (which will be reported at a later time) will cover all other payroll related issues.

Reason for the Audit

Budget Cuts are Needed Due to Sales Tax Revenue Declines

Historically, the City of College Station has seen increases to its annual budget due to the need to provide additional services to its rising population and the availability of revenue from growing sales tax receipts. However, the recent downturn in the national and local economy has led to sales tax revenue declines, which have put pressure on city departments to make significant budget cuts. Because estimated overtime expenditures are over two million dollars per year, an audit to determine if savings can be realized in overtime and compensatory time expenditures was warranted. Table 1 below summarizes overtime expenditures and the value of compensatory time earned between fiscal years 2007 and 2009.

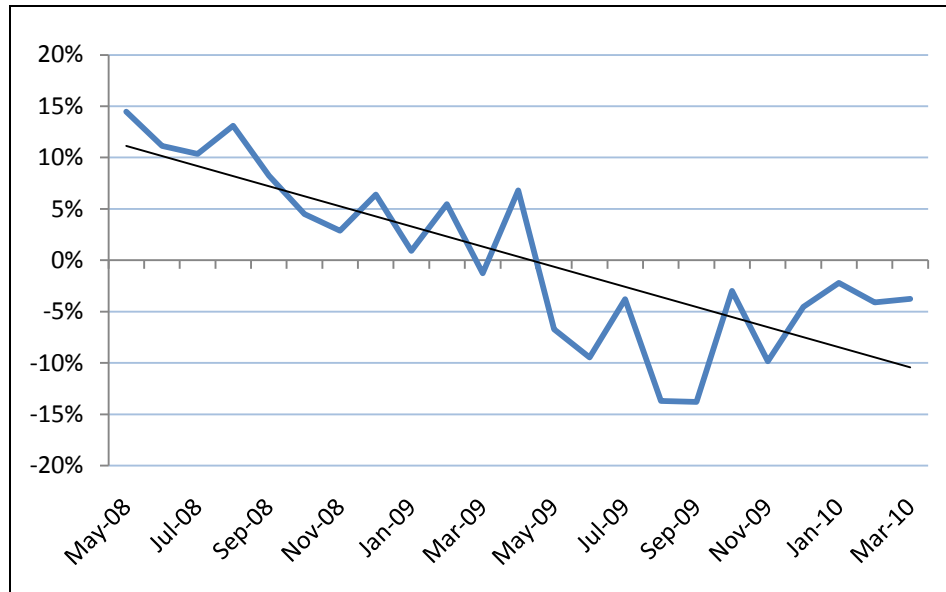
Table 1: Overtime & Comptime Earned from FY07 to FY09

Fiscal Year	Overtime Expenditures	Value of Comp Earned	Total Value of CE & OT
2007	\$ 1,706,000	\$ 311,000	\$ 2,017,000
2008	\$ 2,026,000	\$ 315,000	\$ 2,341,000
2009	\$ 2,013,000	\$ 337,000	\$ 2,350,000

In FY10, departments have been asked to reduce their budgets by \$3.9 million. There have been two budget reductions in fiscal year 2010. The first budget reduction called for approximately \$1,872,000 in cuts. Seventeen percent of the proposed cuts were in salary and benefits (mostly due to holding certain positions vacant). On March 25, 2010, city departments were asked to make another \$2,075,000 in budgetary cuts.

Sales tax revenue has experienced eleven consecutive months of negative growth. Sales tax is the largest single revenue source for the General Fund, accounting for approximately 36 percent of General Fund revenue. In May 2008, sales tax revenue increased 14.47 percent from sales tax revenue received in May 2007. Since May 2008, however, sales tax revenue growth has been steadily declining; and from May 2009 through March 2010, the City witnessed eleven consecutive months of negative sales tax revenue growth. Figure 1 on the next page describes this decline in sales tax revenue growth.

Figure 1: Sales Tax Revenue Declines (May 2008 to March 2010)



Overtime and Compensatory Time Background

FLSA Overtime and Compensatory Time Requirements

The Fair Labor Standards Act (FLSA) requires employers to pay at least one and one-half times the employees' regular rates of pay for all hours *actually* worked over 40 in the work week.

Compensatory time refers to a type of work schedule arrangement that allows workers to take time off instead of, or in addition to, receiving overtime pay. Non-exempt workers must receive one and one half times their normal hourly wage for every hour worked beyond 40 hours in a work week. For example, a worker who clocks 48 hours in one week would forego the 12 hours of overtime pay and instead take 12 paid hours off at some future date.

There are several exemptions from the FLSA for public sector employees. Certain employees in the following examples may be exempt from the overtime requirements of the FLSA:

- employees who solely at their option occasionally or sporadically work on a part-time basis for the same public agency in a

different capacity than the one in which they are normally employed

- employees at their option with approval of the agency, who substitute for another during scheduled work hours in the same work capacity
- employees that meet exemption requirements for executive, administrative, professional or outside sales occupations
- employees working in separate seasonal amusement or recreational establishments such as swimming pools, parks, etc.

Overtime and comptime for sworn firefighters is determined according to the FLSA 207(k) exemption. Section 7(k) of the FLSA provides that employees engaged in fire protection may be paid overtime on a "work period" basis. A "work period" may be from 7 consecutive days to 28 consecutive days in length. For example, fire protection personnel are due overtime under such a plan after 212 hours worked during a 28-day period. For work periods of at least 7 but less than 28 days, overtime pay is required when the number of hours worked exceeds the number of hours which bears the same relationship to 212 as the number of days in the work period bears to 28. The City's firefighters overtime and compensatory time compensation is calculated according to the FLSA 207(k) exemption.

City Overtime and Compensatory Time Policies

According to the City's Employee Handbook, department directors may schedule overtime when necessary to meet essential operating requirements. Employees are not permitted to work overtime, or accrue compensatory time off, without prior authorization and approval by their immediate supervisor or department director.

Non-exempt employees are eligible to receive overtime and comptime. Employees in non-exempt positions with actual work hours that exceed forty in the designated work week are eligible to receive overtime pay or compensatory time off at a rate of one and one-half times their regular rate of pay for the hours worked in excess of forty in a work week. The city policy also states that employees may be entitled to overtime pay for hours worked during a regularly scheduled holiday and for hours worked on an emergency call back basis.

The max accrual for non-exempt comptime is sixty hours.

According to city policy, the accrual of compensatory time off for non-exempt employees is limited to sixty hours, unless otherwise specified by the department. After accruing sixty hours of compensatory time off, an employee receives overtime pay for excess hours in the designated work week.

Leave is included in determining overtime and comptime.

The City's policy includes leave in determining overtime and compensatory time—which is above what the FLSA requires. Specifically, the policy states:

"For the purpose of computing overtime and compensatory time for non-exempt employees, holiday, sick, or vacation time used during the pay period may be included. Upon termination, non-exempt employees will be paid for all accrued overtime and/or compensatory time."

The city has a policy for the determination of overtime in the case of secondary employment. The City's policy relating to secondary employment is in alignment with the FLSA. According to this policy, if an employee, at his/her own option, works a second job with the City in a different capacity from his/her regular employment and on an occasional and sporadic basis, the hours worked in the two jobs should not be combined for the purpose of determining overtime.

Comptime policies for exempt employees have recently changed. Prior to November 1, 2009, exempt employees were eligible to accrue compensatory time on an hour-for-hour basis for work performed above the normal requirements of the job. The accrual of compensatory time for exempt employees was unlimited, but exempt employees were not to be paid for accrued compensatory time upon termination.

Effective November 1, 2009, exempt employees should not record any new compensatory time. However, department directors may grant employees up to 3 days of comptime (24 hours) when unusually high volume of work is required over an extended period of time. This time must be taken within 90 days of the time granted.

Audit Objectives

This audit addresses city overtime and compensatory time policies, procedures and practices. This report answers the following questions:

- Are city employees complying with applicable laws, policies, and procedures?
- Can the city realize any overtime or compensatory time cost savings through changing employee practices or city policies and procedures?

Scope and Methodology

This audit was conducted in accordance with government auditing standards, which are promulgated by the Comptroller General of the United States. Audit fieldwork was conducted from March 2010 through May 2010. Audit tests were performed using payroll data from fiscal year 2007 through fiscal year 2009, which comprised 77,701 payroll checks for approximately \$116,538,000.

The audit methods included:

- Reviewing the work of auditors in other jurisdictions and researching professional literature to identify best practices regarding overtime and compensatory policies and procedures.
- Interviewing staff responsible for performing various payroll related duties and oversight functions.
- Reviewing applicable city policies and procedures and relevant state and federal laws and regulations.
- Identifying potential overtime and compensatory time cost savings by (1) conducting data analysis using specialized auditing software and (2) reviewing a statistical sample of fiscal year 2009 time sheets.
- Identifying all current fulltime employees who have worked a second job with the City during the period of their fulltime

employment. Reviewing support documentation to determine if these employees' secondary employment met FLSA overtime exemption criteria.

- Interviewing city staff in all departments at the production level of the organization regarding scheduling, workload, overtime, and other payroll related issues; while observing them during the normal course of their workday.

Findings and Analysis

Opportunities to Cut Overtime & Comptime Expenses Exist

Given the forecasted budget shortfalls in the current fiscal year, this audit report was prepared to inform city management of potential savings that could be realized if changes are made in overtime and compensatory time policies.

Overtime Pay Exceeds FLSA Requirements

The FLSA requires that all covered nonexempt employees be paid overtime pay at no less than time and one-half their regular rates of pay for all hours worked in excess of 40 in a work week. City fire protection personnel are due overtime after 212 hours worked during a 28-day period. Hours of work include all of the time an employee is on duty at the employer's establishment or at a prescribed work place, as well as all other time during which the employee is suffered or permitted to work for the employer.

Aligning city policy with minimum FLSA requirements could realize significant savings. The city includes leave taken when determining overtime, which is not required by the FLSA. In other words, city employees are paid time and a half when hours actually worked plus any leave is greater than 40 hours in a work week. For example, an employee who is off sick Monday through Thursday and works 10 hours on Friday would get paid time and an half for 2 hours under current city practices.

Changing city practices by drafting an overtime policy in alignment with FLSA minimum requirements would result in significant cost savings. When hours actually worked during a work period do not exceed FLSA requirements for overtime, the City should compensate employees at straight time. By implementing such a policy the City would have saved between \$176,000 and \$191,000 in fiscal year 2009—an 8.7 to 9.5 percent reduction in total overtime cost.

Aligning city policy with minimum FLSA requirements would also reduce the amount of compensatory time earned. For example, the value of the compensatory time that would be saved in fiscal year

2009 (under such a policy) would have been between \$35,000 and \$39,000.

Fire protection personnel overtime calculation exceeds FLSA requirements. In order to accommodate the 24 hour shifts fire protection personnel work, these employees work 216 hours in a 28 day period. Therefore, they should be compensated for 4 hours of overtime for each 28 day period based on FLSA rules. The City, however, is compensating these employees for 5.33 hours of overtime every 28 day period. This overtime compensation is above what is required by the FLSA. As a result, firefighters received overtime overpayments of approximately \$39,460, \$45,110, and \$45,880 in fiscal years, 2007, 2008, and 2009 respectively.

Temporary or Seasonal Employees are Receiving Overtime

Seasonal employment is defined as annually recurring periods of work of at least 6 months, but less than 12 months, during a calendar year. Recurring work that last less than 6 months is generally considered as temporary employment. One of the purposes of seasonal and temporary employees is to reduce overtime costs during forecasted periods of peak workload. Therefore, temporary or seasonal employees typically do not earn overtime. Table 2 below provides a summary of the overtime that has been paid to seasonal or temporary employees over the last three fiscal years.

Table 2:
Temporary/Seasonal Employees Paid Overtime

Department	FY 07	FY08	FY09
Parks & Rec	\$ 94,919	\$ 40,985	\$ 10,472
Gen Govt	33,658	2,658	3,588
Fire	4,029	365	0
Fiscal	1,593	0	0
BVSWMA	367	0	0
IT	0	257	0
Totals:	\$ 134,566	\$ 44,264	\$ 14,949

In addition, local government employees working in separate seasonal amusement or recreational establishments such as swimming pools or parks are exempted from FLSA overtime requirements if (1) the establishment does not operate for more than seven months in a calendar year; or (2) during the preceding year, its average receipts

for any six months of the year were not more than 33 1/3 percent of its average receipts for the other six months of that year. Sixty percent of the temporary/seasonal employees who received overtime over the last three fiscal years were seasonal aquatics employees.

Based on interviews with Parks and Recreation staff, some seasonal employees are misclassified. These misclassified seasonal employees work in a variety of capacities year round and are not taken off of the City's payroll. Therefore, these employees should be classified as part-time employees who are not exempt from FLSA requirements.

Overtime is Earned Regardless the Hours of Sick Time Taken

By flexing schedules, instead of approving sick leave, the City could realize significant savings in overtime expenses. The City could have saved between \$156,000 and \$169,000 in fiscal year 2009 overtime expenditures by implementing such a policy. For example, within the scope of my review, I found a city employee who clocked 20 hours of regular time, 36 hours of sick, 12 hours of overtime, and 1.75 hours of compensatory time within a work week. If this employee was required to flex his schedule in lieu of taking sick leave, he would have only been paid for 40 hours of straight time.

Some Second Jobs Don't Meet Overtime Exemption Criteria

As of March 2010, there were 100 fulltime employees who have worked a secondary job with the City during sometime of their tenure. Over 90 percent of the secondary jobs worked by city employees were in the Parks and Recreation Department. Approximately 68 percent of secondary employment is the result of city sponsored special events—37 percent consisted of event staff and 31 percent consisted of police officers working security for special events.

In considering if secondary employment within the City meets FLSA exemption rules, four criteria must be met. When compared to the primary employment, the secondary employment at the same public agency must be (1) occasional and sporadic, (2) part-time, (3) at the employee's option, and (4) substantially different.

I reviewed employment data for all 100 fulltime employees who worked a second job with the City. I found that all secondary employment was part-time in nature and appeared to be at the

employees' option. On the other hand, some records appeared to indicate that the secondary job was recurring and of a similar nature to the employees' fulltime positions. Table 3 below summarizes these results. Further work is needed to determine for certain if all or any of these employees were due any overtime payments.

Table 3: Secondary Employment Review Results

Number of Employees	Are the jobs in the same department?	Are the jobs' duties similar?	Is secondary employment ongoing?	At least a year in second job?
4	✓	✓	✓	✓
1		✓	✓	✓
4	✓		✓	✓
7			✓	✓
8	✓	✓		✓
2	✓	✓		
35		✓		✓
11	✓			✓
4	✓			
20				✓
4				

Staff is Using Comptime to Earn Comptime or Overtime

Some city employees are taking compensatory time to earn additional compensatory time or overtime. This can be considered an area of abuse because employees earn compensatory time and overtime at time and a half, but compensatory time is taken on an hour for hour basis. If this practice was abolished, the value of the savings in terms of time or money would be between \$29,000 and \$32,000.

Recommendations

1. The City Manager should consider two options in changing the City's overtime and compensatory time policies.

Option 1:

- a. Align city overtime and compensatory time with FLSA minimum requirements. For the purpose of computing overtime and compensatory time for non-exempt employees, holiday, sick, or vacation time used during the pay period would no longer be included.
- b. Adjust fire personnel overtime pay compensation to reflect a 28 day pay period based on the FLSA 207(k) exemption.
- c. Only under very limited circumstances should temporary or seasonal workers be scheduled to work overtime.
- d. The practice of using compensatory time to earn overtime or additional compensatory time should be eliminated.

Option 2:

In addition to all the policy changes considered in option 1, the City Manager should consider directing departments to utilize flexible scheduling when sick leave and overtime or compensatory time is recorded during the same work week. Table 4 below summarizes the estimated FY 2009 savings that may have been realized if these recommended policies would have been in place.

Table 4: FY09 Estimated Overtime & Comptime Savings

FY09 Estimated Savings	Option 1	Option 2
Overtime exceeding FLSA laws	\$176,000	\$121,000
Flexing sick leave in lieu of OT	\$0	\$156,000
Comptime exceeding FLSA laws	\$35,000	\$35,000
Fire FLSA 207(k) exemption	\$46,000	\$46,000
Temp/seasonal overtime savings	\$15,000	\$15,000
Using comptime to earn OT or CE	\$29,000	\$29,000
Totals:	\$301,000	\$402,000

When implementing parts or all of this recommendation, the City Manager should consider the possible impact to emergency situations. City supervisors and staff at various departments expressed concern that many employees would become unavailable if they are not guaranteed some sort of premium pay for being called into work during non-scheduled hours. The greatest risk occurs during the rare circumstances a city emergency arises where additional employees (other than the staff who are on-call) are needed to mitigate the situation.

2. The Parks and Recreation Department should coordinate with the Human Resources Department a good deal before the opening of seasonal facilities to better plan the hiring process of temporary and seasonal workers. In addition, the HR Director should take all the necessary steps to (1) create a part-time without benefits employee classification, and (2) ensure that all city employees are appropriately classified.

According to Parks and Recreation supervisors, there are two primary causes why payroll records indicate that there are several temporary and seasonal workers receiving overtime. First, the employment process is complex, sometime taking weeks to complete; therefore, an inadequate number of seasonal workers are hired prior to the opening of seasonal facilities. Second, some employees are employed throughout the year on a part-time basis. These employees are treated as part-time without benefit employees; however, the City does not currently have such a classification—only a part-time with benefits classification exist.

3. The HR Director should develop procedures to ensure that secondary employment within the City meets the four FLSA exemption criteria—the secondary employment must be (1) occasional and sporadic, (2) part-time, (3) at the employee's option, and (4) substantially different. The HR Director should also work with Parks and Recreation staff to develop a solution to meet staffing needs at special events, while complying with the FLSA.

In addition, better record keeping is needed to ensure that secondary employment hire and termination dates are accurate. Therefore, these records will not appear to be on-going, part-time positions when they are actually temporary and sporadic in nature.

Management Response

Date: June 10, 2010
To: Ty Elliot
Through: Glenn Brown, City Manager
From: Alison Pond, Human Resources Director
Cc: Kathy Merrill, Assistant City Manager
Cc: David Neeley, Assistant City Manager
Cc: Jeff Kersten, Chief Financial Officer

Overall, Management agrees with the recommendations of the City Auditor related to implementation or modification of current practices. It should be noted that the savings that are highlighted in these findings are based on a statistical sampling and may not be actual dollars saved by modifying these practices.

Currently pay practices fall under the Fiscal Services Division (Payroll), however the policy of these pay-related items are under the jurisdiction of the Human Resources Division. Thus, the response from this audit comes directly from the Human Resources Director. Based on the findings and recommendations of this audit, the following is a specific response to each of the categories listed in the audit

Item #1: Overtime & Compensatory Time Policies

The four items listed under Item #1 are related, but require an individual response.

a. Align city overtime and compensatory time with FLSA minimum requirements.

Response: Management concurs with this recommendation and will modify the current policy to realign to meet the requirements of FLSA. This rewritten policy will include the understanding that only time worked will be counted towards overtime, to exclude counting vacation, sick, holiday pay—which are not hours worked, but earned.

b. Adjust fire personnel overtime pay compensation to reflect a 28 day pay period based on the FLSA 207(k) exemption.

Response: Firefighter pay is currently calculated based on a formula that includes their 24-hour workday, and calculations are based on the assumption of paying out a yearly rate that is different than typical pay calculations. Texas Law has allowed for a calculation of hours that would include a different assumption of overtime pay. The HR Director and CFO will review the current calculation method used in calculating firefighter pay and submit to the City Manager's office for further review.

c. Only under very limited circumstances should temporary or seasonal workers be scheduled to work overtime.

Response: Management agrees with this finding, and will begin the implementation of a new category of worker, to include part-time, non-benefitted to better account for the various scenarios workers may be working. This additional category would be added for those employees who work longer throughout the year on a part-time basis, but not eligible to receive benefits.

d. The practice of using compensatory time to earn overtime or additional compensatory time should be eliminated.

Response: Management agrees with this finding and will educate supervisors regarding the practice of approving compensatory time, which would exclude the ability to earn overtime on comp time hours.

Item #2: Seasonal/Temporary Employment

Recommendation; *HR Department coordination of hiring for part-time/seasonal employees and creation of part-time employee classification. In addition, HR should ensure that all city employees are appropriately classified.*

Response: Management agrees with adding an additional category of part-time, non-benefitted and will work on the creation of this additional classification and moving employees to the correct classification.

Item #3: Secondary employment within the City.

Recommendation: *The HR Director should develop procedures to ensure that secondary employment within the City meets the four FLSA exemption criteria including: 1) occasional and sporadic, 2) part-time, 3) at the employee's option, and 4) substantially different.*

Response: Management agrees with this recommendation in the criteria of secondary employment as it relates to FLSA regulations. HR Director will review current procedures and make any changes to ensure that this criteria is met regarding any secondary employment within the City. Currently managers oversee the hiring and termination process for seasonal/temp employees, and HR will continue to educate supervisors of the importance of ensuring that employees are terminated from the system in a timely fashion.