



PORTLAND DEVELOPMENT COMMISSION:

Human resources and payroll practices
functioning effectively

August 2014

LaVonne Griffin-Valade

City Auditor

Drummond Kahn

Director of Audit Services

Kari Guy

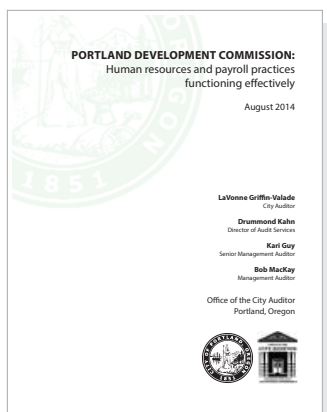
Senior Management Auditor

Bob MacKay

Management Auditor

Office of the City Auditor
Portland, Oregon





Production / Design
Robert Cowan
Public Information Coordinator



CITY OF PORTLAND

Office of City Auditor LaVonne Griffin-Valade

Audit Services Division

Drummond Kahn, Director

1221 S.W. 4th Avenue, Room 310, Portland, Oregon 97204

phone: (503) 823-4005

web: www.portlandoregon.gov/auditor/auditservices



August 12, 2014

TO: Mayor Charlie Hales
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Steve Novick
Commissioner Dan Saltzman
Patrick Quinton, Executive Director, Portland Development Commission

SUBJECT: Audit Report: *Portland Development Commission: Human resources and payroll practices functioning effectively* (Report #458)

The attached audit report contains the results of our audit of payroll and the classification and compensation system at the Portland Development Commission (PDC). Audits of these basic business activities can help ensure effective stewardship of public resources.

The objectives of the audit were to determine whether PDC has systems in place to ensure payroll accuracy and to classify and compensate employees fairly and consistent with law. We found that PDC's payroll practices and classification and compensation system are consistent with best practices and clearly documented.

We recommend two minor changes to mitigate any future risks, and ask the Portland Development Commission to provide us with a status report in one year detailing steps taken to address the recommendations in this report. We very much appreciate the cooperation and assistance we received from PDC staff as we conducted this audit.

LaVonne Griffin-Valade
City Auditor

Attachment

Audit Team: Drummond Kahn
Kari Guy
Bob MacKay
Caroline Zavitkovski

PORTLAND DEVELOPMENT COMMISSION:

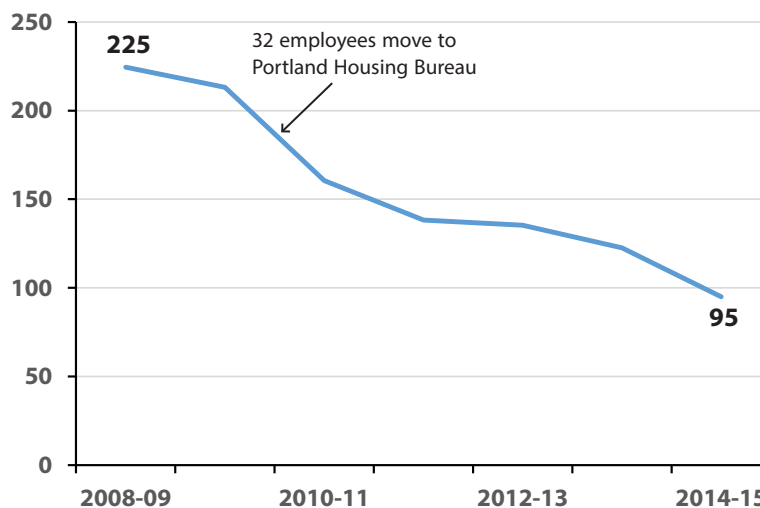
Human resources and payroll practices
functioning effectively

Introduction

The Portland Development Commission (PDC) is charged with implementing the City's urban renewal and economic development goals. Established in City Charter, PDC is administered by a five-member commission appointed by the Mayor and confirmed by City Council. The Commission has the authority to hire employees, set their compensation, and establish conditions of service. PDC employees are paid by PDC, and their job classification and compensation decisions are not part of the City's human resources system.

PDC experienced significant employment changes in recent years:

- In 2007, eligible PDC employees voted to be represented by the American Federation of State, County and Municipal Employees (AFSCME), resulting in a collective bargaining agreement governing salary and benefits for union employees.
- In 2010, the creation of the Portland Housing Bureau (PHB) resulted in a transfer of 32 PDC employees and related responsibilities to the new bureau. In addition, PDC offered a targeted severance program and a voluntary retirement incentive program, and 15 people qualified for and accepted one of these options.
- In 2011, 17 employees were notified that their positions were being eliminated as part of a reduction in force that lowered the total number of positions at PDC by 22.
- Finally, in 2013, the Commission authorized a reduction in force to decrease personnel costs by 30 percent in response to projected declines in urban renewal area funds. PDC reorganized as a result of these staff reductions.

Figure 1 PDC budgeted positions

Source: Audit Services Division analysis of PDC Data

As shown in Figure 1, PDC's budgeted staff decreased 58 percent in seven years, from 225 to 95 employees. Of these 95 positions, 69 are represented by the union and 26 are non-represented.

In light of the recent organizational changes, PDC requested our review of two PDC systems -- the payroll system and the system for classifying and compensating employees. PDC management told us that they are starting to implement new business system software, and a review of their current practices could help inform the system implementation.

The objectives of this our audit were to determine:

1. Whether PDC has systems in place to accurately approve, calculate and record payroll, and
2. Whether PDC has a classification and compensation system to compensate employees fairly and consistently with the law.

We found that the answer is yes to both questions. PDC has managed its payroll system and its classification and compensation system effectively during a time of transition, and both systems are consistent with best practices. We recommend two minor changes to mitigate any future risks as PDC implements its new business system software.

Audit Results

Payroll controls in place

An effective payroll process has adequate controls in place to catch errors and deter any attempt to defraud the system. This helps ensure the responsible stewardship of PDC's public funds. To evaluate PDC's payroll system, we reviewed payroll policies and procedures, interviewed staff, and analyzed a sample of payroll transactions across three pay periods, including review of both hard copy and electronic files.

Standards for Internal Control in the Federal Government, research from independent governance associations, and other audits point to common best practices for payroll management:

- Payroll policies and procedures should define the actions management establishes to achieve objectives and respond to risks.
- Duties should be segregated among different people to minimize the risk of error or fraud, and system access should be controlled.
- All payroll transactions should be properly calculated, approved, and documented.

We found that PDC payroll practices are consistent with these best practices, as described below.

Payroll policies and procedures

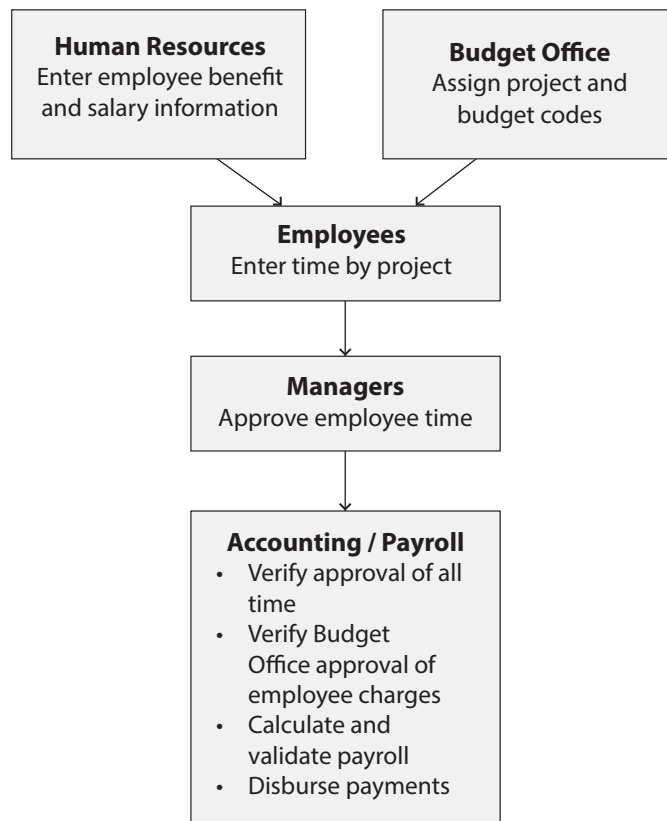
PDC adopted payroll policies designed to ensure employees receive timely pay in accordance with federal and state laws. The policies define employee responsibilities in payroll processing, and the system for recording and approving time. In addition to the adopted policies, PDC has documented detailed payroll procedures. These policies and procedures outline the actions PDC should take to achieve its payroll objectives, manage risk, and comply with relevant laws.

Segregation of duties

PDC payroll duties are divided between its Human Resources, Budget Office, and Accounting staff. Human Resources is responsible for

making changes in the electronic system to update employee salary and benefit information. Payroll processing staff can access the human resources employee master data for information, but cannot change or update the data. Different staff members in Accounting process, approve, and distribute payroll. In addition, Budget Office staff assign budget codes to activities so employees can charge time worked to the correct funds. For example, an employee working on property redevelopment in the River District Urban Renewal Area would charge time directly to that activity and fund, and time would be approved by a manager and reviewed by the Budget Office. Key duties in payroll processing are shown in Figure 2.

Figure 2 Payroll duties and processes



Source: Audit Services Division summary of PDC data

PDC's electronic systems are designed to limit access to that required to perform the assigned duties; for example, Human Resources staff members cannot approve payroll transactions. However, we found that four Accounting staff members have full access to edit electronic data, including both human resources and payroll data. This creates a risk for fraud, as one person could theoretically alter an employee's pay rate and then approve the payroll.

In our review of payroll transactions, we did not see any evidence of improper access to the files. PDC managers told us the access was due to historic system configuration issues, and that they would test new access restrictions in order to address the problem. As PDC implements new business system software, they should review access permissions to limit system access for each employee to those activities necessary to accomplish daily job duties.

Accurate payroll transactions

PDC's payroll process involves multiple verifications of time and pay accuracy. As described above, managers are required to review and approve employee time. A report detailing employee time charges by project and fund is sent to the Budget Office for review and approval each pay period.

Payroll staff conduct other reviews to verify payroll accuracy. These include running deviation reports to flag hours worked outside of normal schedule or missing time records and comparing net and gross pay to the prior pay period. Any discrepancies are researched and verified before continuing.

Once the payroll register is complete, it is reviewed and approved by the Accounting Manager. Paying employees – whether through direct deposit or printing checks – is handled by a separate staff person within Accounting who follows separate procedures. Receipts for all disbursements to external parties are scanned and maintained electronically in the payroll file.

While payroll is generally calculated accurately, we identified a few cases in the sample we reviewed where electronic data was not consistent with hard copy data, or not consistent with policy. For example, a deferred compensation deduction was missed for one employee, and for four employees Federal W-4 documents did not match system information. In each of these cases, only one person reviewed and entered hard copy data in the electronic system. All new employee pay and benefit information entered into the electronic system should be verified by a second person reviewing the original documentation. To confirm that all system documentation is correct, PDC should also periodically compare electronic employee records against original employee files.

We found that PDC's payroll process was clearly documented in policy and procedures, with duties divided among staff to facilitate the timely and accurate calculation of payroll.

Classification and compensation system responded to a changing organization

Job classification is a system for objectively and accurately defining the duties, responsibilities, and authority level of a job. Compensation is then a systematic approach for determining the pay assigned to each job classification, often with a pay range and steps in the range. Effective employee classification and compensation systems enable organizations to attract and retain the personnel they need. Classification and compensation decisions also have significant current and future financial impacts and must be consistent with State and Federal employment law. To evaluate PDC's classification and compensation system, we reviewed PDC classification and compensation studies, job descriptions, labor agreements, and a selection of recent employee re-classifications.

Multiple organizations, including the International City/County Management Association, the Government Finance Officers Association, and the Society for Human Resource Management, identify best practices to establish and manage a high performing classification/compensation system. These best practices including the following:

- Classification and compensation should be aligned with the organization's strategy and goals.

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- Job classifications and compensation should be externally competitive and internally fair.
 - A classification and compensation study should be completed every three to five years.

We found that PDC's classification and compensation system is consistent with best practices, as described below.

Strategic alignment

As PDC reorganized and downsized, they worked to align job classifications and compensation with the strategic goals of the Commission. PDC reviewed and updated all job descriptions, and then used the updated job descriptions in a classification and compensation study that was finalized in 2013. That study informed the collective bargaining agreement for union employees as well as salary adjustments for non-represented employees.

Position reclassifications continued after the collective bargaining agreement was signed, both in response to a Memorandum of Understanding in the agreement and as employees shifted functions or assumed new duties. PDC has a process in place where either an employee or manager can request a reclassification when job duties significantly change due to business needs.

Externally competitive and internally fair

PDC's 2013 classification and compensation study compared PDC salaries against peer agencies in the region and across the country. PDC's union questioned the methodology and accuracy of the initial study. The final study, after further discussion and analysis by PDC and the union, resulted in salary increases or decreases for many positions. If the salary range for an employee was reduced below the employee's current salary, the employee's salary was 'red circled' or held at the current level. The salary study aligns compensation at PDC for both union and non-represented employees with peer positions, adjusted for market conditions in Portland.

One concept of internal fairness is that lower level employees should not be paid more than higher-level, more experienced employees, including their direct supervisors. PDC policies address internal fairness through job classifications and defined salary ranges, which allow room for growth. PDC personnel policy states that the salary structure will be made up of overlapping salary ranges, and that salaries will be generally positioned slightly higher than comparable jobs in the area. In our review of current job descriptions and employee files, we did not find any instances where lower-level employees were paid more than their direct supervisors.

When PDC updates a job description, Human Resources staff also analyze whether the position should be exempt from the overtime requirements of the Federal Fair Labor Standards Act (FLSA). PDC Human Resources staff told us they consult with outside experts as needed. We reviewed FLSA determinations for a selection of employees with similar job descriptions. While PDC did not document the rationale for FLSA determinations in writing, we found that the process for making FLSA determinations is consistent with the law.

Regularly updated

PDC last conducted a classification compensation study in 2007, and completed its current study in 2013. Continuing to update the classification and compensation study every three to five years will help PDC maintain competitive salaries and retain a qualified workforce.

Significant organizational changes, like those PDC instituted in the last few years, could result in disconnects between employee classification, actual job duties, and pay. We found that PDC has used its classification and compensation system to update job descriptions to align with the organizational strategy and the concept of internal and external fairness.

Recommendations

PDC has managed both its payroll system and classification and compensation system effectively in a time of transition, and both systems are consistent with best practices. We noted a few risks PDC should address as they implement new business system software. We recommend that PDC:

- 1. Review access permissions for the new business system software and limit access to that necessary to accomplish daily job duties.**
- 2. Verify all new employee pay or benefit information entered into the electronic system by requiring that a second person review the original documentation.**

To confirm that all system documentation is correct, PDC should also periodically compare electronic employee records against original employee files.

Objectives, scope and methodology

The objectives of our audit were to determine:

1. Whether PDC has systems in place to accurately approve, calculate and record payroll, and
2. Whether PDC has a classification and compensation system to compensate employees fairly and consistently with the law.

To accomplish these objectives, we reviewed PDC's policies and procedures related to personnel and payroll, and reviewed the collective bargaining agreement. We interviewed PDC staff responsible for budget, payroll, and human resources. We also interviewed union representatives.

To identify best practices for payroll and for classification and compensation, we reviewed research from national associations and organizations, audits from other jurisdictions, and State and Federal employment law. We compared these against PDC's policies and procedures, classification and compensation study, and labor agreements.

To verify information in PDC's current business system software, we reviewed hard copy personnel files for a judgmental sample of employees.

To evaluate payroll accuracy, we independently calculated employee gross and net pay for the same sample of employees and pay periods based on data in hard copy employee master files. We also reviewed documentation for all payroll processing actions for one complete pay period. We identified any discrepancies and followed up on those with PDC payroll staff.

To assess system access and controls, we reviewed system security and permissions in PDC's human resources and payroll business software.

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.

RESPONSES TO THE AUDIT



July 29, 2014

Ms. LaVonne Griffin-Valade
Office of City Auditor
Audit Services Division
1221 SW 4th Ave., #310
Portland, OR 97204

Dear Ms. Griffin-Valade:

We thank you for the opportunity to respond to your recent audit, *PDC Human Resources and Payroll Practices Functioning Effectively*, and for the work put into this audit by your staff. It was a pleasure working with them and we appreciate their patience and dedication as they learned how the Portland Development Commission (PDC) does business.

Over the past seven years, PDC has undergone several organizational changes beginning in 2007 with our first collective bargaining agreement and resulting in an overall 57.8 percent reduction in staff. As we begin the implementation of a new enterprise resource planning (ERP) system our goal was to ensure our payroll policies and practices, and our employee classification/compensation system were consistent with best practices. We are pleased with the results of the audit and will note the recommended changes in our implementation plan.

This letter details management's response to the recommendations resulting from your recent audit and the steps we will be taking to implement the corrective actions.

1. *Review access permissions for the new business system software and limit access to that necessary to accomplish daily job duties.*

Historically, in the Lawson System, senior accounting personnel required access to HR/PR modules in order to be able to post transactions from those systems to the General Ledger module. As this access need had not been reviewed or tested in some time, recent software upgrades or enhancements added a new security profile which allowed access to transactional tables for posting purposes without access to the HR/PR modules. After successful testing, senior accounting staff has been transferred to this new security class with access only to what is needed to post to General Ledger. This access limitation will also be established in the new ERP System.

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2. *Verify all new employee pay or benefit information entered into the electronic system by requiring that a second person review the original documentation.*

Employee pay and benefit information is entered by Human Resources. The Payroll Department has read-only access to the Employee Master record; Human Resources will provide original documents to Payroll each pay period for review. A periodic review of electronic employee records against original employee files will be added to our internal process to confirm that all system documentation is correct.

On behalf of the PDC Audit Committee, please extend our appreciation to the Audit Services staff for their effort on this audit and considering our feedback during the process.

Sincerely,



Mayor Charlie Hales
City of Portland



Patrick Quinton
Executive Director
Portland Development Commission

C: PDC Audit Committee

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*Portland Development Commission: Human resources
and payroll practices functioning effectively*

Report #458, August 2014

Audit Team: Kari Guy, Bob MacKay, Caroline Zavitkovski

LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

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