

OFFICE OF THE CITY AUDITOR
PERFORMANCE AUDIT
August 2019

**Retroactive Pay
Adjustments:
Employees Deserve
Timely Pay Increases**



CITY OF
KANSAS CITY,
MISSOURI

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CITY OF FOUNTAINS
HEART OF THE NATION



KANSAS CITY
MISSOURI

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August 26, 2019

Honorable Mayor and Members of the City Council:

This audit focuses on the causes and accuracy of retroactive pay adjustments. Almost 3,800 retroactive pay adjustments were made from May 1, 2016 through April 30, 2019, based on Human Resources Department data. Almost 2,800 of these pay adjustments were caused by management's failure to conduct classified employees' annual performance appraisals timely. Most of the remaining retroactive pay adjustments were the result of negotiated retroactive labor agreement provisions.

Late annual performance appraisals that delay employee pay increases penalize the employee and harm the city. Employees are financially penalized when they are not paid at the correct rate for weeks, months, or years. When an employee does not receive an anticipated pay increase timely, that employee may take a position with another employer, causing the city to lose employee skills and increasing city turnover. Retroactive pay increases also cause extra work for department employees who must calculate, document, and submit the adjustment to the Human Resources Department.

In the small sample of retroactive pay adjustments we reviewed, the adjustment amounts were not always calculated correctly. The most common error was using the wrong number of hours in calculating the adjustment.

We make recommendations to give employees timely merit pay increases; improve communications with the city's third party worker's compensation payer; provide training and written guidance for retroactive pay adjustments; and investigate updating the city's payroll module to automatically calculate retroactive pay adjustments.

The draft report was sent to the Human Resources and Finance directors on August 2, 2019, for review and comment. Their responses are appended. We would like to thank representatives of the Aviation, Convention and Entertainment Centers, Finance, Fire, Human Resources, Law, Neighborhood and Housing Services, and Water Services departments, the City Manager's Office, and Local 42 for their assistance and cooperation during this audit. The audit team for this project was Joyce Patton and Nancy Hunt.


Douglas Jones
City Auditor

Retroactive Pay Adjustments: Employees Deserve Timely Pay Increases

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Introduction

Objectives

We conducted this audit of retroactive pay adjustments under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit provides "findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability."¹

This report is designed to answer the following questions:

- What are the causes of retroactive pay adjustments?
- Are retroactive pay adjustments accurate?

Scope and Methodology

Our review focuses on the causes of retroactive pay adjustments for classified employees and whether the adjustment calculations are accurate. We concentrated on retroactive pay adjustments caused by late annual performance appraisals. Our audit methods included:

- Interviewing staff from the Aviation, Convention and Entertainment Centers, Finance, Fire, Human Resources, Law, Neighborhood and Housing Services, and Water Services departments, the City Auditor's Office, the City Manager's Office, and Local 42 to understand the causes of retroactive pay adjustments and how adjustments are and should be calculated and processed. We also attempted to interview a representative of Local 500, but the union did not respond to our request.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2011), p. 17.

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- Recalculating a judgmental sample of retroactive pay adjustments to determine the accuracy of the payments.
- Reviewing the city's charter and Code of Ordinances, collective bargaining agreements, and the *Department of Human Resources Rules & Policy Manual* to identify rules related to pay and annual performance appraisals.

Method for Verifying Retroactive Pay Adjustments

To determine whether the department correctly calculated the dollar amount of an employee's retroactive pay adjustment, we selected a judgmental sample of eight adjustments for review. The sample included adjustments from six departments; contained a variety of time reporting codes², time periods, and position types (exempt, non-exempt³); and included members of local 42 and local 500.

To determine the accuracy of the pay adjustment, we:

- Used the employee's pay records from PeopleSoft, the city's payroll system, to establish the pay reporting codes and number of hours to be adjusted for the retroactive pay increase.
- Compared PeopleSoft entries to pay rules in the collective bargaining agreements for Local 500 and 42, the *HR Policy Manual*, the Code of Ordinances, and the city charter.
- Calculated the difference between the employee's old and new pay rates.
- Totaled the number of hours to be adjusted into pay rate groups and multiplied by the appropriate rate (for example, regular time, time and one half, and double time).
- Multiplied each pay rate group by the increase in the employee's hourly pay rate.
- Checked our results against the documentation prepared by the department for the employee's retroactive pay adjustment.

² Time reporting codes are abbreviations that identify how the hours corresponding to that code would be classified and paid for payroll compensation purposes. For example, REG is regular earnings.

³ An exempt position is any position not covered by the overtime provisions of the federal government's Fair Labor Standards Act (FLSA). A non-exempt position would be any position covered by certain overtime provisions of the Fair Labor Standards Act.

When the results did not match, we spoke with the department to determine the reason for the discrepancy. We verified whether an error had been made and noted additional explanatory information.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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. No information was omitted from this report because it was deemed privileged or confidential.

Background

Retroactive Pay Adjustments

A retroactive pay adjustment is a lump-sum payment made to an employee to make up for earned but unpaid wages.

Director of Human Resources' Responsibilities

The director of human resources is responsible for establishing and administering rules for the classified service, subject to the approval of the city manager.⁴ The rules are contained in the *Department of Human Resources Rules & Policy Manual (HR Policy Manual)*. The *HR Policy Manual* covers city performance standards including performance appraisals. The director of human resources is responsible for administering the city's employee performance appraisal system.⁵

Classified and Unclassified Employees

A city employee is either a classified or unclassified employee. Unclassified positions are listed in section 903 of the city charter and include elected officials, the city manager, assistant city managers, department directors, deputy department directors, and specified others. City employees not specified in section 903 are classified.⁶

⁴ Charter of the City of Kansas City, Missouri, Art. IX, Sec. 905 (a) and (b).

⁵ *Department of Human Resources Rules & Policy Manual*, effective August 4, 2014, Sec. 10.4.

⁶ Charter of the City of Kansas City, Missouri, Art. IX, Sec. 904.

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A classified employee's pay is established to provide uniform compensation for like service by grade and classification, within a minimum and a maximum pay range by class. The director of human resources' *HR Policy Manual* directs that "performance appraisals shall be prepared for all employees in the classified service."⁷ Appraisals for unclassified employees "shall be prepared...as directed by the city manager."⁸

⁷ *HR Policy Manual*, Sec. 10.2.

⁸ *HR Policy Manual*, Sec. 10.3.

Findings and Recommendations

Majority of Retroactive Pay Adjustments Caused by Late Appraisals

City departments made almost 3,800 retroactive pay adjustments from May 1, 2016 through April 30, 2019, according to Human Resources Department data. Late annual performance appraisals caused almost 2,800 of these pay adjustments. Retroactive labor agreement provisions caused most of the remaining retroactive pay adjustments.

Tone at the Top Matters in Timeliness of Annual Performance Appraisals

Performance appraisals are late because management is not doing its job. Departments tend to follow the example set by their leadership. In departments where management emphasizes the importance of timely performance appraisals, appraisals are completed on time. In departments we reviewed where performance appraisals were not a management priority, even department directors did not complete timely appraisals. One department, whose director emphasized the importance of timely performance appraisals had no late appraisals in each of last two fiscal years. That department's staff, reacting to the director's emphasis on timely reviews, developed a system of multiple reminders and follow-up which began far enough in advance of the appraisal due dates to achieve on-time appraisals.

Withholding Pay Increases Penalizes Employees and City

Late annual performance appraisals that result in delayed pay increases unfairly penalize employees. Pay increases that are delayed for weeks, months, or years can decrease morale and lead to employee confusion about the perceived value and quality of his or her performance. In addition, late annual merit pay increases may negatively affect an employee's finances when a lower, incorrect wage rate is used.

Delaying pay increases can also negatively impact the city. Employees not immediately receiving an earned pay increase may accept a position with another employer, increasing city turnover. Additionally, retroactive pay adjustments for late reviews create work for the employees who must calculate, document, and submit the adjustment to the city's Human Resources Department. These tasks take staff away from other job responsibilities. In fiscal

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years 2017 through 2019, the city could have avoided almost 2,800 retroactive pay adjustments had management completed annual performance evaluations timely. An average pay adjustment takes about 10 to 20 minutes to calculate.

Number of Retroactive Pay Adjustments Could Be Reduced

Late reviews trigger pay adjustment eligibility. The city withholds annual merit pay increases from employees until their supervisors submit the employees' annual performance appraisals. According to the *HR Policy Manual*, employees receiving an overall performance appraisal rating of at least meets expectations on their annual performance appraisals are eligible for an annual merit increase.⁹ A late performance appraisal automatically qualifies an employee for a merit increase, because employees receiving untimely performance appraisals are to receive a rating of at least meets expectations.¹⁰

The number of retroactive pay adjustments could be reduced significantly by automatically giving employees who do not receive timely performance appraisals a merit increase on their pay anniversary date. Section 10.3 of the *HR Policy Manual* requires annual performance appraisals for city employees "coinciding with the employee's pay anniversary date."¹¹ This requirement is intended to ensure that employees receive formal performance feedback at least annually. However, as evidenced by the number of retroactive pay adjustments, this is not happening.

Recommendation To ensure employees receive the pay to which they are entitled and to eliminate the negative impacts of retroactive pay adjustments, the director of human resources should ensure employees who do not receive timely performance appraisals receive their merit pay increase timely.

We found a retroactive pay adjustment that included pay periods in which the employee was being paid through the city's third party worker's compensation contractor. The city did not have a process in place to communicate with the contractor that a retroactive pay adjustment had been made. As a result, the employee's worker's compensation payments were underpaid.

Recommendation To ensure employees on worker's compensation are paid the correct amount, the director of human resources should identify employees whose worker's compensation payments were

⁹ *HR Policy Manual*, sec. 10.6.

¹⁰ *HR Policy Manual*, sec. 10.4.

¹¹ *HR Policy Manual*, sec. 10.3.

underpaid and establish a method to communicate with the city's worker's compensation contractor when an employee's pay is adjusted due to a retroactive pay adjustment.

Retroactive Pay Adjustments Not Always Accurate

Sample of Pay Adjustments Contained Inaccuracies

Although retroactive pay adjustments should accurately reflect the dollar amount that employees are due, not all do. We recalculated eight retroactive pay adjustments to determine their accuracy and found three adjustments that were incorrect. The most frequent error was using the wrong number of hours in calculating the pay adjustment.

Lack of Written Guidance Contributes to Errors

Although the calculation of retroactive pay adjustments can be complicated, no citywide written instructions are provided. Employees making retroactive pay adjustments were trained by their predecessors. Some departments have developed processes or written aids to help them calculate pay adjustment payments. For example, one department corrected a query used to pull information to calculate pay adjustments, when it was discovered that eligible time, such as overtime hours, were being incorrectly excluded from the payment calculation.

The pay adjustment documentation we reviewed was generally based on an old electronic form that had been inconsistently modified by departments. In talking with department staff and reviewing their supporting documentation, it appears that some departments' methods of computing and documenting retroactive pay adjustments result in more accurate results.

One of the departments we reviewed relies on PeopleSoft queries to identify the hours worked by pay reporting code for use in the calculation of the pay adjustment. The PeopleSoft query returned more hours than were recorded in the payroll system for a pay reporting code, resulting in an incorrect pay adjustment. While PeopleSoft electronic queries can save time calculating retroactive pay adjustments, it is critical that queries be written correctly.

Recommendation

To ensure departments use consistent methodologies and receive needed guidance, the director of human resources should develop written instructions and train employees on how to calculate and document retroactive pay adjustments.

Complex Calculations Completed Manually

Manual calculations introduce the opportunity for human error. The city's current payroll system does not calculate retroactive pay adjustments. Employees' manual calculations introduce the risk that a pay adjustment will not be calculated correctly because of human error. For example, the incorrect number of hours was recorded on forms used to calculate the dollar amount of the retroactive pay adjustment. Each manual entry introduces the risk that the employee will be over or underpaid. And, although the calculation of retroactive pay adjustments can be complex, not all calculations and forms are verified by a second department employee.

Recommendation	To reduce the opportunity of human error in retroactive pay adjustments, the director of finance should investigate the possibility of updating the city's current payroll module to calculate retroactive pay adjustments.
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Recommendations

1. The director of human resources should ensure employees who do not receive timely performance appraisals receive their merit pay increase timely.
2. The director of human resources should identify employees whose worker's compensation payments were underpaid and establish a method to communicate with the city's worker's compensation contractor when an employee's pay is adjusted due to a retroactive pay adjustment.
3. The director of human resources should develop written instructions and train employees on how to calculate and document retroactive pay adjustments.
4. The director of finance should investigate the possibility of updating the city's current payroll module to calculate retroactive pay adjustments.

Appendix A

Management's Response

Retroactive Pay Adjustments: Employees Deserve Timely Pay Increases



Inter-Departmental Communication
Human Resources Department
Finance Department

RECEIVED

AUG 23 2019

CITY AUDITOR'S OFFICE

Date: August 21, 2019

To: Douglas Jones, City Auditor

From: Gary O'Bannon, Director of Human Resources
 Randall J. Landes, Director of Finance *RJL by OA*

Subject: Response to Performance Audit
Retroactive Pay Adjustments: Employees Deserve Timely Pay Increases

1. The director of human resources should ensure employees who do not receive timely performance appraisals receive their merit pay increase timely.

Agree. No later than November 10, 2019, the Human Resources Department will prepare a memorandum to all Department Directors and Human Resources Liaisons to implement the following changes:

- So long as the City is not utilizing a variable pay plan, annual merit increases will be entered timely by the Human Resources Department, even if the department has not provided an annual performance review for the employee
- Individuals receiving a timely annual performance review that was "fails to meet expectations" or "failed to meet overall expectations" will not receive a merit increase pursuant to existing policies and procedures
- Departments will be encouraged to continue providing employees with on-going performance feedback and to submit annual performance reviews in a timely manner

2. The director of human resources should identify employees whose worker's compensation payments were underpaid and establish a method to communicate with the city's worker's compensation contractor when an employee's pay is adjusted due to a retroactive pay adjustment.

Agree. No later than November 10, 2019, the Directors of Human Resources and Finance will collaborate to develop a process to communicate to the worker's compensation contractor when an employee's pay is adjusted due to a retroactive pay adjustment. With the implementation of Recommendation No. 1, the number of retroactive pay adjustments should be reduced thereby reducing the impact of this problem.

3. *The director of human resources should develop written instructions and train employees on how to calculate and document retroactive pay adjustments.*

Agree. No later than November 10, 2019, the Directors of Finance and Human Resources will collaborate to develop and implement retroactive pay adjustment instructions and training opportunities for key department personnel to demonstrate how to perform the pay calculations and record the information in the City's payroll system. Training and instruction will include job aids, a revised retroactive pay adjustment calculation form, and the use of PeopleSoft queries to determine number of retroactive hours due to the employee.

4. *The director of finance should investigate the possibility of updating the city's current payroll module to calculate retroactive pay adjustments.*

Agree. The PeopleSoft Human Capital Management (HCM) module has existing retroactive pay functionality available but this functionality has not been implemented nor utilized within payroll operations to date. The Finance Department is currently undertaking a payroll reconfiguration project which will include a review of the HCM retroactive pay functionality with the goal to ultimately implement this feature. We anticipate beginning this process sometime in January 2020 with the hope of implementing, if feasible, on or before May 1, 2020.

cc: Troy M. Schulte, City Manager