

AGENCY USE OF OVERTIME

Audit Report No. AOT0107

March 16, 2007



**MENTAL HEALTH MENTAL RETARDATION
AUTHORITY OF HARRIS COUNTY**

Internal Audit Report

AUDITOR'S REPORT

Agency Use of Overtime

Audit Report Number AOT0107

Harris County, Texas

Internal Audit Report

March 16, 2007

Henry E. Webb, CFE

Internal Auditor





March 16, 2007

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7011 SW Freeway
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Re: Agency Use of Overtime (Report No. AOT0107)

BACKGROUND

The Mental Health and Mental Retardation Authority of Harris County (MHMRA) has formal policies and procedures designed to ensure compliance with the federal Fair Labor Standards Act (FLSA). The FLSA, first enacted in 1938 establishes minimum wage, overtime pay, record keeping, and child labor standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. These standards affect more than 100 million workers. The act stipulates that all non-exempt workers in the United States be paid overtime when they work more than 40 hours in a week and also defines which conditions must be met to be exempted from the terms of the law. FLSA is a dynamic instrument, and many of the requirements have been enacted over the years through judicial challenges.

The Act applies to enterprises with employees who engage in interstate commerce, produce goods for interstate commerce, or handle, sell, or work on goods or materials that have been moved in or produced for interstate commerce. For most firms, a test of not less than \$500,000 in annual dollar volume of business applies (i.e., the Act does not cover enterprises with less than this amount of business).

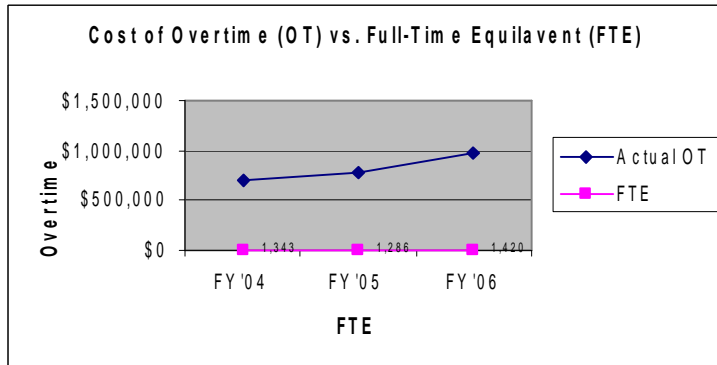
However, the Act does cover the following regardless of their dollar volume of business: hospitals; institutions primarily engaged in the care of the sick, aged, mentally ill, or disabled who reside on the premises; schools for children who are mentally, or physically disabled or gifted; preschools, elementary, and secondary schools and institutions of higher education; and federal, state, and local government agencies.

The Act exempts some employees from its overtime pay and minimum wage provisions, and it also exempts certain employees from the overtime pay provisions alone. The Act does not limit the number of hours in a day or the number of days in a week that an employer may require an employee to work, as long as the employee is at least 16 years old. Similarly, the Act does not limit the number of hours of overtime they may be scheduled. However, the Act requires employers to pay covered employees not less than one and one-half time their regular rates of pay for all hours worked in excess of 40 in a workweek, unless the employees are otherwise exempt.

Employers must keep records on wages, hours, and other information as set forth in the Department of Labor's regulations. Most of this data is the type that employers generally maintain in ordinary business practice.

Overtime expenditures have increased from Fiscal Year 2004 by a rate of growth that exceeds the increases in the overall budget and FTEs (see **Exhibit A**). This equates to overtime expenditures as a percentage of the operating budget that is growing, and the amount of overtime worked by each staff person (on average) is also increasing.

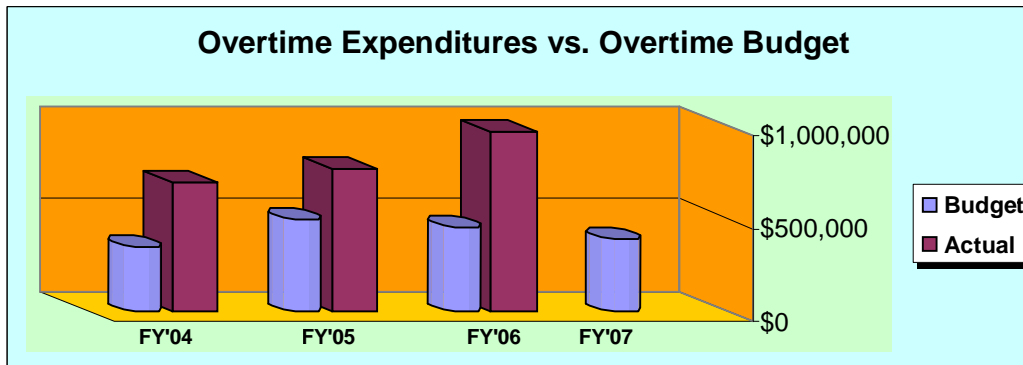
EXHIBIT A



In FY 2004, actual overtime expenditures were over budgeted amounts by \$344,158, FY 2005 by \$281,299 and FY 2006 by \$514,329. Overtime expenditures were approximately 52 percent higher than the overtime budget.

Exhibit B displays overtime budgets and expenditures over the last three Fiscal Years and budgeted amounts for Fiscal Year 2007.

EXHIBIT B



The ability to provide staffing when needed, such as unexpected sick time, is an example of the flexibility that overtime can afford to respond to. Short-term demands for increased staffing resources such as Agency employee turn-over is another. During Fiscal Year 2005, the Agency experienced approximately 360 employees separating from employment and for Fiscal Year 2006 approximately 414 for various reasons. Nevertheless, there are questions about whether the use of overtime for long-term purposes is cost-effective, whether too much overtime can overburden staff, and whether all the overtime that is used is necessary or avoidable.

Exhibit C presents the top ten non-exempt Agency employees receiving overtime pay.

**Exhibit C
Top 10 Non-exempt Employees
Overtime Compensation
Calendar Year 2006**

| EMPLOYEE | ANNUAL BASE SALARY* | OVERTIME COMPENSATION | TOTAL |
|--------------|---------------------|-----------------------|------------------|
| A | \$56,676 | \$25,978 | \$82,655 |
| B | 58,368 | 19,885 | 78,253 |
| C | 56,676 | 17,150 | 73,826 |
| D | 25,980 | 14,516 | 40,496 |
| E | 27,744 | 13,855 | 41,599 |
| F | 58,368 | 13,146 | 71,514 |
| G | 28,668 | 12,404 | 41,072 |
| H | 17,786 | 11,786 | 29,426 |
| I | 27,744 | 11,527 | 39,271 |
| J | 17,640 | 11,455 | 29,095 |
| TOTAL | \$375,504 | \$151,704 | \$527,208 |

*Annual base salary does not include approximately 23% fringe benefit "burden".

Exhibit D presents the Agency top ten non-exempt staff annual overtime hours.

**Exhibit D
Top 10 Non-exempt Employees
Overtime Hours
Calendar Year 2006**

| EMPLOYEE* | CALENDAR YEAR OVERTIME HOURS | CALENDAR YEAR OVERTIME PAY |
|--------------|------------------------------|----------------------------|
| H | 926.50 | \$11,786 |
| K | 922.75 | 11,211 |
| J | 900.50 | 11,455 |
| D | 790.50 | 14,516 |
| E | 708.50 | 13,855 |
| L | 651.65 | 8,290 |
| A | 647.50 | 25,979 |
| M | 611.00 | 10,036 |
| G | 600.00 | 12,404 |
| I | 592.50 | 11,527 |
| TOTAL | 5,502.15 | \$108,062 |

*Corresponds with employee in Exhibit C where applicable.

Health Care Industry

Hospitals and other institutions "*primarily engaged in the care of the sick, the aged, or the mentally ill*" are covered employers under Section 3(s)(1)(B) of the FLSA. Thus, hospitals, residential care establishments, skilled nursing facilities, nursing facilities, assisted living facilities, residential care facilities and intermediate care facilities for mental retardation and developmentally disabled must comply with the minimum wage, overtime and youth employment requirements of the FLSA.

Non-exempt employees must be paid at least time-and-one-half their “regular rate” of pay for all hours worked over 40 in a workweek. The “regular rate” includes an employee’s hourly rate *plus* the value of some other types of compensation such as bonuses and shift differentials. The only remuneration excluded from the regular rate under the FLSA are certain specified types of payments like discretionary bonuses, gifts, contributions to certain welfare plans, payments made to certain profit-sharing and savings plans, and pay for foregoing holidays and vacations.

Under section 7(j) of the FLSA, hospitals and residential care establishments may utilize a fixed work period of fourteen consecutive days in lieu of the 40 hour workweek for the purpose of computing overtime. To use this exception, an employer must have a prior agreement or understanding with affected employees before the work is performed. This eight and eighty (8 and 80) exception allows employers to pay time and one-half the regular rate for all hours worked over eight in any workday and eighty hours in the fourteen-day period.

*“No employer engaged in the operation of a hospital or an establishment which is an institution primarily engaged in the care of the sick, the aged, or the mentally ill or defective **who reside on the premises** shall be deemed to have violated subsection (a) {work week longer than forty hours unless such employee receives compensation for his employment in excess of the hours at a rate not less than one and one-half times the regular rate at which he is employed} if, pursuant to an agreement or understanding arrived at between the employer and employee before performance of the work, a work period of fourteen consecutive days is accepted in lieu of the workweek of seven consecutive days for purposes of overtime computation and if, for his employment in excess of eight hours in any workday and in excess of eighty hours in such fourteen-day period, the employee receives compensation at a rate not less than one and one-half times the regular rate at which he is employed.”*

An employer can use both the standard 40 hour overtime system and the 8 and 80 overtime system for different employees in the same workplace, but they cannot use both for a single individual employee.

An employer’s work period under 8 and 80 overtime system must be a fixed and regularly recurring 14-day period. It may be changed if the change is designed to be permanent and not to evade the overtime requirements. If an employer changes the pay period permanently, it must calculate wages on both the old pay period and the new pay period and pay the amount that is more advantageous to each employee in the pay period when the change was made.

Premium pay for daily overtime under the 8 and 80 system may be credited towards the overtime compensation due for hours worked in excess of 80 for that period.

Penalties/Sanctions

The Department of Labor uses a variety of remedies to enforce compliance with the Act’s requirements. When Wage and Hour Division investigators encounter violations, they recommend changes in employment practices to bring the employer into compliance, and they request the payment of any back wages due to employees.

Willful violators may be prosecuted criminally and fined up to \$10,000. A second conviction may result in imprisonment. Employers who willfully or repeatedly violate the minimum wage or overtime pay requirements are subject to civil penalties of up to \$1,000 per violation.

OBJECTIVES

The overall objectives of the audit were to determine whether the departments:

- Managed and used resources in an efficient, effective, and economical manner
- Administered funds in compliance with applicable laws, regulations, policies and procedures
- Implemented internal controls to prevent or detect material errors and irregularities

The specific objective in this audit was to:

- Determine whether departments are in compliance with the FLSA, and whether controls are in place to adequately govern the overtime process

SCOPE

The scope of the work did not constitute an evaluation of the overall internal control structure of the units. The examination was designed to evaluate and test compliance with established policies and procedures and to test the internal control over tested areas and material. The audit scope was from September 1, 2005 through August 31, 2006.

Department management is responsible for establishing and maintaining a system of internal controls to adequately comply with approved policies and procedures. The objectives of an internal control system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or theft, and that transactions are executed in accordance with management's authorization and are recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected in a timely manner. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate.

The purpose of the audit report is to furnish management independent, objective analyses, recommendations, and information concerning the activities reviewed. The audit report is a tool to help management discern and implement specific improvements. The audit report is not an appraisal or rating of management.

Although due professional care in the performance was exercised, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud is the responsibility of management. Audit procedures alone, even when carried out with professional care, do not guarantee that fraud will be detected. Specific areas for improvement are addressed later in this report.

Other minor findings, not included in this report, have been communicated to management and/or corrected during the audit process. Internal Audit would like to thank management and staff for their cooperation throughout the audit.

METHODOLOGY

In order to meet the objectives, Internal Audit evaluated controls over the use of overtime and reviewed policies and procedures for compliance and completeness. MHMRA staff was interviewed and audit tests and procedures were conducted as considered necessary.

The sample size and selection were statistically generated using a desired confidence level of 95%, expected error rate of 5%, and a desired precision of +/-5%. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

STATEMENT OF AUDITING STANDARDS

The audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that Internal Audit plan and perform the audit to afford a reasonable basis for the judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements

of laws and regulations when necessary to satisfy the audit objectives. An audit also includes assessing the estimates, judgments, and decisions made by agency management. It is believed that this audit provides a reasonable basis for the findings, conclusions, and recommendations.

RESULTS

As a result of the audit procedures and surveys conducted, it was determined that controls over Agency wage and hour administration are adequate. However, it was discovered that certain internal controls need to be strengthened. These and other items are discussed below.

FINDING

Pay Based on the 8 and 80 Overtime System

MHMRA eliminated the use of the 8 and 80 system March 26, 2001 due to the “Agency not being eligible for hospital classification which is necessary for the 8 and 80 rule.” However, included in the November 1, 2006 issued Employee Handbook, **Employee Policies Procedures and Practices, G. Compensation, 3. Overtime, d. Comprehensive Psychiatric Emergency Center Overtime Computation:** “To assist the Comprehensive Psychiatric Emergency Center in maintaining its work schedules, the Federal wage-hour law permits the healthcare industry to use a 14 day work (8/80 rule) period instead of the 7 day work week.

Under the 8/80 rule, employees in non-exempt positions (and registered nurses) will be compensated at a rate of one and one-half times their base hourly rate of pay for all hours worked in excess of 8 hours per day or 80 hours in a pay period or whichever is greater.”

RECOMMENDATION

- It is recommended that during Agency “New Employee Training”, clarification be given to employees concerning pay based on the 8 and 80 overtime system, to avoid any misunderstanding once employment commences.
- It is further recommended that in the next Employee Policies Procedures and Practices edition, sections that relate to the 8 and 80 overtime system be removed.

Management Response

“The section relating to the 8 and 80 overtime system has been removed from the Employee Handbook effective November 1, 2006.” – Human Resources

“Recommend the handbook be changed/added.” – Budget Managers

FINDING

Overtime Approval and Pay

Agency policy and procedures state: “All overtime requires prior approval except in cases of emergencies. In such cases, the overtime must be approved within one workday. Compensations for the use of overtime will be limited to that time absolutely essential to accomplish the job.

1. *Work loads and work schedules will be planned so as to reduce overtime to the minimum.*
2. *All overtime must be approved by the employee’s immediate Supervisor and/or Unit Director prior to the beginning of the overtime work. Documentation for overtime will be maintained on the employee’s Time and Leave Record and submitted on the Payroll Time Record by 10:00 a.m. on Monday of the payroll week.”*

The U.S. Department of Labor, Employment Standards Administration Wage and Hour Division apply the following principle to overtime:

“Employees ‘Suffered or Permitted’ to work: Work not requested but suffered or permitted to be performed is work time that must be paid for by the employer. For example, an employee may voluntarily continue to work at the end of the shift to finish an assigned task or to correct errors. The reason is material. The hours are work time and are compensable.”

Premium Holiday Compensation

Agency policy and procedures state: *“The following holidays are designated as premium holidays:*

*Thanksgiving Day
Christmas Day
New Year’s Day*

Employees who work their shift or the majority of their shift between 0001 hours and 2400 hours on the premium holiday will be compensated at time and one-half pay for their entire shift worked in addition to scheduling and taking paid time off to observe the holiday.

Holiday hours which are paid but not worked are not considered as worked time for the purposes of overtime calculation.”

Listed below are the results of samples taken during the audit process from Payroll Time Sheets:

- 42% of samples tested did not have employee’s Supervisor and/or Unit Director’s signature on the documents approving overtime worked
- 3% of Payroll Time Sheets did not contain employee signatures
- < 1% of employees were paid for Premium Holiday pay who did not work on a day designated as a premium holiday
- 40% or 6 out of 15 employee time sheets sampled selected did not contain accurate hours worked, yet were approved by the employee’s immediate supervisor.

RECOMMENDATION

- In order to ensure overtime expenditures are controlled in an effective manner, Management should ensure that all Supervisor’s and/or Unit Director’s are aware of, understand, and are held accountable for their role in approving overtime expenditures.
- Overtime pay should be budgeted at realistic levels and Agency departments should be held accountable for “holding the line” on overtime. The current practice of having the budget assume that all positions are filled throughout the year, then in practice using “savings” from unfilled positions to help pay for overtime is inexact and prevents an accurate understanding of personnel costs.
- A model should be developed that will identify the least costly mix of full-time staff and overtime given the number of ‘posts’ to be staffed and current leave use practices. If use of leave is excessive or inefficient, however, other methods must be employed to address those issues. A staffing and overtime model that takes estimated leave usage into account and uses statistical techniques to calculate how much overtime will be generated by difference levels of staff to cover a given number of ‘posts’ should be developed. This approach, coupled with projections for other types of demand for overtime can potentially produce an accurate estimate of overtime and can help budget-makers determine the financial break-even point between using full-time employees and overtime hours to staff needed functions.

The model must take into account policy or operational concerns regarding the amount of overtime hours that employees should be expected to work without jeopardizing safety and productivity or causing other unintended consequences. A limitation of such a model is that it starts with estimates of leave usage among staff based on current practices. If the use of unscheduled leave (such as sick leave or family leave) has been growing, or the practices

regarding scheduled leave are inefficient, the model will not reduce inefficiencies. A major advantage of such a model, however, is that it can be used to estimate the budgetary impact of changes in policy that would affect overtime use, and when and how much leave is taken.

Management Response

- *HR agrees with and supports the above proposed recommendations.*
- *Management training needs to be facilitated and clearly defined responsibilities and expectations outlined within divisions/departments.*
- *Timekeeper training must be facilitated along with departmental management training to maintain accountability within the unit/department. – Human Resources*

FINDING

Exempt Employees Paid “Straight Time” for Hours Over 40 – Not Consistent With Policy and Procedures

Exhibit E presents the top 5 exempt employees straight time compensation for calendar year 2006.

**Exhibit E
Top 5 Exempt Employees
“Straight Time” Compensation
Calendar Year 2006**

| Over Time Hours Calendar Year 2006 | Base Employee Salary | “Straight Time” Paid | Total Compensation |
|---------------------------------------|-------------------------|-------------------------|-----------------------|
| 944.08 | \$ 148,508 | \$ 67,407 | \$ 215,915 |
| 833.50 | \$ 150,900 | \$ 60,470 | \$ 211,370 |
| 471.75 | \$ 138,008 | \$ 31,301 | \$ 169,309 |
| 364.50 | \$ 146,504 | \$ 25,672 | \$ 172,176 |
| 294.58 | \$ 156,901 | \$ 22,220 | \$ 179,121 |

The Agency Employee Handbook states:

“MHMRA complies with the Fair Labor Standards Act (FLSA) in classifying Agency positions as exempt or non-exempt from the overtime requirements as defined in the Act. Employees in certain types of jobs are entitled to overtime pay for hours worked in excess of 40 per work week. These employees are referred to as “non-exempt” in the Employee Handbook.

“Certain executive, administrative, professional, computer-related and highly compensated employees are exempted by the Fair Labor Standards Act, and are not required to be paid for overtime, nor are reports and records required to be maintained for worked performed. The determination of those exempt will follow the requirements set forth in the Fair Labor Standards act. The Human Resources Director is responsible for monitoring all activities and determining the Agency’s posture on any questions regarding overtime and compensatory time, and the Agency’s compliance with the Fair Labor Standards Act.”

MHMRA adheres to all provisions of the Fair Labor Standards Act, however, the Agency is not consistent in its treatment of all exempt employees and does not clearly define the payment of ‘straight time’ as it is applied to certain employees in the Employee Handbook.

RECOMMENDATION

- It is recommended that any deviations from the Fair Labor Standards Act be defined in the Employee Handbook, especially as it deals with payment of “straight time” for exempt employees.
- All employees of the Agency should be consistently afforded the same benefits of “straight time”, or establish written statements as to the reasoning and publish these statements in the Employee Handbook. The payments of Agency employees (exempt or non-exempt) in a consistent manner encourages a lower turnover rate, as well as improves employee morale.

Management Response

- *Exempt employees should be paid a salary and possibly supplemented with a monthly stipend.*
- *Any non-exempt employee will be paid in accordance with the Fair Labor Standards Act as it applies to their work schedule. – **Human Resources***

*“We feel that this is a legal counsel / outside counsel / hr issue to come up with a recommendation that can be applied consistently across the agency, go through exec staff and board as this will have operational issues attached to it for several departments.” – **Budget Managers***

FINDING***Employee Status vs. Accrual of Benefits***

The MHMRA Employee Handbook provides the following information in regard to Employee Status:

- 1) **Full-time (100%) Employees** – Full-time employees are those who are regularly scheduled to work a minimum of 40 hours in a defined work week. Full-time employees are classified as 100% employees.
- 2) **Part-time Employees** – Part-time employees are those who are regularly scheduled to work less than 40 hours in a defined work week. A part-time employee is classified, as a percent of forty hours, in accordance with the minimum number of hours the employee is regularly scheduled to work.
 - a) **Part-time classification 75% but less than 100% employees** – Employees classified as 75% but less than 100% may be eligible for Agency benefits, and accrue sick leave and vacation leave in proportion to their percent of employment.
 - b) **Part-time classification less than 75%** - Employees classified as less than 75% generally are not eligible for Agency benefits. However, employees who work less than 100% but greater than or equal to 50% may accrue sick leave and vacation leave in proportion to their percent of employment.
- 3) **Sick Leave** – Full-time Employees accrue at a rate of 3.7 hours per pay period for a total of 96 hours for any 12 consecutive months worked.
- 4) **Eligible Part-time employees** who work less than 100% but greater than or equal to 50% may accrue sick leave allowance on a pro-rata basis up to a maximum of 352 hours.

Internal Audit selected a sample of 10 employee personnel payroll records to determine compliance with accrued benefits. All sampled employee records were reported as receiving benefits at a rate of a Employee classified as Full-time (100%). However, it was noted that 6 out of the 10 samples reviewed (60%), indicated that the employees work was part-time.

RECOMMENDATION

- It is recommended that on a periodic basis, Human Resources and unit supervisors review employee status (full-time/part-time) and revise accrual rate as appropriate.

Management Response

- *The proper paperwork needs to be approved by a Division Deputy and submitted to the HR Department in order to be entered into the HRIS System which in turn will activate the appropriate accrual rate.*
- *Payroll will conduct a quarterly audit to insure appropriate accrual rates equal to current FTE status. – **Human Resources***

Management Response to all Findings (Executive Director)

“MHMRA, will identify and contract with an external consultant to review with each area where there are substantial concerns pertaining to the appropriate and safe utilization of overtime vs staff coverage positions, authorization and monitoring for same, optimal deployment of Agency resources, and compliance with applicable Fair Labor Standards Act provisions.”

- S -

Henry E. Webb

Cc: Rose Childs, MSW, CSWM, Deputy Director, Mental Health Division
Kenneth Collins, LMSW, Deputy Director, Mental Retardation Division
Barbara Dawson, MSE, Deputy Director, Comprehensive Psychiatric Emergency Program Division
Daryl Knox, MD, Medical Director, Comprehensive Psychiatric Emergency Program Division
Sarah Flick, MD, Medical Director, Mental Retardation Services
Sylvia Muzquiz, MD, Medical Director, Mental Health Services
Jeanne Mayo, MS, JD, General Counsel
David Witt, MPA, CPA, Chief Financial Officer
Sivam Mahasivam, CPA
Audit Committee:
Tom Hamilton, Ph.D. (Chairman)
Jane B. Cherry
Paige M. Cokinos
Charles O. Buckner, CPA
Vicki S. Raynold, CPA
Bob Borochoff

ATTACHMENT A
SUMMARY OF RECOMMENDATIONS
March 16, 2007

| | | |
|---|---|---|
| Unit: Agency-Wide Area: Agency Use of Overtime | | |
| Inherent Risk: Low Moderate High | Control Environment: Well Controlled Acceptable Poorly Controlled | Overall Risk: Low Moderate High |
| Type of Procedures: Audit | | |
| Scope: <ul style="list-style-type: none"> * Using Internal Control Evaluation (ICEs) forms, documented internal controls * Conducted a preliminary survey reviewing applicable policies and procedures, etc. * Interviewed various staff, obtain understanding of management controls * Examined detailed receipts, vouchers, and supporting documentation | | |
| Priority Rating: | Audit Recommendations: | |
| 1 | Eliminate wording and reference to the "8 and 80 Overtime Rule" | |
| 1 | Review on a periodic basis the actual work time of employees vs. accrual of benefit rates | |
| 1 | Budget overtime based on realistic levels and methods | |
| 1 | Define in Employee Handbook the use of 'Straight Time' for exempt employees | |
| Follow-up: 1 year | | |

Priority Rating

1. Implement immediately (30 - 90 days) - Serious internal control deficiencies or recommendations to reduce cost, maximize revenues, or improve internal controls that can be easily implemented.
2. Work towards implementing (6 - 18 months) - Less serious internal control deficiencies or recommendations that can not be implemented immediately because of constraints imposed on the unit (i.e., budgetary, technological constraints).
3. Implement in the future (2 - 3 years) - Recommendations that should be implemented but that can not be implemented until significant and/or uncontrolled events occur (i.e. legislative changes, buy and install major systems, requires third party cooperation).