



Mayor Jim Newberry

LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT
Office of Internal Audit

INTERNAL AUDIT REPORT

DATE: February 19, 2008

TO: Jim Newberry, Mayor

CC: Joe Kelly, Senior Advisor for Management
Kimra Cole, Commissioner of General Services
Kyna Koch, Commissioner of Finance & Administration
Jerry Hancock, Director of Parks & Recreation
Michael Allen, Director of Human Resources
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, Director of Internal Audit

RE: Parks & Recreation Payroll Internal Audit Report

Background

The Division of Parks & Recreation is responsible for the operation and maintenance of more than 100 parks consisting of more than 4,000 acres in Fayette County. The Division offers a wide variety of services to the public, including but not limited to; athletics, after school programs, aquatics, community centers, cultural arts, day camps, fitness trails, golf, natural areas, playgrounds, special events, and senior adult programs. The extensive number of parks and events requires a highly decentralized operational structure. Employees are therefore placed throughout the county, and are managed by on-site and off-site supervisors and managers. Due to the seasonal or transitory nature of many of the programs, an extensive number of Parks & Recreation employees are employed as Seasonal or Part-Time.

The population of Seasonal employees in the Parks Division for calendar years 2006 and 2007 was 968 and 863, respectively, while the population of Part-Time Non-CERS employees in the Parks Division for calendar years 2006 and 2007 was 414 and 518, respectively. By Kentucky Revised Statute, Seasonal employees are defined as any employee who works no more that six months (unlimited hours) in either a calendar or fiscal year, while Non-CERS Part-Time employees are defined as employees who may work unlimited months, but must work less than an average of 100 hours per month (based on the actual days worked). For Calendar 2007 Parks & Recreation gross pay

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for all employees totaled \$11,339,152, of which \$3,874,245 (34.2%) was for Seasonal and Part-Time employees.

Scope and Objectives

The general control objectives for the audit were to determine that:

- Non-permanent Division of Parks & Recreation employees were properly coded into the LFUCG payroll system as Seasonal or Part-Time, according to Kentucky Revised Statutes as it applies to the Kentucky Retirement Fund
- Management has established internal controls to ensure payroll payments are only made to actual employees within the Division of Parks & Recreation
- There was no evidence of duplicate payroll payments within the Division of Parks & Recreation for January 1, 2006 through September 2, 2007
- Division of Parks & Recreation Part-Time and Seasonal employees are paid using a pay scale acceptable to the LFUCG

Statement of Auditing Standards

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures provided reasonable assurance that the general control objectives were being met. Opportunities to enhance controls are included in the Summary of Audit Findings.

SUMMARY OF AUDIT FINDINGS

1. Eligible Employees Not Receiving CERS Contribution

We performed a detailed review of Seasonal employee payroll activity for the period January 1, 2006 through September 2, 2007, to determine if Seasonal Employees are properly coded to the correct Employee Classification and if those employees qualified to participate in the County Employee Retirement System (CERS) are in fact doing so. Per the Kentucky Retirement System (KRS), Seasonal employees may work six months within a calendar or fiscal year without being required to

pay into the CERS. However, if they exceed that threshold, the employer and employee must contribute to the CERS for that employee if the employee also works an average of 100 hours per month per calendar or fiscal year. (In practice, KRS rounds the average hours worked to the nearest 10, so any employee who averages 95 or more hours worked per month is treated by KRS as having worked 100 average hours).

For calendar 2006, our review noted that 22 of the 968 Non-CERS Seasonal employees (2.3%) should have been classified as Seasonal CERS employees because they exceeded six months of employment with LFUCG and should be allowed to participate in the CERS. In addition, 62 of the 968 (6.4%) Non-CERS Seasonal employees were misclassified based upon the 2006-2007 Kentucky Retirement System Reporting Official Manual, and should have been Part-Time employees, because employees who work less than an average of 100 hours per month and are expected to work more than six months in either a calendar or fiscal year should be classified as Non-CERS Part-Time employees per the Kentucky Retirement System and its supporting Kentucky Revised Statutes. For calendar year 2007 through September 2, 2007, 14 of 863 (1.6%) Non-CERS Seasonal employees exceeded six months of employment averaging more than 100 hours per month and therefore should have been classified as Seasonal CERS, while 13 of the 863 (1.5%) should have been classified as Part-Time because they worked less than an average of 100 hours per month.

We also performed a similar review for Non-CERS Part-Time employees. For calendar 2006, our review noted that 29 of the 414 Non-CERS Part-Time employees (7.0%) should have been classified as either CERS Part-Time or Seasonal CERS employees, based upon the above stated criteria. For calendar year 2007 through December 31, 2007, this number was reduced to seven of 518 (1.4%) non-CERS Part-Time employees due to Parks taking a pro-active approach to resolving this issue when it was brought to their attention by Internal Audit personnel during audit field work. Parks & Recreation management developed an automated tracking report to identify non-CERS Part-Time employees who are about to exceed the 100 hours per month average that would then require them to be re-classified as CERS Part-Time employees. We noted that this report can also be used to track Seasonal employees work history, although in its current format it requires significant manual review to identify Seasonal employees who are nearing the six month limit for Non-CERS Seasonal.

It is recommended that certain job titles be classified initially as Non-CERS Part-Time (e.g. ESP person who works during the school year and does not reach or exceed an average of 100 hours per month), while certain other jobs are clearly better classified as Non-CERS Seasonal (e.g., a lifeguard who only works during the summer pool season). A decision matrix may be the best method to help assure an employee is classified correctly when they begin employment with LFUCG. Therefore, such a matrix has been developed by the Office of Internal Audit and approved by Kentucky Retirement System management personnel as a possible solution to this classification problem (See Attached). In addition, computer-generated management reports need to be created to identify Non-CERS Seasonal employees nearing the six months' threshold of employment with LFUCG during a calendar or fiscal year in order to reclassify them as non-CERS Part-Time if appropriate.

The 2006-2007 Kentucky Retirement System Reporting Official Manual recommends an audit of all Part-Time employees at the end of each calendar or fiscal year to determine if such employees have also had outside employment with another participating agency whose cumulative effect would require employee participate in the Kentucky Retirement System (the same approach is probably

warranted for Seasonal employees as well). It is the opinion of the Office of Internal Audit that this recommendation has merit, and the Division of Human Resources may want to consider performing such an audit on an annual basis. As an alternative approach requiring less time and effort, LFUCG should consider requiring Seasonal and Part-Time employees to inform Human Resources upon being hired, and at any point during their employment with LFUCG, if they have been employed by any other agency or government that may cause them to be eligible to participate in the CERS. The initial reporting, and requirement to report any subsequent employment with another agency or government, could be incorporated into the Benefits Available for Part-Time, Seasonal, and Temporary Employees acknowledgment form that must be signed by all Part-Time and Seasonal new hires.

Director of Parks & Recreation Management Response: We agree with the findings. The rules provided to us over the last five years with respect to seasonal and part-time have changed so often, that compliance has been almost impossible. Only since Internal Audit became involved has clarity been achieved, which included the rescission of rules provided to us in the Spring of 2007, during the audit. We have taken steps, as indicated, to improve our classifications. IA's decision matrix, now 'approved' by CERS will help our managers accurately classify seasonal/part-time employees. The process must allow us flexibility to either move seasonal/P-T wage money within sections, between retirement categories, or disregard over/under spending, since employee tenure affects their status under the retirement rules and individual employee decisions about hours, where else they work etc cannot be predicted. IT needs to assist in accurate reporting of hours worked. We would welcome appropriate language on the application placing the responsibility for reporting non-LFUCG CERS program participation on the employee. We are not equipped to perform such audits internally.

Commissioner of General Services Management Response: I concur with the recommendations as stated.

Director of Human Resources Management Response: We will have a meeting with the Director of Parks and the HR Generalist assigned to discuss audit's recommendations concerning changing the classifications. I think it would be advisable to have a signed statement from each employee belonging to these classifications that acknowledges the responsibility to inform HR if they are employed by any other agency in LFUCG that would trigger the CERS eligibility.

Commissioner of Finance & Administration Management Response: I concur with the recommendations as stated by Internal Audit.

2. Pay Scale Parameters not Consistently Adhered to

For the most part, specific Seasonal and Part-Time positions are not created by Ordinance and their related pay scales are not governed by Ordinance. Their pay is primarily dictated by wage scales developed internally by Parks & Recreation management, and their pay rates are managed at the Parks & Recreation Superintendent level. We therefore examined a sample of Seasonal and Part-Time employees hourly (or by event) wages to determine if these employees are paid according to the Division of Parks & Recreation's internal payroll scales.

We obtained the payroll data for all Seasonal and Part-Time employees in the Division of Parks & Recreation for the period January 1, 2006 through September 24, 2007, and compared their hourly wage rate to a position and experience based wage scale provided to us by Parks & Recreation management. From this population, we selected 75 Part-Time employees whose hourly wages were 1.3 Standard Deviations above or below the mean (average) for all Part-Time employees in each Position Title to determine the justification for the high or low deviations in pay. The same approach was also taken for Seasonal employees, except that 1.2 Standard Deviations was used to select 49 Seasonal employees as a 1.3 Standard Deviation would have produced a sample size considered too small for sufficient testing purposes. Job experience was validated on a judgmental sample basis by reviewing selected employees' job applications and years of service per the mainframe Payroll System.

Our testing noted that 7 of 75 (9.3%) Part-Time employees were being paid above their maximum pay-grade scale based on the given number of years of experience, while 2 of 75 (2.7%) Part-Time employees were being paid below their minimum pay-grade scale based on the given number of years of experience. Also, 2 of 16 (12.5%) Part-Time employees did not have in their personnel files the documented work experience used by Parks Management in the experience portion of their wage calculations.

Our testing also noted that 7 of 49 (14.3%) Seasonal employees were being paid above their maximum pay-grade scale based on the given number of years of experience, while 5 of 49 (10.2%) Seasonal employees were being paid below their minimum pay-grade scale based on the given number of years of experience. Also, 2 of 22 (9.1%) Seasonal employees did not have in their personnel files the documented work experience used by Parks Management in the experience portion of their wage calculations.

The test results indicate that wage parameters set by the Parks & Recreation Part-Time and Seasonal pay-scales are not being consistently complied with. The test results also indicate that proof of work experience should be consistently obtained as validation of wages based upon the work experience criteria. The Director of Parks & Recreation represented to us during the audit that internal pay scales have existed at Parks & Recreation for several years with inconsistent application, while the practice of monitoring for compliance with those scales has only begun in the past year.

The Office of Internal Audit recognizes that it is important for the Division of Parks & Recreation to be able to maintain flexibility in its Seasonal and Part-Time hiring practices in order to respond to the needs of the public in a highly decentralized, labor intensive, service oriented operation. However, it is also equally important that Parks & Recreation demonstrate consistency and full accountability in establishing pay rates for its Seasonal and Part-Time employees. To that end, it is recommended that the Divisions of Parks & Recreation and Human Resources senior management establish a process whereby Parks & Recreation retains the ability to hire Seasonal and Part-Time employees, but where oversight of pay rates is shared between Parks & Recreation and Human Resources management. One possible approach is to have the hourly rate calculated by the hiring Supervisor and then checked by the Payroll Coordinator using clearly defined pay rate guidelines. This initial calculation would then be validated by a Superintendent reporting directly to the Director of Parks & Recreation. This should be done when the employee is hired and prior to their being entered into the LFUCG payroll

system. The Human Resources Generalist assigned to Parks would then test such pay rates on a sample basis to provide Human Resources' independent oversight of this process.

Director of Parks & Recreation Management Response: We agree with the findings but not all the recommendations. The few affected employees have either been terminated or their pay is being adjusted or they are being moved into more appropriate classifications with different pay scales. We believe all the discrepancies are the result of class assignment mistakes, not the result of paying less/more than the scale relative to peers performing similar work. Hundreds of our employees move between jobs within Parks during the year, which creates a P-1/reclassification effort which needs to be better monitored by us, as well as assurances that HR will input the changes in a timely manner. We will add a 'Pay Approval' section to the seasonal/part-time application (actually a 'stamp' on the back page), where supervisors will note the class title, min and max of the range, and any applicable adjustments for education, tenure, special qualifications or other legitimate adjustments to the minimum of the grade being paid, and the resulting actual pay level, which would become a permanent part of the record. It will need to be signed by the hiring supervisor, checked by the Payroll Coordinator, and initialed by the applicable Superintendent. We welcome HR's audit of such a system, after the fact, but can't wait for them to perform any such review before individuals are put on payroll.

Commissioner of General Services Management Response: I concur with the recommendations as stated.

Director of Human Resources Management Response: A matrix of experience and corresponding pay for positions will be developed for the year's Seasonal and Part-Time hiring with the HR Generalist having oversight responsibilities.

Commissioner of Finance & Administration Management Response: I concur with the recommendations as stated by Internal Audit.

3. Pay Range Variances Between Programs

Some pay ranges for the same job title differ between programs, apparently due to the fact each Superintendent has a different pay scale matrix with different steps for each year of experience. Some also have educational considerations built into their pay scales while others do not. A notable example is Class Code 886 (Recreation Leader), which has the following annual pay scale differences within the various programs:

<u>Program</u>	<u>Start Pay</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
ESP (S)	\$7.00	\$7.25	\$7.50	\$7.75	\$8.00
Special Pop. (S)	\$7.00	\$7.25	\$7.50	\$7.75	\$8.00
Natural Areas (U)	\$7.25	\$7.76	\$7.96	\$8.31	\$8.75
Programming (S)	\$7.25	\$7.85	\$8.45	\$9.05	\$9.65

S=Seasonal

U=Undefined (possibly both Seasonal and Part-Time)

We also noted three instances out of a population of 47 Part-Time employees with pay grades defined by Ordinance who were paid less than the minimum hourly rate as defined by that Ordinance. In addition, a number of Part-Time positions had both Ordinance defined and Parks & Recreation created pay scales. While Parks & Recreation appropriately used the Ordinance pay scale, this observation further identifies the need for a simplified pay scale system for the Parks & Recreation Part-time and Seasonal employees.

It is recommended that Parks & Recreation and Human Resources senior management jointly evaluate Seasonal and Part-Time pay scales for the various programs to determine that any variances are reasonable and justifiable based upon actual job duties and other variables (e.g., market wage conditions related to those specific job duties). With the exception of those positions that are clearly minimum wage in nature and therefore should be exempt from annual wage increases, it may be advisable to evaluate whether Seasonal and Part-Time employees job titles should be more generic in nature, thereby making them fewer in number with fewer pay ranges to manage. To that end, it may also be advisable to assign the various Part-Time and Seasonal job titles to existing pay ranges already created by Ordinance, e.g., in the Grade 102-116 range. By adapting the job titles to fit under LFUCG pay scales already in existence, this would instill a more disciplined approach into the pay range process.

Director of Parks & Recreation Management Response: We agree with the recommendation for fewer, broader classification ranges and have already started and will complete that effort before our big spring ramp up. We will send a consolidated package of Classification titles and pay ranges to HR, but feel that our market and program knowledge better prepares us to determine our salary needs. We disagree with IA regarding tying our seasonal/PT pay ranges to existing pay ranges created by Ordinance although their typical 50% range spread is a good model. We feel that that would create certain annual pay raise expectations that are not necessary, and we pay a lot of people at the minimum wage (currently \$5.85/hr) while the minimum of civil service grade 102 is \$7.766/hr. The problems identified here are of execution, not pay scale levels.

AUDITOR'S NOTE: The concerns expressed by the Director of Parks have merit with regard to managing the annual cost (and potential cost increases) of Seasonal and Part-Time labor. We noted that most Seasonal and Part-Time positions have sliding pay scales as developed by Parks management, and the pay increases as defined in those scales are based on years of experience. If Parks does not adopt the existing Ordinances pay ranges as recommended, it will be important to develop procedures to ensure that rate increases built into existing Parks Seasonal and Part-Time pay scales are consistently applied.

Commissioner of General Services Management Response: I concur with the recommendations as stated.

Director of Human Resources Management Response: I concur with this recommendation and will request implementation.

Commissioner of Finance & Administration Management Response: I concur with the initial recommendation of Internal Audit. A more disciplined approach to the pay range process is essential.

Human Resources Senior Management and I will work with the Division of Parks and Recreation to ensure consistent application across government.

4. Ordinance Needs Clarification

Section 22-59(1) of the LFUCG Code of Ordinances addresses the accrual of vacation and sick leave for Seasonal and Part-Time employees. It appears that there is some ambiguity of purpose when referenced against other applicable ordinances. It is therefore recommended that the Department of Law confer with the Administration and Council as to the overall intent of the ordinances, and that the ordinances be amended to eliminate the ambiguities.

Director Parks & Recreation Management Response: We agree.

Commissioner of General Services Management Response: I concur with the recommendations as stated.

Director of Human Resources Management Response: Concur.

Commissioner of Finance & Administration Management Response: I concur.

RISK OBSERVATION

The following observation identifies a process improvement associated with LFUCG payroll activity that is not considered an audit finding, but that if implemented would result in improved payroll internal controls and reduced payroll processing costs.

Full Use of Direct Deposit for Payroll Purposes Recommended

The Lexington Fayette Urban County Government currently pays its employees through either direct deposit or actual printed paychecks, with approximately 900 (about 26%) being paid via the latter method. Employees having direct deposit also receive a paper pay stub.

In our opinion, LFUCG senior management should consider converting to 100% direct deposit for payroll purposes with pay stubs issued electronically. The Director of Finance for the Fayette County Schools has informed us that going to 100% direct deposit has been successfully implemented in that organization, with significant efficiencies obtained in the payroll recon process, as well as reduced paper costs and mailing costs. Direct deposit is also recommended by the Association of Certified Fraud Examiners, as it eliminates the risks created by paper paychecks, including forgery, check alteration, and most theft schemes associated with payroll activity (it does not prevent the misdirection of deposits into unauthorized accounts). The overall increase in internal controls and the likelihood of increased efficiencies and cost reductions make this an option well worth consideration

by senior management, with the conversion occurring either within the current mainframe payroll process or when the STARS Payroll Module is implemented.

Director of Parks & Recreation Management Response: We agree conceptually that direct deposit should be strongly encouraged, but a substantial number of our seasonal/P-T employees are young people/adults without bank accounts and we don't feel that a bank account should be a condition of employment.

Commissioner of General Services Management Response: I concur with the recommendations as stated.

Director of Human Resources Management Response: Due to the nature of the workforce I don't see it likely that LFUCG can require a bank account as a condition of employment. We would be putting ourselves in a less than competitive position with this group of highly sought employees. I feel we should strongly recommend rather than require.

Commissioner of Finance & Administration Management Response: I concur with the recommendation of the Internal Auditor and will seek to implement as we move forward with the implementation of the Human Capital Management module of PeopleSoft.

Part-Time and Seasonal Decision Model

