

**AGENCY-WIDE AUDIT OF  
EMPLOYEE INCENTIVE PAYMENTS**

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**Audit Report No. EINC0108**

**May 2, 2008**



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

**Internal Audit Report**

**AUDITOR'S REPORT**

**Agency-Wide Audit**

**Employee Incentive Payments**

**Harris County, Texas**

**Internal Audit Report**

**May 2, 2008**

**Henry E. Webb, CFE**

**Internal Auditor**





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Re: Employee Incentive Payments (Report No. EIP0108)

#### **BACKGROUND**

In accordance with provisions of the Fair Labor Standards Act (FLSA), MHMRA has defined a workweek as “a fixed and regularly recurring period of 168 hours-seven consecutive 24-hour periods. It need not coincide with the calendar week but may begin on any day at any hour of the day.” The work week for all employees will begin on Monday at 0700 and extend through the following Monday at 0659.

In addition to time spent performing regular job duties, the following activities are considered work time:

1. travel as part of the employee’s job duties;
2. on-call emergencies that require returning to Agency premises, workstation, or duty assignment;
3. meal periods of less than 30 minutes during which the employee is not completely relieved of duty;
4. meal periods of 30 minutes or more that are interrupted by an emergency, or that are interrupted regularly and frequently; and
5. work breaks of not more than 15 minutes during each shift segment.

Travel time is considered hours worked when the employee is in transit;

1. between job sites during the day’s work;
2. on official travel status out of town to attend or return from work-related training, conferences, or meetings, (except for bona fide meal periods, when sleeping or when otherwise free to pursue personal activities). Travel away from an employee’s home is considered work time when it cuts across the employee’s workday. This time is not only hours worked on regular working days during normal working hours, but also during the corresponding hours on non-working days; or
3. transferring consumers between locations or on out-of-town trips, except for bona fide meal periods, when sleeping, or when otherwise free to pursue personal activities.
4. Travel time between the employee’s home and regular duty station is not considered work time.

Scheduled meal periods are provided to employees during the regular work shift and generally are not considered as hours worked. The length of an employee's meal period is subject to the demands of the employee's assigned work unit. Meal periods should not be less than 30 nor greater than 60 minutes.

A supervisor may authorize two paid work breaks a day of up to 15 minutes for each work break, provided that the employee's workload permits such breaks without a disruption of the employee's duties. Breaks are usually scheduled during the first half and the last half of the employee's workday.

Work breaks are not an entitlement, but a privilege, and cannot be accrued or accumulated to extend lunch breaks or shorten the workday.

When employees are required to be on duty for 24 hours or more, the entire period is usually not counted as hours worked due to the deductions outlined below.

The time required for the following activities is usually deducted from the hours worked:

- sleeping time of up to eight hours,
- meal times, and
- and off-duty time during which the employee has complete freedom from duties and may leave the premises for personal purposes.

As an exception, the entire period, except for meal periods, will be counted as hours worked if:

- the total sleeping time per 24-hour period is less than five hours, or
- interruptions are so frequent as to prevent reasonable periods of sleep.

Participation in required training programs is considered hours worked, as is voluntary training considered hours worked, only when the Agency chooses to recognize such hours. MHMRA may recognize training hours if the training is related to the employee's job.

Time spent by an employee waiting for and receiving medical attention on the premises or at the direction of the employee's supervisor during the employee's normal working hours on a day when he/she is working constitutes hours worked.

On-call time will not be considered hours worked if the employee is not required to remain at the facility or work station premises, and is free to engage in his/her own pursuits, (subject to the employee being accessible to his/her supervisor).

1. If an employee is required to be on call and must complete a job assignment, only the time actually spent completing the assignment will be calculated as hours worked. On call compensation also will include 1 hour for portal-to-portal travel time (30 minutes to the location, 30 minutes back).
2. If an employee's "on-call" condition is so restrictive that he or she is not free to use the on call period for his or her own benefit, the "on call waiting time" will also be counted as hours worked.
3. Any off-duty time during which the employee has complete freedom from duties and may leave the premises for his/her own purpose will not be counted as hours worked.

A record of time worked and leave time taken from work will be maintained for each employee. Employees are responsible for keeping track of and reporting accurate time worked and paid and unpaid time off, and submitting a time report to the supervisor in a timely manner for approval.

In order for payroll checks to be processed, all relief employees are classified as non-exempt and are required to promptly report all time worked so that the Payroll Department may receive the information by 10:00 a.m. on the Monday following the end of the time period. Failure to promptly report time worked may result in a delay in the payment of wages until the following payday.

Non-exempt employees are compensated for actual hours worked and for approved paid leave time off from work taken during a defined pay period. A pay period extends from Monday at 0700 for the two weeks through the following Monday at 0659. There are twenty-six defined pay periods within a calendar year.

Paydays are based on a scheduled bi-weekly pay cycle. Paydays are normally every other Friday, unless otherwise determined by the Executive Director.

MHMRA adheres to all applicable laws that require deductions from an employee's pay be made for Federal Withholding Taxes, Social Security taxes, and wage garnishments. In the event situations arise in which a wage attachment or garnishment of an employee's pay is ordered by an official local, state, or federal agency, or court, the Agency will honor and fulfill the wage attachment or garnishment as required by law, and the employee will be notified regarding the notice of garnishment.

Employees may not receive payment in advance of time worked and may not receive regular paychecks in advance of the scheduled payday.

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 in exempt status will follow the requirements set forth in the Fair Labor Standards Act. The determination of exempt/non-exempt status will be made by the Human Resources Director with approval from the deputy directors and the Executive Director. 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.

All overtime requires prior approval except in cases of emergencies. In such cases, the overtime must be approved within one work day. Compensation for the use of overtime will be limited to that 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.
3. 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.

Overtime is based upon the total hours physically present and worked at the place of duty. Hours not worked due to the use of sick time, vacation time, leave without pay status, or holidays are not counted as worked hours for overtime calculation.

Hours worked defined for special situations – hours worked include all the time an employee is required to be on duty, on the facility premises, or at a prescribed work place. Overtime is computed on the basis of hours worked in excess of 40 hours in the 7 day work period. Overtime accrued by the employee will be charged to the program unit where the overtime is worked.

## **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, and policies and procedures.
- Implemented internal controls to prevent or detect material errors and irregularities.

The specific objective in this audit was to:

- Assist management with the assessment of the adequacy of internal controls associated with compliance with applicable Federal and State laws, regulations, and policies.
- To determine whether employee incentive payments complied with the terms and guidelines of the Agency and the laws of the State of Texas.

## **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 scope of work included reviewing applicable policies, procedures, and laws; interviewing appropriate Agency employees; examining supporting documentation; and applying any other appropriate audit procedures deemed necessary. The audit also examined payments made to Agency non-exempt and exempt employees that were categorized as either incentive or overtime payments. The audit also analyzed any payments to employees that appeared unusual in nature. The audit scope was from September 1, 2007 through February 29, 2008.

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 and reviewed policies and procedures for compliance and completeness. MHMRA staff were 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 the departmental compliance with established criteria and accuracy of reporting do not meet Agency policy and procedures. In most cases the units put forth their best efforts to prepare reasonable and appropriate payment methods, however, it was concluded that some of the methods were unorganized, difficult to comprehend, and at times departments obtained inconsistent approvals.

It is apparent that the Agency needs clear and consistent administrative guidance for the payment of overtime or incentive payments for employees classified as exempt. Until this occurs the Agency is at risk for legal consequences for inconsistent payment of overtime/incentive payments to exempt employees. The results of the auditing procedures disclosed instances where internal controls require strengthening and are presented below.

## FINDING

### *Exempt Employees Paid 'Straight Time' for Hours worked Over 40 Hours*

During the audit period Internal Audit identified 12 units that met our audit criteria. Our criteria were to identify instances where Agency employees received additional compensation over and above their base salary (exempt employees only), including payments that appeared unusual. The 12 units examined during the audit period with "exempt overtime" are listed below for one pay period:

- Comprehensive Psychiatric Emergency Program Division – **243.25 Hours**
- Early Childhood Intervention – **49 Hours**
- Ripley – **35 Hours**
- Southwest Clinic – **25.25 Hours**
- MCOT – **20 Hours**
- Katrina Rita Crisis Counseling – **20 Hours**
- Information Technology – **20 Hours**
- Northwest – **12.95 Hours**
- Children's Mental Health – **11.5 Hours**
- Eligibility Center – **8 Hours**
- Bristow – **4.75 Hours**
- HCPC – **2 Hours**

## 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 payment of Agency employees (exempt or on-exempt) in a consistent manner encourages a lower turnover rate, as well as improves employee morale.

**Management Response**

*"The Agency complies with all provisions of the FLSA regarding the requirement to pay overtime to non-exempt employees. Exempt employees no longer receive overtime. With assistance from IT, a process has been developed to identify and decline requests for overtime from exempt employees. Additionally, an internal audit of the most recent three payrolls confirms that exempt employees have not been paid overtime."*

**FINDING****Agency Approval and Payment of Overtime**

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 work day. 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 reasons are 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 and supporting documentation:

- 35% of samples tested did not have employee's supervisor and/or unit director's signature on the documents approving overtime worked
- 10% of Payroll Time Sheets did not contain employee signatures
- 20% of time sheets tested did not contain accurate hours worked, yet were approved by the employee's immediate supervisor for payment

**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.

***Management Response***

*"HR / Payroll is holding a timekeeper training session this month, and will endeavor to hold them periodically throughout the year. In addition, HR / Payroll will begin developing written guidance for these issues. Finally, HR / Payroll will remind managers of the overtime approval requirements at future management team meetings."*

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Henry E. Webb, CFE, Internal Auditor

Cc: Rose Childs, MSW, CSWM, Deputy Director, Mental Health Division  
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Vicki S. Raynold, CPA  
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**ATTACHMENT A**  
**SUMMARY OF RECOMMENDATIONS**  
**May 2, 2008**

Unit: (ALL) Employee Incentive Payments		
Area: Procedural Audit		
Inherent Risk:      Low <b>Moderate</b> High	Control Environment:    Well Controlled Acceptable <b>Poorly Controlled</b>	Overall Risk:      Low Moderate <b>High</b>
Type of Procedures: <b>Audit</b>		
Scope: * Using Internal Control Evaluation (ICEs) forms, documented internal controls * Conducted a preliminary survey reviewing applicable policies and procedures, etc. * Interviewed various staff, obtained understanding of management controls * Examined detailed receipts, vouchers, and supporting documentation		
Priority Rating: 1 1	Audit Recommendations: Any deviations from the FLSA should be defined in the Agency Employee Handbook Overtime should be approved (in writing) by supervisor's in advance of being worked	
Follow-up:    Six Months		

**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).