



STATE OF NORTH CAROLINA

**OFFICE OF STATE PERSONNEL
DEPARTMENT OF HEALTH AND HUMAN SERVICES**

FINANCIAL RELATED AUDIT

**OVERTIME PAYMENTS RELATED TO NEW MEDICAID PAYMENT
SYSTEM**

FEBRUARY 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

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AUDITOR'S TRANSMITTAL

February 14, 2013

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
C. Neal Alexander, Jr., Director, Office of State Personnel
Dr. Aldona Wos, Secretary, Department of Health and Human Services

This report presents the results of our financial related audit at the Office of State Personnel and the Department of Health and Human Services. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The objective of our audit was to determine if the Office of State Personnel approved the payment of overtime for Department of Health and Human Services employees working on the new Medicaid payment system and if employees were paid in accordance with the policy exception and state law.

We found that Office of State Personnel verbally approved an exception but did not document the terms of the exceptions. We also found inadequate controls and reviews within the Department of Health and Human Services' manual processing of overtime pay that led to overpayments and other leave and payroll errors.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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FINANCIAL RELATED AUDIT

BACKGROUND

North Carolina General Statute §126-1 assigns the Office of State Personnel (Office) the responsibility to provide oversight of State Personnel Commission policies. The policies are recorded in the State Personnel Manual.

“Section 4: Salary Administration – Hours of Work and Overtime Compensation” of the State Personnel Manual was revised in accordance with the Supreme Court’s February 19, 1985, ruling that State and local governments were subject to the Fair Labor Standards Act. As such, it is state policy that, “No employee whose position is designated as exempt from overtime compensation provisions shall be paid in any way for hours worked in excess of forty in a work week unless a **specific exception** (emphasis added) has been approved.”

Around 2007, the Department of Health and Human Services (Department or DHHS) made a request to the Office for an exception to this policy. Under this exception, the Department would be authorized to pay overtime-exempt employees for overtime hours worked on the replacement Medicaid Management Information System project.

As of July 31, 2012, the Department had paid \$580,758 in overtime to 12 employees under this exception.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objective was to determine whether the Office of State Personnel and the Department of Health and Human Services policies and procedures provide reasonable assurance that the overtime compensation policy exception was implemented and managed according to the approved terms.

The Office of the State Auditor initiated this audit to identify improvement opportunities in administering and managing state personnel policy exceptions.

The audit scope included a review of management practices at two agencies. First, the audit scope included a review of current Office management practices over the policy exception approved for DHHS. Second, the audit scope included a review of DHHS policy management practices and overtime payroll transactions between April 1, 2008, and July 31, 2012. We conducted fieldwork from September 2012 to January 2013.

To determine current Office policy exception management, we interviewed with Office Recruitment, Selection and Salary Administration personnel and reviewed policies and procedures as they related to policy exception management. We also interviewed the prior Personnel Director who approved the policy exception for DHHS.

To determine current DHHS policy exception management, we conducted interviews with payroll, human resources, and Office of Medicaid Management Information System Services personnel.

To determine if DHHS accurately processed payroll under the terms of policy exception, we analyzed overtime records of five of the 12 employees who received overtime pay under the

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exception from April 1, 2008 to July 31, 2012. The five employees selected for review included the four employees who received the most overtime pay and one terminated employee who had received overtime pay under the exception during the period.

To determine the accuracy of overtime pay and leave balances, we had the Office of the State Controller use BEACON¹ to recreate the payroll using actual time worked (i.e. employee timesheets) from April 1, 2008, to July 31, 2012, for the five employees selected for review. We compared these results to the DHHS calculated overtime payments and balances for these same employees and time period.

We judgmentally selected the four employees who received the most overtime pay and one separated employee who received overtime pay. Because the sample of items analyzed is not intended to be statistically representative, the results of our analysis cannot be projected to all 12 employees who received overtime payments during the period April 1, 2008, to July 31, 2012. The results of any analysis performed under this audit are restricted to the specific employees selected for testing.

This report contains the results of the audit including findings and recommendations. Because of the test nature and other inherent limitation of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

We conducted this financial related 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.

We conducted this audit under the authority vested in the State Auditor of North Carolina by *North Carolina General Statute §147.64*.

¹ BEACON is the statewide system used by the Office of the State Controller for processing state employee payroll as required by *North Carolina General Statute § 143B-426.39 (6)*.

AUDIT FINDINGS AND RECOMMENDATIONS

1. OSP DID NOT DOCUMENT APPROVAL OF OVERTIME EXCEPTION

The Office of State Personnel (Office or OSP) lacks documentation of its verbal approval of an overtime pay exception granted to the Department of Health and Human Services (DHHS) in 2008. This policy exception allowed DHHS to make more than \$580,000 in overtime payments between April 2008 and July 2012 to employees normally excluded from receiving such payments.² As a result, the Office cannot provide assurance that its approval was in the best interest of the state and that overtime payments made were consistent with the terms of the verbally approved exception.

Evaluation and Approval of Overtime Pay Specifics is Missing

The Office did not document its evaluation and approval of DHHS's exception request to allow salaried employees to receive overtime payments. Specifically, OSP did not document if the purpose of the exception was in the best interest of the state nor did it document the specific terms of the verbally approved exception.

DHHS noted certain purposes and objectives of the exception in a draft policy³ provided to the Office on May 7, 2008. In its draft policy, DHHS wrote, "The MMIS (Medicaid Management Information System) project is time-sensitive and requires many extra staff hours in order to meet various deadlines." The draft policy further stated that "regular staff" (i.e. not managers and directors) and subject matter experts would be eligible for overtime payments under this policy exception.

DHHS also stated timely implementation would result in savings of up to \$1.2 million per month upon the project's completion.

A key reason DHHS gave for pursuing the exception was that the federal government would pay 90% of the overtime cost, making the impact to the State's budget minimal.

However, the Office did not document its evaluation of the costs associated with implementing the exception and if those costs were warranted. There is no evidence that the Office requested any cost information related to implementing the policy exception from DHHS. Additionally, there is no evidence that the Office requested documents to support projected savings.

Furthermore, neither the Office nor the former Personnel Director was able to provide any written documentation that any of the draft agency policy was approved. Specifically, there is no documentation of:

- The time period overtime-exempt employees would be allowed to receive overtime pay;
- The details of how overtime and leave would be processed under the exemption;
- The date the policy exception authorization would expire.

² Section 4 Page 48 of the State Personnel Manual states "No employee whose position is designated as exempt from overtime compensation provisions shall be paid in any way for hours worked in excess of forty in a work week unless a specific exception has been approved."

³ "OMMIS Pay Incentives for FLSA Exempt Project and SME Employees Effective 1-1-2008."

AUDIT FINDINGS AND RECOMMENDATIONS

During the audit, the former Personnel Director told auditors that he recalled granting DHHS approval to make either: 1) A payout of accumulated overtime (comp time) to identified MMIS staff as of December 31, 2007; or 2) pay future earned overtime that exceeded a 200 hour accumulated balance to those people, but not both.

The former Personnel Director also stated that if DHHS elected to pay future overtime, he was agreeing for the exception to be applied for the expected life of the replacement MMIS project. In other words, the personnel policy exception was approved with an intended termination date of August 2011, the expected MMIS replacement project completion date.

DHHS implemented both overtime payout options (payout of accumulated comp time and future overtime payments) and the MMIS project did not meet its August 2011 deadline. As a result, DHHS overtime was paid to employees for six years (from January 2007 to January 2013).

Currently, DHHS expects to implement the MMIS project in July 2013, two years past the original project schedule. In hindsight, the belief that approving overtime pay would ensure that the project would be completed on time is questionable.

Policy Exception Should Have Been Formally Documented

Prohibiting overtime pay for exempt employees provides for better control and management of the State's and agencies' budgets. Consequently, it is imperative that any exceptions be thoroughly vetted and justified.

Section 4 of OSP's Personnel Policies Manual specifies that "No employee whose position is designated as exempt from overtime compensation provisions shall be paid in any way for hours worked in excess of forty in a workweek unless a **specific exception** has been approved." (emphasis added)

According to OSP, it is standard operating procedure for the Office to document the terms of policy exceptions and communicate approvals and denials to the requesting agency in writing.

Documenting and communicating a policy exception in writing is important for at least two reasons. First, it lays out the specific terms of the exception, such as the area affected, how the exception is applied, and the duration of the exception. Secondly, it serves as a reference for those implementing or monitoring the policy exception.

As a result of this audit, the Office formally adopted an internal policy titled "Policy and Procedures for Processing Requests for Policy Exceptions." The policy, adopted on October 18, 2012, provides standard guidelines and procedures for processing requests for exceptions to personnel policies which include:

- Requests for policy exceptions must be in writing;
- Approval or denial of the exception request must be communicated to the agency in writing and include OSP's rationale for approving or denying the request;
- Terms and conditions of the exception must be documented.

AUDIT FINDINGS AND RECOMMENDATIONS

In accordance with that policy, OSP provided written notification to DHHS on October 19, 2012, of the amended terms of the personnel policy exception. The terms included:

- Termination of overtime payments to overtime-exempt employees effective January 31, 2013;
- Completion of a labor market analysis with recommended salary adjustments for MMIS project positions effective February 1, 2013;
- Extension of the time MMIS project employees may use compensatory time earned from 12 to 18 months.

Implementation and Management of Exception Couldn't be Verified

Since the previous OSP administration did not document its approval of the personnel policy exception in 2008, future administrations were not aware of its existence. As a result, the verbally approved terms of the exception were not managed or enforced.

For example, no one outside of DHHS understood that a significant majority of the employees who received compensatory overtime payments held manager and executive level positions, not staff level positions as laid out in DHHS's draft exemption policy.

Of the 12 overtime-exempt employees who received overtime compensation under this personnel policy exception, three employees (25%) held staff level positions while nine employees (75%) held manager and executive level positions.

Additionally, a significant portion of overtime payments were made to manager and executive level positions, not staff level positions. Of the \$580,758 paid for overtime compensation from April 1, 2008, to July 31, 2012:

- \$70,523 (12.14%) was paid to the three employees holding staff positions;
- \$510,235 (87.86%) was paid to the nine manager and executive level positions;
- \$237,500 (40.89%) of all overtime payments was paid to the MMIS program director.

Recommendation

The Office of State Personnel should determine if any agencies, departments, or institutions are operating under an undocumented Office approved exception.

The Office should process and manage all State Personnel policy exception requests in accordance with the internal policy made effective October 18, 2012, "Policy and Procedures for Processing Requests for Policy Exceptions."

The Office should monitor exceptions granted to agencies to ensure that agencies implement the exception as approved.

AUDIT FINDINGS AND RECOMMENDATIONS

OSP Response

The Office of State Personnel (OSP) concurs with the chronology of the events described in the draft audit. As noted in your report, OSP was not aware of the “verbal approval of an overtime pay exception granted to the Department of Health and Human Services (DHHS) in 2008” by the former State Personnel Director. Since being made aware of this verbal exception, OSP has developed a written internal policy entitled “Policy and Procedures for Processing Requests for Policy Exceptions” and distributed the policy to all OSP employees in October 2012. In keeping with the recommendations provided in the audit report, OSP will process and manage such exceptions in accordance with this internal policy, including any future revisions.

OSP communicated the details of a written policy exception regarding the MMIS project to DHHS on October 19, 2012, and, at that time, also provided a copy to your Office. OSP will continue to work with the Office of the State Controller (OSC) and DHHS in the implementation and monitoring of the exception.

Additionally, we will take the opportunity to communicate OSP’s internal policy for processing policy exception requests to agency and university HR Directors and, as recommended in the audit, ask if they are operating under any policy exceptions that do not comply with this policy. In the event there are any such exceptions, OSP will review the circumstances and communicate in writing as to appropriate dispositions.

2. No Reviews or Error Corrections for Manual Payroll Process

The Department of Health and Human Services (DHHS or Department) used a manual process to calculate overtime pay and leave balances for the 12 Office of Medicaid Management Information System employees covered by the OSP exception. Inadequate controls and reviews within the manual system contributed to payroll processing errors such as overpayments, inaccurate leave balances, and the failure to withhold and make retirement contributions. The labor cost associated with using a manual system is indeterminable.

Overtime Pay and Leave Processed Outside of BEACON

In April 2008, the Department and several other state agencies began using a uniform payroll system known as BEACON. The Office of the State Controller (OSC) designed BEACON to be compliant with all of the State’s legal and constitutional payroll-related requirements.⁴

Although BEACON processes payroll automatically, the Department found it necessary to assign an employee to manually track and calculate overtime hours to be paid to the 12 employees covered by the Office of State Personnel (OSP) verbal exception.

The Department stated manual tracking of overtime was necessary because the Department found BEACON could not accommodate tracking overtime pay under the OSP exception. The Department stated that initially, OSC could not allocate the time and resources to develop a programming solution for DHHS because it was still addressing larger BEACON implementation issues.

⁴ NCGS§ 143B-426.39 (6)

AUDIT FINDINGS AND RECOMMENDATIONS

Later, after OSC resolved BEACON implementation issues, the Department reported that OSC would not invest the resources to develop a programming solution because there was no written OSP approval of the exception. The Department reports that, “as recent as January 2012, OSC indicated they could not do anything to resolve the MMIS (Medicaid Management Information System) pay and time process until it was clear that OSP had approved the exception.”

However, the Department’s manual payroll process did not provide reasonable assurance that the Department accurately paid its employees in accordance with OSP and OSC policy. Specifically:

- There was no supervisory review of overtime calculations;
- There was no supervisory review of payment calculations;
- Identified calculation and process errors were not corrected.

The labor cost associated with using a manual system is indeterminable.

Payroll Should be Processed Accurately

The Department should have a payroll process that provides reasonable assurance that it pays its employees accurately and in accordance with state personnel policy for two reasons: (1) state law requires it and (2) it is a best practice according to the Government Accountability Office (GAO).

First, the Department should have a payroll process designed to ensure its employees are paid in accordance with OSP and OSC policy because state law requires it. The State Governmental Accountability and Internal Control Act⁵ states, “The management of each State agency bears full responsibility for establishing and maintaining a proper system of internal control within that agency.” The Act further defines internal control as “An integral process...designed to provide reasonable assurance regarding...compliance with applicable laws and regulations.”

OSC guidance⁶ specifies that employees’ time and attendance data be accurately coded, properly processed and documented, and that payroll be reviewed and approved by a responsible official.

Designing a payroll process to achieve compliance with labor and personnel policy is also a best practice according to the GAO. The GAO states that agency managers have a fundamental responsibility to implement systems that are designed to achieve compliance with applicable laws and regulations.⁷

Without a process designed to ensure payroll is processed in compliance with OSP and OSC policy, there is a risk that payroll errors occur and go undetected.

⁵ NCGS§ 143D.

⁶ Office of the State Controller Self-Assessment of Internal Controls, Human Resources Cycle.

⁷ United States Government Accountability Office, Government Auditing Standards, Chapter A1.08(c), August 2011.

AUDIT FINDINGS AND RECOMMENDATIONS

Inaccurate Payments Made to Employees

As a result of deficiencies in its manual system, the Department did not accurately apply State Personnel leave policies to determine overtime hours paid to employees.

Auditors conducted an analysis of the records for one terminated employee and four employees who received the most overtime pay under the exception and identified \$2,764 in errors resulting from misapplied leave policies. Specifically:

- \$2,067 was paid for sick leave that was converted to overtime;
- \$602 was paid for holiday compensatory leave that was converted to overtime;
- \$95 in other miscellaneous errors.

While these dollar amounts are relatively small, deficiencies in the manual process could have resulted in much larger errors.

Inaccurate Leave Balances

Another effect of using its manual system is that the Department did not accurately record the payment of overtime hours in the state's payroll system. Although overtime hours were recorded in BEACON as they were earned, the Department did not reduce those hours as they were paid. This caused overtime balances in the state's payroll system to be overstated by 1,277 hours⁸ for the five employees.

Retirement Contributions Not Withheld and Paid

An additional effect of using its manual system is that the Department did not withhold and pay the employees' or employer portion of retirement contributions for overtime pay. During the period April 2008 to July 2012, no contributions were made on \$289,847 in salaries for the five employees.

The Department did not make the employee and employer contributions because overtime payments were miscoded in the payroll system. The Department stated it was directed by the OSC to use the manual code. However, payments made under the code the Department used are not included when determining employee and employer retirement contributions.

Employees may not receive the full retirement benefit they are entitled because DHHS did not accurately calculate and pay required retirement contributions. Since no contributions were made, no retirement benefit can be received.⁹

Recommendation

The Department should provide OSC with written authorization from OSP of any state personnel policy exception and use BEACON to automatically process all payrolls.

⁸ Amount reported as of July 31, 2012.

⁹ Per *NCGS* § 135-8(b2), the Department and employees must pay catch-up contributions, including interest on earnings, in order for employees to receive any retiree benefits on this compensation.

AUDIT FINDINGS AND RECOMMENDATIONS

The Department, in coordination with OSC, should review all overtime payments made under the policy exception to identify errors, correct underpayments, and recoup any overpayments. The Department should adjust leave balances in BEACON so accurate balances are reported in the State's official payroll and leave system.

The Department, in coordination with the Department of State Treasurer, should determine the total amount of unpaid retirement contributions. Additionally, the Department should inform employees of the provisions allowed under state law to make catch-up retirement contributions that would allow them to receive all entitled benefits.

The Department should ensure that payroll transactions are reviewed by supervisors so that any mistakes and errors would not go undetected and unresolved.

DHHS Response

The Department agrees with the recommendations.

The exception granted by the Office of State Personnel (OSP) was time-limited and ended January 31, 2013. The Department will provide the Office of State Controller (OSC) with written authorization of any future state personnel policy exceptions.

Since the exception expired January 31, 2013, DHHS will process and pay compensatory time in accordance with approved OSP policies and procedures. DHHS Human Resources, OMMISS and BEACON met Wednesday, February 6, 2013, to discuss reconciling any time/pay issues that have arisen, now that the exception has ended with the January payroll.

Any future state personnel policy exceptions will be authorized by OSP, in writing, and provided to OSC, and BEACON will be used to automatically process all payrolls.

The Department is conducting a review of the other seven employees who received compensatory overtime payments to identify any potential errors. Corrections will also be made to reflect leave balances as of January 31, 2013. In addition, affected employees will be notified of any discrepancies identified during the review.

DHHS Human Resources, OMMISS and BEACON met Wednesday, February 6, 2013, to discuss how leave balances should be adjusted and reported accurately.

As a result of an incorrect payment code provided to the Department, by OSC, an underpayment of retirement contributions occurred. The DHHS Human Resources will contact the Retirement System for assistance with the unreported amounts. Employees will be notified of the error and instructed as to how the error is to be corrected.

Internal control procedures have been enhanced to ensure payroll transactions are reviewed by supervisors and any errors made are identified and corrected timely.

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This audit required 1,684 audit hours at an approximate cost of \$106,202.