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The Corporation of the City of London

Management compensation process assessment

Internal Audit Report

Audit performed: October 2017 - January 2018
Final report issued: April 23 2018

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Executive summary

Introduction

As part of the 2017 Internal Audit Plan, Deloitte performed an internal audit of the Corporation of the City of London's ("City") management compensation process. The internal audit commenced in October 2017 and fieldwork was completed in February 2018. The purpose and objective of this internal audit was to evaluate the operational effectiveness and efficiency of processes and controls undertaken by the Human Resources & Corporate Services Service Area in updating the new compensation rates into the relevant management compensation systems as well as an assessment of the City's procedures to process management payroll.

Management compensation

Human Resources & Corporate Services Service Area (HR) at the City has embarked on an initiative over the last two years to review and update the management compensation strategy, philosophy, and program. An independent consultant was engaged to assist in reviewing and assessing the City's management compensation strategy and program against industry best practices. Following the finalized engagement, HR was tasked with realizing the recommendations made by the consultant. This major initiative was undertaken to establish and implement a more simplified management compensation strategy and program. This simplification of the new strategy and program also lends itself to process efficiency and effectiveness enhancement opportunities.

There are two divisions within HR, Rewards & Recognition and Employee Systems, who are responsible for administering management compensation increases resulting from annual performance reviews. Rewards & Recognition's role is to obtain the performance review results and consult with the Senior Leadership Team to finalize the compensation distribution list. Rewards & Recognition is also responsible for advising City management of their compensation increases via a letter. Employee Systems receives direction from Rewards & Recognition to update the relevant management employee compensation information in the JD Edwards system using an approved compensation increase list. Employee Systems is also responsible for calculating any retroactive pay, with consideration given to employee benefit implications.

The detailed purpose and objective of this internal audit was to:

- Review and assess the City's practices surrounding the review of data input into the management compensation systems; and
- Evaluate the processes and controls in place to ensure the ongoing integrity of data within the management compensation system.

The specific agreed upon scope details between management and internal audit are included in *Appendix 1: Internal Audit detailed scope*.

Key strengths

Accuracy of management compensation information: Control activities are in place to ensure the accuracy and completeness of management compensation including information used in the determination of compensation increases and the subsequent upload of the final rates to the JD Edwards system. Rewards and Recognition performs activities to calculate new management compensation increases using credible inputs applied to defined MS Excel formulae based on the management compensation program. Additionally, effective controls are in place for Employee Systems to receive the final compensation information and update the JD Edwards system.

Accuracy of management employee retroactive pay: Controls are in place for Employee Systems to calculate the management compensation retroactive pay. Retroactive pay is determined in MS Excel where formulae are effectively applied to relevant management data with consideration given to related items (e.g., pension implications, compensation effective date, etc.). Retroactive pay values are adequately reviewed by Employee Systems management for accuracy and subsequent payments.

Management employee profile updates: The City maintains effective procedures for Employee Systems to process management employee profile updates. Procedures and controls are effectively designed to ensure all change requests are received using a standardized Payroll Action Form that evidences the appropriate approvals and the population of relevant information. Change requests for management employees received, such as changes due to promotion and leave, were updated in JD Edwards in a timely manner.

JD Edwards system controls: Within the JD Edwards system, the City utilizes an audit trail function to maintain records of changes. This function maintains system record changes, such as changes to employee compensation rates or employee status, enabling Employee Systems to more effectively and efficiently identify unwarranted changes. An audit trail report is reviewed prior to each bi-weekly management payroll to validate the integrity of management employee data. Additionally, Employee Systems also utilizes other JD Edwards control functions such as restricted user access and rules to control payment abilities.

Key observations

Deloitte's review of the management compensation practices identified the following observations:

Priority	High	Medium	Low	Leading Practice
Observations	0	3	1	0

Medium priority observations

Observation 1.0: Payroll liability account reconciliation

- **Observation:** The Manager of Employee Systems reconciles the payroll liability accounts, including payroll liability accounts for management compensation. However, the reconciliation of payroll liability accounts is only performed on an annual basis.
- **Risk & implication:** There is risk that payroll liability accounts could be financially misstated if reconciliations are not completed on a frequent basis.
- **Management action plan:** Employee Systems currently reconciles the payroll liability account balances annually. Employee Systems will fill an existing vacancy to allocate responsibility for undertaking this process on a quarterly basis and establish a procedure in this regard. This procedure will include established monitoring and oversight to ensure timely completion.
- **Responsible party**: Julie Kovacs, Manager, Employee Systems

Observation 2.0: Temporary off cycle and acting pay compensation increases

- **Observation:** There is an informal process for Rewards & Recognition to receive expected end dates for new temporary off cycle and acting pay compensation increases. These end dates are subsequently provided to Employee Systems to code in the JD Edwards system. Inspection of the system determined that there were no end dates uploaded to systemically stop payments.
- **Risk & implication:** There is risk that overpayments are made to management employees if end dates are not coded in the JD Edwards system.
- **Management action plan:** Rewards and Recognition will develop a procedure for ensuring Employee Systems receives a start and end date for all current and future temporary off cycles or acting pay adjustments. Employee Systems will ensure the date is entered into JDE. Employee Systems will develop a quarterly report for Rewards and Recognition to note when a temporary compensation is nearing its end date. A procedure will be developed by parties outlining this process
- **Responsible party:** Sue Miller, Manager, Rewards and Recognition

Observation 3.0: Management compensation program procedural documentation

- **Observation:** There is a need for HR to further document management compensation procedures including procedures to obtain and reconcile data, finalize performance ratings and adjust compensation, receive appropriate approvals, update the JD Edwards system for payroll, and process retroactive payments.
- **Risk & implication:** The lack of revised and formalized documented practices could lead to ineffective, inefficient, or duplicated processes.
- **Management action plan:** Employee Systems and Rewards and Recognition will revise and formalize documented management compensation program practices. Specifically, the procedures to obtain and reconcile data, finalize performance ratings and adjust compensation, receive appropriate approvals, update the JD Edwards system for payroll, and process retroactive payments.
- **Responsible party:** Gary Bridge, Manager, Human Resources & Corporate Services

Priority heat map
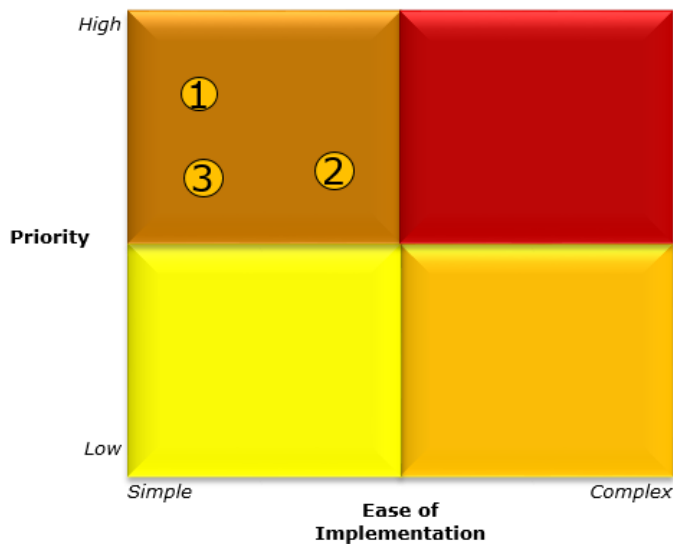
Conclusion

Based on our assessment of management compensation practices we noted three medium priority observations with the potential to impair the effectiveness of current processes. The issues noted in the report should be addressed in a timely manner to enhance current controls and mitigate relevant risks.

The following scale depicts our overall process conclusion as it relates to the scope of areas audited as outlined above:
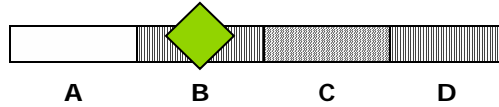
Description		Definition
	A	No or insignificant process control or efficiency weaknesses identified
	B	Minor process control or efficiency weaknesses identified
	C	Moderate process control or efficiency weaknesses identified
	D	Significant control process or efficiency weaknesses identified Impairing the effectiveness of the process

Detailed observations and recommendations

Observation 1.0 – Payroll liability account reconciliation

Observation	Implication	Recommendation	Management comments and action plan	Responsible party and timing
1.0 Payroll liability account reconciliation There are defined processes established for Employee Systems to match and verify payroll registers to the vouchers each pay period. Additionally, the Manager of Employee Systems reviews the accrued wages during the first pay periods of a new fiscal year to ensure prior fiscal year payment allocations are correct. However, based on review and discussion with Employee Systems management, the reconciliation of payroll liability accounts is performed annually.	**1.0 Payroll liability account reconciliation** There is risk that payroll liability accounts could be financially misstated if reconciliations are not completed on a frequent basis.	**1.0 Payroll liability account reconciliation** Employee Systems should reconcile all relevant payroll liability account balances on a more frequent basis (i.e. quarterly, monthly). When implementing the control, the following should be considered: • Allocate responsibility to an appropriate individual with adequate segregation of duties to perform the reconciliation; • Establish clear follow-up procedures supported by defined thresholds and timelines; and • Establish monitoring and oversight to ensure performance of payroll account reconciliations are performed in a timely manner.	**Management Agrees.** Employee Systems currently reconciles the payroll liability account balances annually. Employee Systems will fill an existing vacancy to allocate responsibility for undertaking this process on a quarterly basis and establish a procedure in this regard. This procedure will include established monitoring and oversight to ensure timely completion.	Julie Kovacs, Manager, Employee Systems September 30, 2018

Observation 2.0 – **Temporary off cycle and acting pay compensation increases**

Observation	Implication	Recommendation	Management comments and action plan	Responsible party and timing
2.0 Temporary off cycle and acting pay compensation increases Existing practices at the City allow management employees to receive temporary off cycle or acting pay adjustments that results in their salary being "off-grid" (i.e., salary outside of the standard pay grid). For example, if a management employee temporarily takes on additional duties in addition to their existing responsibilities. Currently, there is an informal process for Rewards & Recognition to obtain end dates from the Service Area management for the off cycle salary increases. Internal Audit noted through inspection of the Management Compensation Guideline that temporary compensation increases must have a specified end date. However, Internal Audit inspected the JD Edwards system and noted that existing temporary off cycle and acting pay increases do not have an end date attached within the system. Through sample testing, no overpayments were identified.	**2.0 Temporary off cycle and acting pay compensation increases** There is risk that overpayments are made to management employees if end dates are not coded in the JD Edwards system.	**2.0 Temporary off cycle and acting pay compensation increases** The City should enhance the current process to ensure that Service Area management provide expected end dates when communicating temporary compensation increases to Rewards & Recognition. When formalizing the process, the City should consider the following: • Communicating pay period results to management responsible for Service Area budgets. • A template that requires an expected end date used for Service Area management to submit for temporary compensation increases. • Periodic (e.g., monthly, quarterly) confirmation from Service Area management affirming that temporary compensation increases are still active. In addition, Employee Systems should formalize practices to receive end dates from Rewards & Recognition and code end dates within JD Edwards system to prevent overpayments.	**Management Agrees.** Rewards and Recognition will develop a procedure for ensuring Employee Systems receives a start and end date for all temporary off cycles or acting pay adjustments. Employee Systems will ensure end date is entered into JDE. Employee Systems will develop a quarterly report for Rewards and Recognition to note when a temporary compensation is nearing its end date. A procedure will be developed by parties outlining this process.	Sue Miller, Manager, Rewards and Recognition June 30 2018

Observation 3.0 – Management compensation program procedural documentation

Observation	Implication	Recommendation	Management comments and action plan	Responsible party and timing
3.0 Management compensation program procedural documentation Internal Audit noted that while relevant guidelines are in place to establish and apply clear compensation criteria and rules, there is a need to formalize the documentation available for Rewards & Recognition and Employee Systems to execute procedures effectively and consistently. Informal documentation exists, however documentation of procedures to obtain and reconcile the data, finalize performance ratings and adjust compensation, receive appropriate approvals, update the JD Edwards system for payroll, and process retroactive payments is required. Additionally, multiple existing process guide documents, including Payroll Processing, Time Accounting, and Updating Master Files have not been reviewed and revised since 2012.	**3.0 Management compensation program procedural documentation** The lack of revised and formalized documented practices could lead to ineffective, inefficient, or duplicated processes.	**3.0 Management compensation program procedural documentation** Rewards & Recognition and Employee Systems should work to revise and formalize documented management compensation program practices. Specifically, the procedures to obtain and reconcile data, finalize performance ratings and adjust compensation, receive appropriate approvals, update the JD Edwards system for payroll, and process retroactive payments. When drafting these documents, HR should consider the following: • Clearly define roles and responsibilities including decision-making authority; • Collaborate with all relevant process owners to capture all areas of responsibility; • Review existing procedures and revise, where needed, to align with program parameters to achieve objectives; • Write clearly articulated procedures for ease of understanding and consistent performance; • Use a flexible, modular outline to allow for efficient modifications; and • Store documents centrally for easy reference.	**Management Agrees.** Employee Systems and Rewards and Recognition will revise and formalize documented management compensation program practices. Specifically, the procedures to obtain and reconcile data, finalize performance ratings and adjust compensation, receive appropriate approvals, update the JD Edwards system for payroll, and process retroactive payments. Currently undergoing a JD Edwards system upgrade for payroll, which is estimated to be complete by November 2018. Employee Systems and Rewards Recognition will not be able to finalize documented management compensation program practice until this time.	Gary Bridge, Manager, HR and Corporate Services December 2018

Observation 4.0 – Performance management program guide

Observation	Implication	Recommendation	Management comments and action plan	Responsible party and timing
4.0 Performance management program guide HR maintains a performance management guide and template letters used to educate and communicate relevant items to key stakeholders including program principles, timelines, and performance results. There is a need for HR to increase clarity in the following areas: • **Annual Performance and Development Cycle**: The performance guide requires enhanced clarity for stakeholders to understand where the compensation increases and retroactive pay timelines fit within the performance cycle. HR also develops key milestone dates for the performance management program. Milestones created for 2016 performance year were not met due to inherent reliance on related procedures performed outside of HR. Management also noted that key milestones have not been met for the previous two cycles.	**4.0 Performance management program guide** There is risk that unclear timelines can lead to misunderstanding of milestones and expectations.	**4.0 Performance management program guide** HR should review the current Performance Management Program Guide and update the information to reflect the current process and practical estimated timeframes. HR may consider the following: • Collaborate with key stakeholders to identify challenges facing the current program cycle, including timing of source inputs; • Consult with key stakeholders to assess challenges including reasonableness of the current cycle milestones; • Assess opportunities to enhance existing program practices to meet existing milestones or consider revising program cycle; • Create an implementation plan to implement enhancements or adjust program cycle; and • Enhance existing monitoring practices to actively evaluate effectiveness against program cycle.	**Management Agrees.** Rewards and Recognition will consider collaborating with key stakeholders to identify challenges facing the current program cycle, reasonableness of the current cycle milestones; assess opportunities to enhance existing practices, create an implementation plan to implement enhancements; and enhance existing monitoring practices. Rewards and Recognition will enhance the performance guide to clearly outline where the compensation increases and retroactive pay timelines fit within the performance cycle.	Sue Miller, Manager, Rewards and Recognition September 30, 2018

Appendix 1: Internal Audit detailed scope

Specifically, the internal audit addressed the following areas:

Reviewed and assessed the City's practices surrounding the review of data input to the management compensation payroll system and tools:

- Reviewed management compensation procedures to record and retain relevant information including tax table updates, salary scale updates, and time and attendance and assessed the ability to process in a timely manner;
- Reviewed the processes surrounding the addition, change and deletion of employees records within the management compensation payroll system;
- Reviewed the process for reviewing, approving, monitoring and reporting of payroll transactions and activities; and
- Reviewed the process for management to review management compensation data input into the system and assessed the adequacy and timeliness of their review.

Evaluated the integrity of the data within the payroll system used for the management compensation program:

- Reviewed the flow of information into the payroll system and assessed the process to identify gaps that exposes risk of data inaccuracies;
- Assessed and validated the internal controls in place surrounding the process to collect and maintain relevant information for management compensation; and
- On a sample basis, assessed the extent of data integrity for the relevant information input and stored within the management compensation payroll system.

Appendix 2: Internal Audit rating scale

Individual observation prioritization

Internal Audit will prioritize each observation and recommendation within a report using a three point rating scale. The three point rating scale will be as follows:

Description		Definition
	High	Observation is high priority and should be given immediate attention (e.g. 0-3 months) due to the existence of either significant internal control risk or a potential significant operational improvement opportunity.
	Medium	Observation is a moderate priority risk or operational improvement opportunity and should be addressed in the near term (e.g. 3-6 months).
	Low	Observation does not present a significant or medium control risk but should be addressed (e.g. within a 6-12 month timeframe) to either improve internal controls or process efficiency.
	Leading Practice	Consideration should be given to implementing recommendations in order to improve the maturity of the process and align with leading practices.

Appendix 3: Stakeholder involvement

In conducting the assessment, the following management and staff were interviewed to gain an understanding of the City's management compensation processes and practices.

Stakeholder	Position
Sue Miller	Manager IV Rewards & Recognition, Human Resources & Corporate Services
Gary Bridge	Manager IV Human Resources & Corporate Services
Julie Kovacs	Manager III, Employee Systems, Human Resources & Corporate Services
Liliana Osowski	Manager II, Payroll Operations, Human Resources & Corporate Services
Various – Deloitte met with various management and staff in the Human Resources & Corporate Services Service Area to gather an in-depth understanding of the management compensation processes and practices and perform audit procedures.	

Appendix 4: Audit procedures performed

As part of the management compensation process assessment the following procedures were performed:

- Conducted a planning meeting with the Managers of Rewards & Recognition, Employee Systems, and Human Resources & Corporate Services (HR);
- Updated and issued a finalized Project Charter and request for information;
- Conducted meetings and interviews with HR management and staff to:
  - Gain an understanding of management compensation program expectations and practices;
  - Identify and gain an understanding of the various management compensation procedures including procedures to finalize management compensation increases, update compensation increases within relevant systems and tools, and process management payroll; and
  - Gain an understanding of HR's procedures and controls over management employee data;
- Obtained documentation regarding relevant procedures and controls to perform an inspection of:
  - Performance Guide Jan 2017;
  - Management Compensation Guidelines Feb 2017;
  - Payroll Processing;
  - Updating Master File;
  - Time Accounting;
  - Kronos Audit Checklist;
  - Payroll Action Form / Payroll Action Form 2;
  - Various checklists (e.g., retirement, termination, new hire, leave, etc.);
  - New hire, termination, and retirement emails;
  - Salary grid including transition to one grid Excel sheet;
  - Management Performance and Compensation Timeline with Milestones;
  - Agency 09 management employee listing;
  - Final 2017 compensation increases from 2016 performance review;
  - 2017 retroactive pay from 2016 performance review;
  - Off-cycle, TMPA, and Acting Pay Tracker;
  - Year-end accrued wage to payroll ledger reconciliation;
  - Monthly payroll liability reconciliation;
  - 2017 Pay Schedule;
  - Memo to Managers;
  - Sample Letter to Employees;
  - Sample payroll documentation (Prepay register, all paycodes balancing, prepay balancing, payroll register, all pay codes, direct deposit file creation, bank file email)
- Conducted strategic sample testing activities related to management compensation increases, management employee profile changes (e.g., terminations, promotion, etc.), and management payroll procedures to identify areas for improvement;
- Drafted observations and validated observations with management;
- Conducted a closing meeting with key management stakeholders to validate and communicate our findings; and

- Issued this internal audit report with our detailed observations.

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