CITY AUDITOR'S OFFICE

Retirement Incentive Program and Reorganization

June 14, 2010

AUDIT REPORT NO. 1014

CITY COUNCIL
Mayor W.J. “Jim” Lane
Lisa Borowsky
Wayne Ecton
Vice Mayor Suzanne Klapp
Robert Littlefield
Ron McCullagh

June 14, 2010

Honorable Mayor and Members of the City Council:

Enclosed is a report on the City's *Retirement Incentive Program and Reorganization*, Audit No. 1014. This audit focuses on whether the provisions of the Retirement Incentive Program were followed and identifies savings realized as a result of the Program, reorganization and related budget initiatives.

We found that management's projected savings for the Retirement Incentive Program, reorganization and related budgeted initiatives were achieved overall. However, key variables affecting program costs were not presented to City Council. In particular, paying the retirement incentive amount after each employee's effective retirement date could have minimized or avoided the additional payment due to the Arizona State Retirement System. In addition, program provisions were not consistently followed, and some salary actions reduced the available savings associated with the Retirement Incentive Program, reorganization and budget related initiatives.

We would like to thank staff in the Human Resources and Finance & Accounting Divisions for their assistance throughout this audit.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

Sharron Walker

Sharron Walker, CPA, CFE
City Auditor

Audit Team:

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EXECUTIVE SUMMARY

This audit of *Retirement Incentive Program, Reorganization and Related Budget Initiatives* was approved by the Audit Committee as an amendment to the Council-approved FY 2009/10 Audit Plan.

In January 2009, the former City Manager implemented a Council-approved Retirement Incentive Program (Program) designed to help address the City's unprecedented $35 million FY 2009/10 budget deficit. Ultimately, 100 employees participated in the program designed by the "Compensation Options Team." In addition to the Program, the former City Manager highlighted the following staff-related actions to reduce City expenses: layoffs, elimination of vacant positions, cancellation of an employee 2% market adjustment, a 2% pay reduction, and elimination of merit increases and the Superior Performance Program.

We found that actual costs exceeded the anticipated costs by $582,784, largely due to salary increases after the reorganization. However, primarily due to laid-off employees' salary and benefits not being factored in, the resulting savings were $3.8 million more than had been projected. The structural payroll savings from eliminated positions, which totaled approximately $13 million, can carry forward into future years until positions are replaced or salaries increased.

In addition, we found that:

- Management did not advise City Council of an available option to pay the retirement incentive *after* the employee's retirement effective date. Such an action may have reduced the City's $5.2 million invoice from the Arizona State Retirement System (ASRS) by more than $4.8 million.
- Salaries of 64 Program participants were excluded from the 2% across-the-board pay reduction that was effective on July 5, 2009. As a result, the cost to the City was approximately $62,000, which includes additional salary, vacation and medical payouts.
- Rounding up service years and including prior City service years in the incentive payment calculations was not disclosed to Council. This resulted in 83 weeks of additional pay, totaling almost $115,000.
- Program provisions were not consistently followed. A program application was accepted beyond the due date and some required approval signatures were missing. Further, 12 calculation errors totaling almost $44,000 were made. Only half of these errors were corrected, leaving 6 overpayments totaling $9,500.
- Some salary actions reduced the available savings associated with the Retirement Incentive Program, reorganization and related budget initiatives. Since July 1, 2009, 8 new positions have been added totaling more than $591,000; 161 employees have received salary increases totaling more than $820,000; and 19 employees' salaries exceed their maximum salary range, with the excess totaling more than $124,800.

BACKGROUND

In January 2009, the former City Manager implemented a Council-approved Retirement Incentive Program (Program) designed by an ad hoc Compensation Options Team (see textbox) to help address the City's unprecedented $35 million FY 2009/10 budget deficit. This audit focuses on whether the provisions of the Retirement Incentive Program were followed and identifies savings realized as a result of the program, reorganization and other related budget initiatives.

*Compensation Options Team**
Acting City Manager
Assistant City Manager (3)
Financial Services General Manager
Financial Services Assistant General Manager
Budget Director
Payroll Manager
Senior Budget Analyst
Human Resources General Manager
Human Resources Assistant General Manager
Benefits Manager
Staffing Services Manager

**titles effective in December 2008 and January 2009*

Retirement Incentive Program

On January 20, 2009, City Council approved a Retirement Incentive Program. The stated goal of the program was to remove approved (or equivalent) positions from the City's organizational structure on or before September 17, 2009. The program was available to employees eligible for normal or early retirement under their applicable retirement system. Ultimately, 100 employees, equating to 98.4 full time equivalents (FTEs), participated in the program.

The Program incentive consisted of receiving a payment of 1 week of pay for each year of City service. As a result of this incentive payment impacting the retirement system, management estimated the Arizona State Retirement System (ASRS) would bill the City amounts ranging from $5,000 to $50,000 per retiree, depending on such variables as employee hire date, years of service and age. In March 2009, after the Program was approved by Council, this estimate was revised to average $49,000 per retiree. However, the ASRS estimate upon which this revision was based ranged from $2,000 to $300,000 per retiree.

Other costs included the standard vacation and medical pay-outs available to all exiting employees. Any employee leaving City employment is paid the cash value of unused vacation hours. However, only retirees with 300 or more unused medical hours can be paid for medical leave balances. Depending on the retiree's hire date, the retiree can receive a cash payout or convert the cash equivalent of those medical leave hours to a Medical Leave Conversion plan (MLC).

Retirement Health Savings (RHS) Plan

Effective July 1, 2009, all City retirees with available MLC balances were automatically converted to the less restrictive Retirement Health Saving (RHS) Plan approved by Council on February 24, 2009.[1] The MLC required retirees to remain covered under the City medical

[1] For retirees hired prior to July 1, 1982, only the nontaxable amount of the MLC balance could be converted to the RHS plan.

insurance plan after retirement, and when the retiree became Medicare-eligible, any balance remaining reverted to the City. During the past 2 fiscal years, these revertments totaled approximately $80,000 annually. In contrast, the RHS allows retirees to retain ownership of the monies beyond age 65 and use them to pay for any qualified medical expense, including payment of City medical plan premiums. The City's medical coverage will no longer be available to employees who retire after July 1, 2012.

Human Resources management estimated that the RHS Plan would result in no additional cost to the City if 30% of retirees opt out of the City's medical plan and obtain medical coverage elsewhere. As of June 1, 2010, staff estimates that only 7% of eligible retirees (i.e., those under age 65) have opted out of the City's medical plan. This includes 9 of the 73 eligible Retirement Incentive Program participants, 7 of the 23 more recent retirees, and 5 of the 225 eligible previously-retired MLC participants.

Reorganization and Other Staff-Related Budget Initiatives

In addition to the Retirement Incentive Program, on June 2, 2009, the former City Manager highlighted other staff-related actions being taken to reduce City expenses. Based on the audit, these actions included the following:

- Layoffs - impacting 66 positions, equating to 61.9 full-time equivalents (FTEs). This action affected 49 employees.
- A hiring freeze. According to Executive Director of Human Resources, this action was not implemented.
- Elimination of vacant positions – impacting 112 positions, equating to 105.1 FTEs.
- Cancellation of an employee 2% market adjustment pay increase, which had been scheduled to go into effect in January 2009.
- A reduction of senior management staff salaries effective December 2008, eliminating a 2% increase that went into effect in June 2008.
- A 2% employee pay reduction effective on July 5, 2009. This reduction excluded Retirement Incentive Program participants, laid-off employees, Charter officers (whose salaries are set by contract), contract employees and elected officials (whose salaries are set by Charter).
- Elimination of the Superior Performance Program, cost of living increases, merit increases and executive pay increases.

Costs and Savings Result

Table 1, on page 5, reflects the actual costs and savings resulting from the Retirement Incentive Program, reorganization, and related budget initiatives. Actual costs exceeded the anticipated costs by $582,784, largely due to salary increases after the reorganization. However, primarily due to laid-off employees' salary and benefits not being factored in, the resulting savings were $3.8 million higher than had been projected. The structural payroll savings, which currently total approximately $13 million, can carry forward into future years until positions are replaced or salaries increased.

Table 1. Retirement Incentive Program, Reorganization and Related Budget Initiatives Actual Vs. Projected Costs and Savings

Costs	Actual	Projected *	Difference (Higher) Lower
Retirement Incentive Payment	$ 3,156,534	$ 3,600,000	$ 443,466
Medical Payout (a)	2,362,121	2,600,000	237,879
Vacation Payout (a)	904,197	1,000,000	95,803
ASRS (Retirement Pension Related Costs) (b)	5,282,042	4,900,000	(382,042)
Subtotal	11,704,894	12,100,000	395,106
Offset Replaced Positions – 19 Positions	1,301,542	1,355,974	54,432
Retiree Positions to be Replaced – 19 Positions (c)	(1,534,684)	(1,534,684)	-
Subtotal	(233,142)	(178,710)	54,432
Retirement Incentive Program	**11,471,752**	**11,921,290**	**449,538**
Vacation Payout – Laid Off Positions	212,139	-	(212,139)
Salary Adjustments	820,183	-	(820,183)
8 Newly Created Positions (d)	591,785	591,785	-
Reorganization/Budget Initiatives	**1,624,107**	**591,785**	**(1,032,322)**
Total Costs	**$ 13,095,859**	**$ 12,513,075**	**$ (582,784)**

Budgeted Savings	Actual	Projected *	Difference Higher (Lower)
Salary/Benefits - 100 Retired Employees	$ 8,749,301	$ 8,900,000	$ (150,699)
Retirement Incentive Program	**8,749,301**	**8,900,000**	**(150,699)**
Salary/Benefits - 66 Laid Off Employees	4,464,836	-	4,464,836
Salary/Benefits - 112 Vacant Positions	7,929,441	8,400,000	(470,559)
2% Salary Reduction (e)	4,000,000	4,000,000	-
No Merit Increase (FY 2008/09 Budget) (f)	4,000,000	4,000,000	-
No Merit, Superior Performance (FY 2009/10 Budget) (f)	3,200,000	3,200,000	-
Reorganization/Budget Initiatives	**23,594,277**	**19,600,000**	**3,994,277**
Total Savings	**$ 32,343,578**	**$ 28,500,000**	**$ 3,843,578**

*Information publicly provided to City Council as of July 1, 2009.

(a) Medical payout is available to all City retirees with 300 or more unused medical leave hours; vacation payout is available to all exiting employees.
(b) Originally estimated between $5,000 and $50,000 per retiree. Estimate revised March 17, 2009, to $4.9 million.
(c) Management realized the need to replace certain retiree positions when the decision was made to approve all retirement program applications. As a result, 19 vacant FY 2008/09 budgeted positions from throughout the City were used to offset those positions being refilled.
(d) Positions were hired prior to July 1, 2009; therefore, actual amounts were included in the FY 2009/10 budget.
(e) Actual savings resulting from the 2% salary reduction are not available since these adjustments were made in a regular payroll cycle. The budget amount was calculated using December 2008 salaries as reflected in the Salaries & Wage Information Management System (SWIMS).
(f) Actual savings are not available for elimination of merit increases and Superior Performance awards. The budget amount was calculated using December 2008 salaries as reflected in SWIMS.

SOURCE: Auditor analysis of related Council Action Reports, the FY 2009/10 Budget Book and various reports provided by the Human Resources and Finance & Accounting Divisions.

OBJECTIVES, SCOPE, AND METHODOLOGY

The City Auditor's Office performed this audit to evaluate whether the City Council-approved Retirement Incentive Program provisions were followed and to identify salary savings as a result of the program, reorganization and related budget initiatives. The scope of the audit included fiscal years 2008/09 and 2009/10 salaries and positions.

During the audit, we obtained position and salary information from Payroll and Budget staff within the Finance & Accounting division and from the Human Resources division.

We reviewed and analyzed:

- City Council Reports and meeting videos which discussed the retirement incentive package, reorganization and Retirement Health Savings (RHS) plan.
- Hotline communication, No. 343 dated April 13, 2009, issued to City employees explaining proposed budget cuts and targeted future savings impacting positions and salaries.
- Vacancy Review Committee and Compensation Options Team correspondence and documentation.
- Scottsdale City Code sections 14-82 Vacation, 14-83 Medical Leave, and 14-22 Appropriate Salary.
- The City of Scottsdale FY 2009/10 Budget Book for information related to the retirement incentive program and elimination of positions.
- Employee Position Control reports documenting pay rates and vacant positions that existed in June 2009 and subsequent vacancies created as the result of the Retirement Incentive Program and layoffs.
- Employee Leave Reports to verify medical and vacation leave balances of employees who retired or were laid off during this period.
- The Arizona State Retirement System (ASRS) invoice dated April 5, 2010, applicable to the City's Retirement Incentive Program participants.

In addition, we tested:

- Adherence to the Retirement Incentive Program timeline provisions and management approval of submitted applications.
- The accuracy of retirement incentive, medical leave and vacation payments made to retired and laid-off employees.
- Compliance with the City Manager-directed 2% across-the-board pay cut and related budget reduction measures, including elimination of vacant positions and merit increases.
- Existing employee's salaries compared to the Council-approved maximum pay range for each position.

- Compliance with policies regarding salary adjustments which include promotions, salary increases and organizational job changes.

We found that management's projected savings for the Retirement Incentive Program, reorganization and related budget initiatives were achieved. However, key variables affecting program costs were not presented to City Council, program provisions were not consistently followed and some salary actions reduced the available savings associated with the Retirement Incentive Program, reorganization and related budget initiatives.

We conducted this audit in accordance with generally accepted government auditing standards as required by Article III, Scottsdale Revised Code, §2-117 et seq. Those 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. Audit work took place from March through May 2010; Lisa Gurtler conducted the audit, with assistance from Kyla Anderson, Joyce Gilbride and Lee Pettit.

FINDINGS AND ANALYSIS

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1. Key variables affecting the Retirement Incentive Program cost were not presented to City Council.

A. Key variables affecting the City's retirement system costs that were not disclosed to Council included an option to avoid the ASRS retirement incentive penalty and a decision to exclude Retirement Incentive Program participants from a 2% across-the-board pay reduction in July 2009.

1) Management did not advise City Council of an available option to pay the retirement incentive *after* termination of employment, which would have reduced the City's $5.2 million invoice from the Arizona State Retirement System (ASRS). According to an Attorney General opinion (I01-004) dated January 23, 2001, for employees hired prior to December 31, 1983:

> *"… ERP* (early retirement program) *benefits paid at or before termination of employment are compensation for the purpose of the ASRS plan, but ERP benefits paid thereafter are not".*

Approximately $1.9 million of the City's retirement incentive was paid to retirees with ASRS membership prior to December 31, 1983[2]. Because the incentive payments were paid prior to the employees' retirement effective dates, those amounts were included as compensation in the calculation of their pensions thereby increasing their lifetime pension costs. As a result, ASRS has billed the City for the retirement system's increased costs related to those payments. Based on the ASRS billing, the City Treasurer estimated the City's savings could have been more than $4.8 million.

Human Resources management explained that although they discussed several incentive payment scenarios with ASRS management, they were not made aware of this Attorney General opinion. However, emails exchanged among the Compensation Options Team (Team) members indicate they were aware of the payment timing issue.

On January 21, 2009, the day after Council approved the Program, a staff member emailed the Program application documents and information for the City's intranet web page to Team members. At least 2 of these documents stated that the tenure-related incentive payment "… will be made approximately **one month after** *(emphasis added)* your retirement system pension benefits begin."

Later the same day, an email from an Assistant City Manager, a pre-1984 hire who subsequently participated in the Program, stated:

> "…In reading the "fine print" I see that the lump sum payment will be

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[2] Retirees may have had ASRS membership prior to employment with the City of Scottsdale. Based on information provided by ASRS, 46 of the program participants were members of ASRS prior to December 31, 1983.

made to the employee approx. one month after retirement pension benefits begin. This makes no difference to post-1984 retirees, who cannot roll such payouts into their pension calculation. However, this approach would greatly disadvantage pre-1984 retirees who have the option under ASRS rules to roll their lump sum payouts (eg, *(sic)* vacation, medical leave, retirement incentive) into their final earnings for pension calculation purposes, if the *(sic)* take the 5 year averaging formula.

This is problematic in my opinion and would have a chilling effect on pre-1098 *(sic)* retirees who may otherwise consider this proposal. …"

The Program documents were revised to remove the phrase indicating the incentive payment would be made *after* a participant's retirement date.

2) Retirement Incentive Program participants were excluded from a 2% employee pay reduction effective July 5, 2009. Of the 100 participants, 64 were still employed with the City on that date. On April 15, 2009, 2 days after the former City Manager announced the 2% across-the-board pay cut in a Citywide electronic communication, the former Financial Services Assistant General Manager issued an email inquiring "how to get the message out" that the 2% pay cut would not apply to retirees. In the email, he notes that the Citywide communication "did ***not*** say potential retirees were excluded from the reduction". An Assistant City Manager replied back recommending "individualized contact to each of the retirees, either via email or in person" to explain that they would not be impacted. We found no evidence that Council was advised of this additional benefit to the remaining Program participants.

   Excluding the remaining Program participants from the 2% pay reduction cost the City approximately $62,000, which includes additional salary, vacation and medical payouts. The retirement incentive payment amounts were already specified in signed agreements with each participant before the announced 2% pay cut. However, the City paid higher salary rates for their vacation and medical payouts than otherwise would have been paid. And these higher payouts also increased the average salaries used to calculate the pre-1984 participants' future pension benefits and the related ASRS penalty.

B. When management presented the Retirement Incentive Program to City Council on January 20, 2009, key information used to calculate the incentive payments was not disclosed. This included such factors as rounding up an employee's years of service and counting prior years of service rather than only the most recent continuous years of City service.

   The draft Application for Participation dated December 10, 2008, included the following statement:

   "Incentive – Equal to 1 week of pay per year (rounded up) of City of Scottsdale service; City of Scottsdale service is defined as the most recent date of hire. If an employee has left City service and

returned, their most recent date of hire would be utilized regardless of rehire."

However, the final Application for Participation dated January 21, 2009, rounded up years of service and expanded the definition to include all verifiable years of service as a City of Scottsdale employee.

Because the draft Application for Participation was not included in the previous day's Council Action Report, the City Council and citizens did not have the opportunity to discuss relevant factors directly affecting the cost of the Retirement Incentive Program. The cost of rounding up service years and including previous years of City service added an additional 83 weeks of pay to the incentive payments and totaled $114,778.

Recommendation:

A. The City Manager should ensure sufficient research is conducted to fully understand available options for new programs, and that costly choices are not made without Council review and approval. For any future such benefit programs, the City Manager should ensure that individuals who stand to benefit significantly from the programs do not participate in their design and implementation.

B. The City Manager should ensure that all known key financial variables and their projected costs are reported when presenting new programs for Council consideration.

2. Retirement Incentive Program provisions were not consistently applied.

An application for program participation was accepted beyond the due date, some required approval signatures were missing, and several errors were made in retirement incentive calculations.

A. One application was received 4 days after the stated deadline, but the former City Manager allowed the individual to participate in the program. This decision increased the Retirement Incentive Program's cost by $29,449.

   A program's integrity is compromised when such exceptions are made. In addition, 2 individuals who had been accepted into the program but failed to return the signed agreement on time were subsequently laid off. They also could have benefited from late admission into the program.

B. Of the 37 retirement incentive agreements tested, 1 agreement was missing, 1 did not have an employee signature date, and 5 did not have a General Manager signature.

   Human Resources management explained that some applications were submitted as a group, and the General Manager only signed one signature page, while others were the result of unintentional oversight.

Without properly completed forms, it is not clear that time-sensitive provisions of the retirement program were followed or that management verified the sustainability of removing the position (or an equivalent one) from the City's organizational structure.

C. One hundred former City employees received retirement incentive payments that collectively totaled $3.2 million and equated to 2,334 weeks of pay. As stated on the retirement application, incentive pay was to be computed on the basis of 1 week of pay per year of all verifiable City of Scottsdale service, rounded up. In all, 12 calculation errors totaling $43,772 were made.

   Three errors occurred because the payment was based on a full-time rather than part-time rate. The remaining 9 errors resulted from miscalculations or an additional year of service being credited to the employee.

   Human Resources management stated that 9 errors were detected when some participants questioned their calculated retirement incentive amounts. Three additional errors were identified during this audit. While most were corrected, 6 checks were issued with errors totaling $9,544.

   Management stated that an unverified Excel spreadsheet with some erroneous information was used to calculate the retirement incentive payments.

Recommendation:

A. The City Manager should ensure stated program provisions are consistently followed, and any exceptions should only be approved after review by the City Attorney.

B. & C. The City Manager should ensure that applicable Executive Directors require an appropriate level of review and verification of calculations if a program such as this is used in the future.

3. Subsequent salary actions reduced projected savings associated with the Retirement Incentive Program, reorganization and related budget initiatives.

At the June 2, 2009, City Council Special Meeting, the former City Manager listed cost saving actions affecting salaries or positions. These included a hiring freeze, a 2% across-the-board pay cut, and elimination of merit increases and Superior Performance awards. The Retirement Incentive Program, reorganization and related budget initiatives have structurally reduced the City's payroll by approximately $13.2 million ($8.7 million due to the Retirement Incentive Program and $4.5 million due to layoffs). However, since July 1, 2009, 8 new positions have been added and 161 employees have received promotions or salary increases. In addition, 19 employees are paid salaries that exceed their maximum salary range.

While most of these actions may have been appropriate, resulting planned savings are reduced.

A. Eight new positions have been added to the City's organizational structure with total annualized salary and benefit costs of $591,785. Five of the positions are assigned

to the Water Resources Division, one to Public Works, one to the Police Department, and one to the Finance & Accounting Division.

All 8 positions were appropriately approved by City Council, primarily as part of the annual budget approval process. Subsequent to the budget's approval, all requests to fill positions (other than the City Treasurer position) were forwarded to a Vacancy Review Committee consisting of various executive management staff. This committee was disbanded in January 2010; all requests to fill vacant budgeted positions are now reviewed and approved by the City Manager.

B. Salary adjustments totaling $820,183 (annualized) have been processed since the announced salary reduction initiatives. The recent salary adjustments associated with 161 employees can be categorized as follows:

Promotion/ Temporary Upgrades	$611,581
Organization Change, Salary Adjustments (salary range increase)	244,425
Voluntary Job Change, End of Temporary Upgrade	(35,822)
	$820,184

Source: Auditor analysis of information provided by the Payroll department.

While many of these salary increases may have been necessary, 19 promotions or salary adjustments totaling $76,045 were made retroactive to a date on or before July 5, 2009. Further, 4 of these adjustments were retroactive for a period of 6 to 7 months each.

Human Resources (HR) management explained that these salary adjustments were the result of ongoing business needs of the organization. They indicated promotions and salary adjustments were not specifically identified by the former City Manager as a budget reduction measure.

C. According to HR Staffing Requisition Action Codes, a promotion increases the employee's salary to the new salary range minimum or by 5%, whichever is higher. Exceptions require a justification memo from the department General Manager[3] and concurrent approval of the HR General Manager. In addition to the HR instructions, Police Department (PD) General Orders (GO) 44.10 Compensation/Classification, states the starting salary for sworn personnel at a given rank is at least the maximum of the salary range the employee is moving out of plus 5%.

Of the promotions noted in section B, 11 employees received increases in excess of 5% or the minimum of their new salary range. These excess increases totaled $120,827 annually and ranged from 7% to 39% of the employee's former salary. While most of these were supported by detailed explanations to justify the action, 5 were not. These 5 promotional increases, totaling $42,973, were supported only by Class & Pay Plan Amendments and/or Staffing Requisition forms that did not adequately justify the amount of increase or contain the appropriate level of approval. Further, 2 of these increases were for PD civilian staff although the applicable GO only applies to sworn personnel.

[3] General Managers are now called Executive Directors.

HR management explained their practice is to accept the Class & Pay Plan Amendment or Staffing Requisition forms in lieu of a formal justification memo. Lack of the appropriate level of approval was due to unintentional oversight. Further, HR management explained that PD and HR have applied GO 44.10 to both civilian and sworn PD staff.

D. Of the 3,101 City of Scottsdale employees as of February 5, 2010, 19 employees receive salaries that exceed their maximum salary ranges approved by Council. The excess amounts total $124,813 annually.

Eleven of the 19 employees' salaries exceed the maximum range due to an organizational job change in which the employee was moved to a lower-salaried position, but allowed to keep her/his existing salary. According to Scottsdale City Code Sec. 14-22 (h), an employee may be assigned a "Y rate" if the new maximum is lower than the incumbent's salary. This is generally done for employees whose demotions are for reasons beyond their control.

Five employees exceed their maximum salary range due to a 10% Day Assignment pay policy. This policy, approved by the HR General Manager effective August 2008, allows certain sworn Fire Department positions to receive a 10% increase in lieu of overtime. These employees are working a 40-hour week, but would normally work a 56-hour week with scheduled overtime.

Three employees exceed their maximum salary range due to a temporary upgrade while taking on additional duties and serving in a higher paid "Acting" position.

E. When the decision was made to approve all retirement program applications, management realized the need to replace certain retiree positions. As a result, 19 vacant FY 2008/09 budgeted positions from throughout the City were used as equivalents to offset those positions.

A review of these 19 vacant positions revealed that all vacant positions were being automatically rolled forward into the next year's budget, regardless of how long they had been vacant. As reflected below, 4 of the 19 positions had been vacant for more than 1 year, at a budgeted total of $318,037.

Days Vacant	Number of Positions	Budget
0-60	7	$534,631
61-120	1	57,747
121-180	4	277,157
181-365	3	168,402
> 365	4	318,037
Total	19	$1,355,974

Source: Auditor analysis of information provided by Finance & Accounting Division staff.

Of those 4 positions, 2 had been vacant more than 3 years. By continually including aged vacant positions in the budget, these unused committed resources are unavailable to other areas within the City that may be short staffed.

Recommendation:

A. The City Manager should continue to carefully review the need for new positions to be added to the City's organizational structure.

B. The HR Executive Director should carefully review salary increases to ensure that all salary adjustments are appropriate, particularly at a time when most City employees are being asked to perform more work without a promotion or salary increase. The City Manager should be periodically apprised of all salary adjustments.

C. & D. The City Manager, in conjunction with the HR Executive Director, should review the appropriateness of existing practices that allow promotional increases to exceed stated policy and salaries to exceed Council-approved maximum salary ranges. If these practices are allowed to continue, the HR Executive Director should develop formal policies for approval. In addition, the HR Executive Director should ensure that all promotions exceeding City policy are sufficiently justified and approved by the appropriate level of management.

E. The City Manager should determine if the practice of rolling forward long-term vacant positions into the next year's budget is appropriate. If the practice is allowed to continue, the age of the vacant position should be identified, along with sufficient justification.

ACTION PLAN

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1. Key variables affecting the Retirement Incentive Program were not presented to City Council.

A. Key variables affecting the City's retirement system costs that were not disclosed to Council included an option to avoid the ASRS retirement incentive penalty and excluding Retirement Incentive Program participants from a 2% across-the-board pay reduction in July 2009.

MANAGEMENT RESPONSE: Management agrees that the City Manager and the City Treasurer should ensure sufficient research is completed before programs of this nature are implemented. However, in this case, research was done and it was determined that the City's Retirement Incentive Program would create an unfunded liability under the ASRS program. It should also be pointed out that "an option to avoid ASRS retirement incentive penalty" was not brought to the City's attention by ASRS. In discussions with ASRS, several scenarios were presented regarding incentive payments, yet the response was the same, the program would still incur costs from ASRS since participants were leaving earlier than anticipated.

The organization was under immense pressure to reduce a $65 million budget deficit for the combined fiscal years of 08/09 and 09/10. Significant structural and one time decisions had to be proposed to policy makers and implemented by the administration. Multiple rounds of cuts were made by the operations. The retirement incentive was a key element of a multi-pronged approach to reduce payroll. Several other types of programs to reduce payroll on an immediate and long term basis were discussed. They included severance packages, pay cuts, furloughs and other alternative methods. Some were selected and others were not. Various individuals, at several levels of responsibility, conducted research and participated in discussions. This approach reflects the decision-making culture of the organization at that time.

City management, Finance/Payroll, Human Resources and Legal were the most involved functional areas. At certain times, the City Manager informed or sought input from a much broader leadership team before making final decisions. Information provided to the City Council was organized and reviewed by a number of individuals. We are not aware of any intent to withhold any information from policy makers.

The goal of the incentive program was to realize short and long term payroll savings. The audit report confirms that this overriding goal has been achieved. As the budget pressures escalated, decisions were made to encourage as many employees as possible to take this option, while still being able to sustain the organization. Staggered exits was deemed necessary for some of the operations. The concern was the ability to transfer knowledge and implement transition plans, As a result, 22% of the employees exited the organization prior to July 1, 2009, or the end of fiscal year 08/09; 38% exited on September 17, 2009 the final day of the program; all other employees exited between July 1, 2009 and September 16, 2009. This staggered exit approach also reduced service impacts to citizens.

PROPOSED RESOLUTION: The City Manager and City Treasurer will ensure that sufficient research is conducted to fully understand available options for new programs, and that more costly choices are not made without Council review and approval. Additionally, for any future

such benefit programs, the City Manager and the City Treasurer will ensure that individuals who stand to benefit significantly from the programs do not participate in their design and implementation.

RESPONSIBLE PARTY: Finance and Accounting (Budget)

COMPLETED BY: The proposed resolution will be in place for any future similar program.

B. When management presented the Retirement Incentive Program to City Council key information used to calculate the incentive payments was not disclosed. This included such factors as rounding up an employee's years of service and counting prior years of service.

MANAGEMENT RESPONSE: Current management agrees that rounding up an employee's years of service was a detail that should have been scrutinized more closely. Other alternatives, such as calculating a percentage of the year or just the years of service would have been more suitable. Counting prior years of service is considered appropriate because the employee had to provide documented proof of any prior years of service and that information was verified. This action encouraged employees to participate in the program, and thus assisted the City in incurring additional savings based on their acceptance.

The City Council Report prepared by Human Resources and Financial Services dated January 20, 2009 provided a level of detail and specifics that the leadership at the time felt was adequate. The driving force again was to make significant budget reductions in a short period of time, with the retirement incentive being just one of several ways this was occurring.

PROPOSED RESOLUTION: The City Manager and the City Treasurer will ensure that all known financial variables and their projected costs are reported and analyzed when presenting policy makers with key decisions.

RESPONSIBLE PARTY: Finance and Accounting (Budget)

COMPLETED BY:

2. Retirement Incentive Program provisions were not consistently followed.

A. One application was received 4 days after the stated deadline, but the former City Manager allowed the individual to participate in the program.

MANAGEMENT RESPONSE: The provisions of the Incentive Program were consistently followed. The City Manager reviewed and approved all Incentive Program applications and only he had the authority to approve exceptions. The application was received late, reviewed and forwarded for final review. Based on the circumstances involved, an exception was made for this late application. This action added to the savings realized as part of the retirement incentive program.

PROPOSED RESOLUTION: In the future we will continue to ensure that that program provisions are consistently followed.

RESPONSIBLE PARTY: City Manager

COMPLETED BY: The proposed resolution will be in place for any future similar program.

B. & C. Of the 37 retirement incentive agreements tested, 1 agreement was missing, 1 did not have an employee signature date, and 5 did not have a General Manager signature. Twelve retirement incentive calculation errors totaling $43,772 were made. While most were corrected, 6 checks were issued with errors totaling $9,544.

MANAGEMENT RESPONSE: The statement above that indicates that 1 agreement is currently missing is true. It was received, reviewed and processed as required but has been subsequently misplaced. All other 99 agreements are accounted for.

Retirement incentive calculations were performed in Financial Services by the Payroll Department. When the first discrepancy occurred, it was brought to Human Resources attention. The discrepancy was that the individual received half the amount of payment that was listed in their agreement. Human Resources worked in conjunction with Payroll to resolve the issue and it was determined that the eligible part time participants had been inadvertently calculated at a full time rate. Human Resources corrected this, updated the part time agreements and met with each of the participants in question to inform them of the change.

PROPOSED RESOLUTION: We will ensure that all documents are properly archived and maintained according to the records retentions schedule.

We will ensure that the applicable Executive Directors require an appropriate level of review and verification of calculations if a program such as this is used in the future.

RESPONSIBLE PARTY: Finance and Accounting and Human Resources

COMPLETED BY: The proposed resolution will be in place for any future similar program.

3. Subsequent salary actions reduced projected savings associated with the Retirement Incentive program, reorganization and related budget initiatives.

A. Eight new positions have been added to the City's organizational structure with total annualized salary and benefit costs of $591,785.

MANAGEMENT RESPONSE: Any positions filled were within budget authorizations. Seven (7) Water Resource positions were appropriately reviewed during the annual budget approval process. The eighth position was the city treasurer position approved by City Council in the 09/10 fiscal year. A hiring freeze is referenced on pages 3 and 10 of the report. There is considerable information that points to the fact that vacancies were and continue to be closely scrutinized, but no hiring freeze was implemented. All positions that were filled were authorized.

PROPOSED RESOLUTION: The City Manager, City Treasurer and operational leaders will continue to carefully review the need for new positions to be added to the City's organizational structure.

RESPONSIBLE PARTY: Finance and Accounting

COMPLETED BY: Process is already in place

B. Salary adjustments totaling $820,184 (annualized) have been processed since the announced salary reduction initiatives.

MANAGEMENT RESPONSE: These salary adjustments were the result of ongoing business needs of the organization. When the City Council did not accept or approve the CIP transfer recommendation, the need for more personnel reductions occurred. Consolidations of functions and duties, increased workloads, and other operational impacts occurred. Some of these changes resulted in employees performing duties of a higher classification and greater scope. At the direction of city management, and for general good business purposes, human resources had to work closely with operational leaders to make appropriate adjustments. Some promotions and/or salary adjustments were approved based on these circumstances. In most instances, savings were still realized as the increases were minimal in comparison to staffing a full time position with benefits, to complete the same work. The executive committee spent considerable time together identifying principles and issues that would ensure as much consistency as possible, understanding that the amount of change occurring in a short period of time was significant.

PROPOSED RESOLUTION: The HR Executive Director will continue to carefully review salary increases to ensure that all salary adjustments are appropriate. City management will be advised when there are issues warranting their attention.

RESPONSIBLE PARTY: Human Resources

COMPLETED BY: Process is already in place

C. & D. Eleven employees received salary increases in excess of 5% or the minimum of their new salary range. Nineteen employees currently receive salaries that exceed their maximum salary ranges approved by Council.

MANAGEMENT RESPONSE: We agree that the City Manager, in conjunction with the Human Resources Executive Director, should review the appropriateness of existing practices. Consistent with approved and established policies, employees in the Police Department received increases as dictated in their General Orders: 22.1.1 #6 "The starting salary for sworn personnel, at a given rank is a minimum of five percent above the maximum salary of the next lower rank." The remainder of those salary increases for employees in excess of 5% or the minimum of the new salary range were reclassifications and/or individuals who were brought to the minimum of the pay grade.

Management agrees that there are employees whose salaries currently exceed the maximum salary ranges approved by Council. Consistent with Council approved language and policy in the code, there are different categories for salaries that exceed the maximum of the salary range. The instances in which this may occur are for employees who are "y-stepped," those that are as a result of the Fire Department's "10% day assignment," and those that are "temporarily upgraded." The majority of the employees that exceed the

maximum of their pay range fall into these three categories.

All of these instances fall into policies and procedures currently outlined. All of these instances are reviewed and approved as appropriate. Any exceptions to those instances listed above, are reviewed by the Division Executive Director and the Human Resources Executive Director.

PROPOSED RESOLUTION: The HR Executive Director will continue to ensure that policies are followed for promotions and salary adjustments and that any salary adjustments and promotions outside of policy are appropriately justified and approved as required.

RESPONSIBLE PARTY: Human Resources

COMPLETED BY: Process is already in place

E. Long term vacant positions are automatically rolled forward into the next fiscal year's budget.

MANAGEMENT RESPONSE: It has been the practice of Financial Services to automatically roll forward vacant positions into the following year's budget regardless of how long they have been vacant. It has long been the policy of this and many other cities to roll forward vacant positions into the next year's fiscal budget. These vacant positions capture savings. This does not mean that vacancies are not closely scrutinized for potential structural reduction as a routine matter and during the annual budget process. They are closely scrutinized as a regular business practice. The budget is structured to allow for vacancies to make decisions about ongoing business needs for the City and to achieve savings.

PROPOSED RESOLUTION: The City Manager and City Treasurer will determine if the practice of rolling forward long-term vacant positions into the next year's budget is appropriate. If the practice is allowed to continue, the age of the vacant position should be identified, along with sufficient justification.

RESPONSIBLE PARTY: Finance and Accounting

COMPLETED BY: JULY 1, 2011

MEMO

DATE: 6/14/2010

TO: Sharron Walker, City Auditor

FROM: David N. Smith, City Treasurer

SUBJECT: Draft Audit Report No. 1014, item 2 C

Response to the Draft Audit Report No. 1014, item 2 C:

The majority of payments in excess of the amount due the employee at separation began with rounding discrepancies created by Excel software. This "rounding up" occurs most often when calculations are performed in individual cells and those cells are added together in summation. To prevent this type of error from occuring in the future staff will be directed to verify sums calculated in Excel for all special payroll checks (i.e., those not produced through WebTime Plus) to ensure that rounding errors do not occur. Verification will be accomplished through a manual calculation of all special payroll checks.

The balance of miscalculated payments in excess of the amount due employees at separation was because several employees participating in the program were part-time employees and the calculations were done based on full-time employment. These errors were caught prior to issuance of their severance payment and were corrected. In addition, please consider this memorandum positive affirmation that the Finance and Accounting Division will be the Responsible Party going forward regarding the following audit findings with the exception of Finding 3 A, which we believe should have shared responsibility of the City Manager and Finance and Accounting:

1. Finding 1 A – Key variables affecting the Retirement Incentive Program were not presented to City Council.
2. Finding 1 B – When management presented the Retirement Incentive Program to City Council key information used to calculate the incentive payments was not disclosed. This included such factors as rounding up an employee's years of service and counting prior years of service.
3. Finding 2 C (partial) – Twelve retirement incentive calculation errors resulted in $43,772 of overpayments. While most were corrected, 6 checks were issued with errors totaling $9,544.

4. Finding 3 A – Eight new positions have been added to the City's organizational structure with total annualized salary and benefit costs of $591,785.
5. Finding 3 E – Long-term vacant positions are automatically rolled forward into next fiscal year's budget.

Thank you for your assistance in these matters.

SUPPLEMENTAL INFORMATION — Provided by City Manager, Assistant City Manager and Human Resources Executive Director

In reviewing the draft audit report, there were several items that require further clarification, that were incorrect or presented inaccurate;

The audit report references a "Compensation Options Team" on page 1 of the Executive Summary and assumed members are listed on page 2 as the:

a. Acting City Manager
b. Assistant City Manager (3 employees)
c. Financial Services General Manager
d. Financial Services Assistant General Manager
e. Budget Director
f. Payroll Manager
g. Budget Liaison
h. Human Resources General Manager
i. Human Resources Assistant General Manager
j. Benefits Manager
k. Staffing Services Manager

The report indicates that "Compensation Options Team" designed the Incentive Program. This is incorrect, with the main point being that there was no such ongoing decision making group with ultimate administrative authority as suggested. As previously mentioned, multiple individuals across many functions, with varying responsibilities, offered input and played a role. Other related information is:

a. An ad-hoc group was pulled together in early September/October 2008 to conduct research on a variety of options focused on reducing the city's budget.
b. This group only provided research results, pros and cons of each program and methods to implement as discussion points for the Budget Committee.
c. This group consisted of staff members set forth in d below. Occasionally the Budget Director, Financial Services Assistant General Manager, Assistant Human Resources General Manager and Human Resources General Manager would attend to review the findings of the research.
d. The "team" consisted of:
    a. Senior Budget Analyst
    b. Payroll Manager
    c. Senior Human Resources Analyst
    d. Senior Benefits Analyst
    e. Staffing Services Manager
    f. Benefits Manager
e. The group met a few times to review the tasks assigned which were proposals that had come from the Budget Committee. They also met to review the research prior to putting the information into the "Compensation Options Memo" that was distributed at the Budget Committee. Legal was also included in these reviews.
f. The Incentive Program was developed based on the research conducted, the discussions from the Budget Committee, and review from Financial Services and the legal department.

g. "Compensation Options Memo" where the Incentive Program was one of eleven options listed included a brief summary of how the program might work and the fiscal impact.
h. Once the determination was made to implement the Incentive Program, Human Resources was tasked with processing the applications, inputting the calculations obtained from Payroll/Financial Services into the agreements and sitting with each approved applicant to review their agreements and the process. Benefits ensured that all applicants were given the appropriate retirement information in order to make an informed decision.

2. The draft report references a "hiring freeze" as one of the measures the former City Manager implemented as part of a budget reduction plan. This is referenced on page 3, as well as on page 10. . Current management understands that the former city manager did reference it once in a particular presentation. Specific and easy to obtain information that a hiring freeze was not implemented includes:
    a. In the October 7, 2008 Employee Hotline Number 315 it refers to "limiting new hires" It goes on to say: "The city has not imposed a citywide hiring "freeze. However in our vacancy review process, we will fill only those positions essential to continue services considered the most critical."
    b. The November 18, 2008 Hotline Number 321 refers to "the City's continued measures to ensure we were reviewing every vacancy: "In addition, we are continuing to closely scrutinize the need to fill any vacant positions and we continue to emphasize to managers, budget liaisons, and all employees that we need to carefully weigh the need for any discretionary spending."
    c. In a November 20, 2008 e-mail from Senior Budget Analyst Judy McIlroy to all the budget liaisons, budget analysts, budget director, police personnel supervisor and Assistant General Manager of Financial Services, the vacancy process was outlined. The e-mail specified the criteria that the Committee was going to use for position review and stated that the Vacancy Review Committee had been re-established.
    d. In a December 22, 2008 e-mail from Senior Budget Analyst Judy McIlroy, to all budget liaisons, budget analysts, budget director, police personnel supervisor and Assistant General Manager of Financial Services, it indicates the new process for the Vacancy Review Committee and that the process was changing. All bi-weekly Vacant Position Recommendation Reports were to be submitted bi-weekly to each department's HR Analyst.
    e. In a January 16, 2010 e-mail from Senior Budget Analyst Judy McIlroy to the City Manager, the three Assistant City Managers, the Financial Services General Manager, Assistant General Manager of Financial Services and the Budget Director, she outlines that the department's vacant position recommendations will now be going through Human Resources for review prior to submitting to the Budget Office.
    f. Bi-weekly reminders were sent out from Human Resources starting in January 2009 to all Budget Liaisons for their information on any potential vacancies they needed reviewed in the Vacancy Committee Meeting.
    g. As part of this procedure, bi-weekly e-mails were sent from departments to Human Resources from January 2009 through August 2009, that specified the status of their vacancies. An example of this is a March 24, 2009 e-mail from Assistant City Auditor Joyce Gilbride to Senior HR Analyst Mark Wilson in

which she forwards their vacancy report and indicates that there are no changes.

3. On page 7 of the draft report, it references an e-mail exchange from an Assistant City Manager regarding the payment timing issue of the incentive program. This reference implies that management was aware of the payment timing issue and the additional cost implications through ASRS. It also states that management did not advise City Council of an available option to pay the retirement incentive after termination of employment. These are inaccurate statements.
    a. The e-mail string is a response from an Assistant City Manager to the recipients of the e-mail: the Payroll Manager, the Benefits Manager; two Assistant City Managers, the Human Resources General Manager, the Assistant Financial Services General Manager, the Financial Services General Manager, and the City Manager.
    b. Based on information provided by ASRS that the City would still have to pay whether or not we delayed the incentive payment, the recommendation was to defer the incentive payment until each participant had received their first pension check to ensure compliance with the program, which required that the employee must retire from the City.
    c. Management recommendation had been to ensure that the incentive was calculated as part of the participants' retirement as the research indicated payment would be due either way.
    d. Included in this e-mail string are the comments from the Payroll Manager and the Financial Services General Manager. The Payroll Manager, who at the time reported to the Assistant Financial Services General Manager, recommended that the value of the incentive be included in the final paycheck, as opposed to one month later, as "the retirement benefit will not be recalculated." The Financial Services General Manager responded stating: "why did we structure for payment one month later? Why not at termination from service? I haven't seen any rational in these e-mail strings explaining why this was set up this way to begin with."
    e. From the research done in conjunction with ASRS, staff did not learn of the Attorney General opinion (I01-004) dated January 23, 2001 for employees hired prior to December 31, 1983, until after the start of this audit. The research found that the City would have to pay regardless of when the person received their payment because the City was incentivizing employees to retire earlier than anticipated.
    f. To ensure that employees were still incented to participate in the program, and to not impact them negatively by delaying their pension, the decision was made to pay the incentive on the employee's final paycheck and include it in their retirement calculation.
    g. ASRS has yet to explain why they did not provide this information to the City at any time through this process.
    h. Current management is challenging the invoice received from ASRS and has yet to receive a response or what specifically was included in their calculations.
    i. The City Council was not advised of an available option to pay the retirement incentive after termination of employment as management was not aware of this option.

4. The draft report indicates (page 8) that "the program documents were revised to remove the phrase indicating the incentive payment would be made after the participant's retirement date." This statement is incorrect.
    a. None of the program documents (application, instructions, agreement) indicate when the incentive payment would be made.
    b. The only place where the timing of the payment was included was in the FAQ's and on the website page.
    c. Both the FAQ's and website page were updated to reflect the decision made on the timing of the incentive payment.

5. The draft report indicates (page 12, part C) that: "lack of appropriate level of approval was due to unintentional oversight." This statement is incorrect.
    a. It has been the practice to accept the Class and Pay Plan Amendment or Staffing Requisition forms in lieu of a formal justification memo.
    b. The Class and Pay Plan Amendment does require the signature of at least the Executive Director – Human Resources and, in specific instances, such as a reclassification, the addition of the City Manager's signature.
    c. Any exceptions with regards to pay are reviewed and signed by the Executive Director – Human Resources.
    d. Staffing requisitions are reviewed by Human Resources staff and any exceptions to pay policies are reviewed and approved through the Executive Director – Human Resources in conjunction with the division in question.
    e. In addition, the Class and Pay Plan Amendments in the case of reclassifications, title changes and/or creation of new positions, is accompanied by a report that justifies the changes recommended. This report is reviewed and approved by the Executive Director – Human Resources and the City Manager.

6. Page 3 of the draft report addresses implementation of the Retirement Health Savings Plan (RHS) on July 1, 2009. The report mentions that the RHS is less restrictive than the prior Medical Leave Conversion program and that the City will no longer receive the forfeited balances as retirees attain age 65. While this true, it should not be overlooked that the City also made a significant change to future retiree medical plan eligibility at the same time. Modifying retiree medical eligibility provisions will provide long-term cost management for the City by reducing and ultimately eliminating the City's implicit retiree cost which has been estimated to be $14.8 million.

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